

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 2003.

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 profit for the year ended 31 December 2003 and the state of financial affairs of the Company and the Group at that date are set out in the financial statements on pages 41 to 108.

The directors do not recommend the payment of a final dividend for the year of 2003.

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 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				
	2003	2002	2001	2000	1999
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Turnover	3,277,297	2,300,223	1,863,824	1,997,314	2,865,137
Profit/(loss) before tax	56,872	(35,096)	(97,607)	(168,056)	138,009
Tax	(23,847)	(16,776)	(16,786)	(13,142)	(44,294)
Profit/(loss) before minority interests	33,025	(51,872)	(114,393)	(181,198)	93,715
Minority interests	(16,697)	(7,618)	(3,406)	24,145	(13,594)
Net profit/(loss) from ordinary activities attributable to shareholders	16,328	(59,490)	(117,799)	(157,053)	80,121

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Consolidated assets and liabilities

	As at 31 December				
	2003 RMB'000	2002 RMB'000	2001 RMB'000	2000 RMB'000	1999 RMB'000
Total assets	3,660,072	3,334,388	3,088,579	3,292,787	3,657,209
Total liabilities	(1,465,153)	(1,180,321)	(914,200)	(1,000,726)	(1,022,644)
Minority interests	(129,749)	(105,225)	(66,047)	(65,930)	(195,409)
Total	2,065,170	2,048,842	2,108,332	2,226,131	2,439,156

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, CONVERTIBLE SECURITIES, OPTIONS AND WARRANTS

There was no change in the registered or issued share capital of the Company during the year.

During the year of 2003, 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 in 2003.

8. RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 36 to the financial statements.

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9. DISTRIBUTABLE RESERVES

Details of the distributable reserves of the Company as at 31 December 2003 are set out in note 36 to the financial statements.

10. MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2003, 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

During the year, the 2nd Board of Directors and Supervisory Committee of the Company retired on 30 June 2003. The 3rd Board of Directors and Supervisory Committee were appointed for a term of three years commencing from 1 July 2003 to 30 June 2006.

Executive Directors:

The executive directors of the 2nd Board of Directors, including Mr. Dong Yong An, Mr. Liu Da Gong, Mr. Liu Wen Ying, Mr. Shao Hai Chen, Mr. Li Teng Jiao, Mr. Zhang Jing and Mr. Liu Shuang Cheng were re-appointed as the executive directors of the 3rd Board of Directors at the annual general meeting of the Company on 13 June 2003. Mr. Zhao Yan Shui and Mr. Huang Yan Zhao were appointed as new executive directors thereof. Mr. Cui Qi Hong and Cao Chun Guo retired and ceased to serve as executive directors of the 3rd Board of Directors commencing on 13 June 2003.

Independent Non-executive Directors:

The independent non-executive directors of the 2nd Board of Directors, including Mr. Lu Zhong Min, Mr. Tao Xiang, Mr. Chan Sau Shan, Gary and Mr. Chen Zhi were re-appointed as the independent non-executive directors of the 3rd Board of Directors at the annual general meeting on 13 June 2003.

Supervisors:

The supervisors of the 2nd Supervisory Committee, including Mr. Liu A Nan, Mr. Zhao Zhong Hai and Mr. Xu Wei Lin were re-appointed as the supervisors of shareholders' representatives of the 3rd Supervisory Committee at the annual general meeting of the Company on 13 June 2003. Ms. Wang Ai Ying and Mr. Shao Jian Xin were appointed as the supervisors of staff's representatives of the 3rd Supervisory Committee on 10 May 2003 for a term of three years commencing from 1 July 2003 to 30 June 2006.

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 19 to 22 of the Annual Report.

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13. SERVICE CONTRACTS OF THE DIRECTORS AND THE SUPERVISORS

Mr. Dong Yong An, Mr. Liu Da Gong, Mr. Liu Wen Ying, Mr. Shao Hai Chen, Mr. Li Teng Jiao, Mr. Zhang Jing, Mr. Liu Shuang Cheng, Mr. Zhao Yan Shui, Mr. Huang Yan Zhao, Mr. Liu A Nan, Mr. Zhao Zhong Hai, Mr. Xu Wei Lin, Ms. Wang Ai Ying and Mr. Shao Jian Xin entered into service contracts with the Company on 30 June 2003. These service contracts are the same in all material respects, details of which are set out as below:

- (i) Each service contract commences from 1 July 2003 to 30 June 2006;
- (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. DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2003, none of the directors and supervisors of the Company had any interests or short positions in any shares and underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("the SFO")), as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

16. 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 2003.

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17. SUBSTANTIAL SHAREHOLDERS

As at 31 December 2003, the following shareholders holding interests of 5% 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 336 of the SFO:

Shareholders	Class	Capacity and nature of interest	Number of shares (‘000 shares)	Percentage of total shares (%)
China Yituo Group Corporation Limited ("China Yituo")	State-owned legal person shares	Directly beneficial owned	450,000	57.32
The HKSCC Nominees Limited	H shares	Owned as Nominee	330,146	42.06

As confirmed by the HKSCC Nominees Limited, The Hong Kong and Shanghai Banking Corporation Ltd, Standard Chartered Bank and Citibank N.A. respectively held 111,606,000, 64,494,000 and 29,934,932 shares of the Company as at 31 December 2003, representing 33.32%, 19.25% and 8.94% of the Company's H shares in issue.

Save as disclosed above, no other parties held any interests or short positions in shares and underlying shares of the Company as required to be recorded in the register of interests pursuant to Section 336 of the SFO.

18. DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any directors, supervisors, or their respective spouse or minor children, or were any rights exercised by them; or was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors or supervisors to acquire such rights in any other body corporate.

19. CONNECTED TRANSACTIONS

The Group's connected transactions are set out in note 42 to the financial statements.

Regarding the investments as disclosed in note 42 (g), (h), (i) to the financial statements, since China Yituo is the controlling shareholder of the Company and Yituo (Luoyang) Diesel Company Limited ("YLDC"), the said investments constituted the Company's connected transactions pursuant to Rule 14.23 of the Listing Rules. The Company's investments, amounting to RMB59,000,000 (approximately HK\$55,400,000), RMB5,000,000 (approximately HK\$4,690,000) and RMB15,960,000 (approximately HK\$14,980,000) respectively, were more than HK\$1 million but less than 3% of the net book value of tangible assets in the latest accounts published by the Company. Accordingly, the Company made announcements respectively on 24 July, 2 October and 2 December 2003 under Rule 14.25(1) of the Listing Rules.

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

- (1) entered into in the ordinary and usual course of business of the Group;
- (2) conducted 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
- (3) carried out (a) in accordance with the terms of the agreements governing such transactions or (b) if no relevant agreement, on terms no less favourable than terms available to the independent third parties.

Save as the above transactions, the Group also entered into the following connected transactions (as defined in the Rules governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")):

On 29 May 2003, the Company's subsidiary China First Tractor Group Finance Company Limited ("FTGF") entered into the Agreement on Financial Services with the Company's holding company China Yituo, pursuant to which FTGF will provide China Yituo and/or entities in which China Yituo has equity interests or controlling rights with such financial services as deposit, loan, discounted bills, financial lease and guarantee. The Company has made disclosures pursuant to the provisions in relation with connected transactions under the Listing Rules. The Agreement on Financial Services and connected transactions thereunder were approved at the Company's Extraordinary General Meeting on 6 August 2003. A waiver from compliance with Rule 14.26 of the Listing Rules has been granted by the Stock Exchange.

Upon review of the connected transactions under the Agreement on Financial Services, the independent non-executive directors of the Company confirmed that such connected transactions were:

- (1) entered into in the ordinary and usual course of business of the Group;
- (2) conducted either on normal commercial terms (which expression shall be applied by reference to transactions of similar nature and to be made by similar entities); or (where there is no available comparison) on terms no less favourable than those available to or from independent third parties.
- (3) entered into on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and
- (4) Save for deposits and loans, no balance of any other transaction at any time of the period from 1 January 2003 to 31 December 2003 exceeded the cap as required by the waiver granted by the Stock Exchange.

In view of the fast growing business of FTGF, the Company intends to apply to the Stock Exchange for an increase in the cap of the waiver regarding the transactions under the Agreement on Financial Services. Currently, the relevant procedures are in progress.

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20. 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 RMB1,180,725,000 which have been spent and disclosed in the previous annual reports, were also applied to the following purposes during the year:

- approximately RMB68,370,000 were applied to financing the purchase of fixed assets in respect of wheeled tractors with great horse-power, and to appreciation in projects under construction.
- the remaining balance of the proceeds were used as additional working capital of the Company.

21. 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.

22. 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).

23. 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 of 2003.

24. 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, basic medical insurance and subsidy to serious illness of the Company's existing staff are stated as staff welfare.

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25. DESIGNATED DEPOSIT AND DEPOSIT DUE

The Company had a sum of RMB87,125,000 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 Yituo Group Corporation Limited. The Company did not have any deposits other than those aforesaid deposited with any non-banking financial institution.

The Company granted a loan of RMB20,000,000 and a loan of RMB2,000,000 to two of its subsidiaries, Yituo (Luoyang) Building Machinery Company Limited and Guizhou Zhenning Biological Industrial Co., Ltd. respectively. These loans were granted in the form of designated deposits deposited with FTGF. The Company did not have any designated deposit other than those aforesaid. Save for the above-mentioned deposit in FTGF, 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.

26. POLICIES ON UNIFIED INCOME TAX

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

27. LAND USE RIGHTS

Under the land leasing agreement entered into between the Company and its controlling company China Yituo 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.

28. AUDIT COMMITTEE

The Company has set up an independent audit committee as required under the Listing Rules in order to perform the functions of reviewing and inspecting the procedures for the Group's financial reporting and internal surveillance. The audit committee comprises of three independent non-executive directors of the Company.

29. SIGNIFICANT EVENTS

Save for the connected transactions disclosed in item 19 of this report, the Company had the following significant events during 2003:

- 1 On 22 July 2003, the Company entered into a Promoter Agreement with Henan Construction and Investment Corporation ("HCIC"), China Yituo, Luoyang Yituo East Industry Company Limited ("East Industry") and Mr. Liu Zhen Min, pursuant to which Luoyang First Motors Company Limited ("LFMC") was to be established under joint investment. Registered capital of LFMC was RMB200,000,000, of which the Company contributed RMB59,000,000 by way of cash, representing 29.5% of its registered capital, HCIC contributed RMB120,000,000 by way of cash, representing 60% of its registered capital, China Yituo contributed RMB18,000,000 by way of cash, representing 9% of its registered capital, East Industry contributed RMB2,000,000 by way of cash, representing 1% of its registered capital, and Mr. Liu Zhen Min contributed RMB1,000,000 by way of cash, representing 0.5% of its registered capital.

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- 2 On 27 September 2003, the Company entered into a joint venture agreement with China Yituo and the Accessories Plant of First Tractor Construction Machinery Co., Ltd (“Yituo Accessories”), pursuant to which Yituo (Luoyang) Casting and Forging Company Limited (“YLCF”) was to be established under joint investment of the Company, China Yituo and Yituo Accessories. Registered capital of YLCF was RMB20,000,000, of which China Yituo contributed RMB10,000,000 by way of valued assets, representing 50% of its registered capital, Yituo Accessories contributed RMB5,000,000 by way of cash, representing 25% of its registered capital, and the Company contributed RMB5,000,000 by way of cash, representing 25% of its registered capital.
- 3 On 28 November 2003, the Company entered into the Agreement on Joint Venture of Yituo (Luoyang) Engine Machinery Company Limited and YLDC and other management members including Mr. Li Xibin. Registered capital of Yituo (Luoyang) Engine Machinery Company Limited (“YEMC”) was RMB38,000,000, of which YLDC contributed RMB19,000,000 by way of cash, representing 50% of its registered capital, the Company contributed RMB15,960,000 by way of cash, representing 42% of its registered capital, and management members including Mr. Li Xibin contributed RMB3,040,000 by way of cash, representing 8% of its registered capital.
- 4 As the Company’s subsidiary, Yituo Qingjiang Tractor Company Limited (“YTQT”) continued to incur losses as adjusted in accordance with accounting principles generally accepted in Hong Kong, the Company and Jiangsu Qingjiang Tractor Group Company (“Qingtuo Group”) entered into an agreement on 10 August 2003 for the transfer of 51% equity interests in YTQT after the comprehensive consideration of the conditions of the assets and liabilities of YTQT. Pursuant to the agreement, the Company transferred 51% equity interests in YTQT to Qingtuo Group at a consideration of RMB10,000. After the transfer of equity interests, the Company no longer held any equity interests in YTQT.
- 5 On 22 December 2003, the Company entered into the Agreement on Joint Venture of Yituo (Luoyang) Standard Components Company Limited (“YLSC”) with Yuyao Jieyu Machinery Company Limited (“Jieyu Company”) and other parties including Mr. Liu Rui Jiang, pursuant to which YLSC was to be established under joint investment. Registered capital of YLSC was RMB8,000,000, of which the Company contributed RMB3,055,000 by way of cash and RMB2,145,000 by way of valued assets, representing 65% of its registered capital, Jieyu Company contributed RMB2,000,000 by way of cash, representing 25% of its registered capital, other management members including Mr. Liu Rui Jiang contributed RMB800,000 in total, representing 10% of its registered capital. YLSC is principally engaged in process, manufacture and trade of standard and non-standard parts, machinery spare parts and metal materials; manufacture and trade of agricultural machinery. YLSC was established on 16 January 2004.
- 6 On 16 March 2004, Mr. Liu Da Gong was elected as Chairman of the Company at the 9th meeting of the third Board of Directors. Mr. Yan Lin Jiao was appointed as the General Manager, and Mr. Zhao Yan Shui was appointed as the Executive Deputy General Manager of the Company. Due to changes in work arrangements, Mr. Dong Yong An ceased to serve as Chairman, and Mr. Shao Hai Chen, Mr. Du Huan Lin and Mr. Yang You Liang ceased to serve as the General Manager and Deputy General Managers of the Company respectively.

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- 7 On 8 April 2004, the Company entered into an Agreement on Joint Venture with China Yituo and other parties including Mr. Jin Yang, pursuant to which Yituo (Luoyang) Shentong Construction Machinery Company Limited ("YLST") was to be established under joint investment. Registered capital of YLST was RMB13,000,000, of which the Company contributed RMB6,500,000, representing 50% of its registered capital, China Yituo contributed RMB3,120,000 by way of valued net assets, representing 24% of its registered capital, other management executives including Mr. Jin Yang contributed RMB3,380,000 in total by way of cash, representing 26% of its registered capital. YLST was principally engaged in research and development, manufacture, sales of agricultural machine, construction machine and specialised motor vehicle, and manufacture and sales of tractor spare parts and engine spare parts.

30. POST BALANCE SHEET EVENTS

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

31. 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 Listing Rules throughout the fiscal period covered by the annual report.

32. 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.

33. 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

Liu Da Gong

Chairman

Luoyang, the PRC

17 April 2004