

# MANAGEMENT DISCUSSION AND ANALYSIS

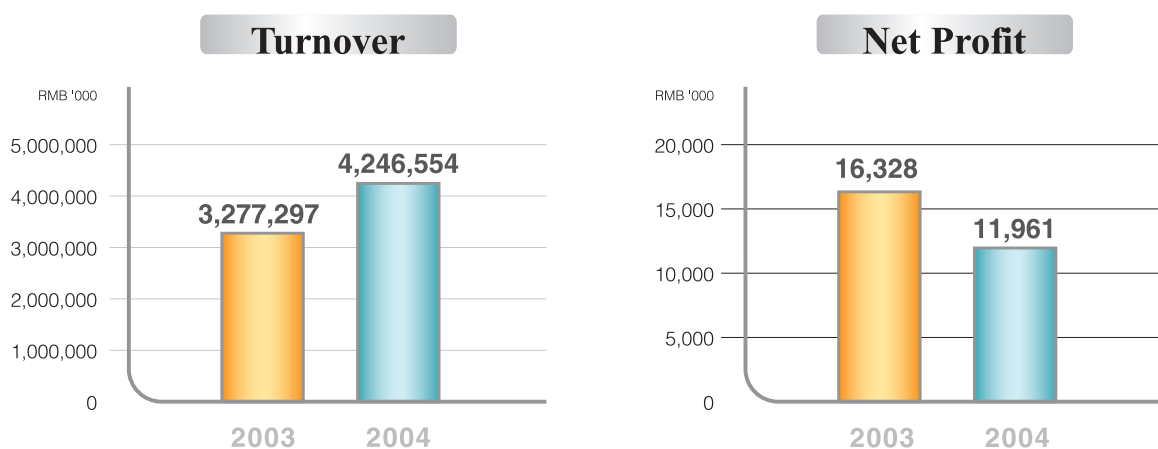
## ANALYSIS OF FINANCIAL RESULTS

For the year ended 31 December 2004, the Group recorded a turnover of RMB4,246,554,000, representing an increase of 29.57% over the same period last year. Consolidated profit after tax and minority interests amounted to RMB11,961,000, representing a decrease of 26.75% over the same period last year. Earnings per share was RMB1.52 cents.

### The Group's turnover by business classification for 2003 - 2004

Classification by business	January - December 2004 RMB'000	January - December 2003 RMB'000	Increase / decrease (+/-)
Tractor business	2,953,914	2,014,219	+46.65%
Road machinery business	802,655	886,514	-9.46%
Construction machinery business	379,827	263,099	+44.37%
Harvesting machinery business	110,146	109,036	+1.02%
Others	12	4,429	-99.73%
Total	4,246,554	3,277,297	+29.57%

### Structure of the Group's turnover / Analysis of net profit for 2003-2004



# MANAGEMENT DISCUSSION AND ANALYSIS

## OPERATING INCOME ANALYSIS

### Tractor business

In 2004, the Group recorded a rapid growth in tractor business with an increase of 46.65% in turnover as compared with the same period of last year, representing 69.56% of the Group's turnover. Reasons for the rapid growth in tractor business are set out below:

- (1) with implementation of the policy of "Two Exemptions and Three Subsidies" (note 3) adopted by the government of the PRC for supporting agricultural development, the burden of farmers were alleviated with increased income, thus boosting the demand in tractor market.
- (2) the Group amended its traditional sales model by focusing on key areas and subdividing markets to expand new markets.
- (3) for the convenience of customers, the Group strengthened the network for after-sales service and spare parts supply, thus gaining customers' satisfaction.
- (4) new products of large/medium wheeled tractors were developed and launched into the market to address the needs of customers.
- (5) as for small wheeled tractors, the Company integrated industry resources through joint ventures and cooperation to give full brand advantage of "Dongfanghong". Accordingly, the market share of the Company for 2004 climbed to 27.85% from 23% in 2003.

*Note 3:* Two exemptions: exemption of the agricultural tax and exemption of taxes on special agricultural products (exclusive of tobacco leaves).

Three subsidies: the direct grain subsidy, the subsidy on improved breed of wheat and paddy rice and the subsidy for purchase of agricultural machinery.

### Harvesting machinery business

As affected by the over-supply of wheat harvesters in 2003, sales volume of wheat harvesters in the PRC for 2004 declined to approximately 12,000 units, representing a substantial year-on-year decrease of over 70%. With more efforts on branding services, the Group took initiatives such as follow-up services before, after and in the course of sales. Sales of harvesting machines amounted to 1,773 units, representing a year-on-year decrease of 5.03%, but the market share for 2004 increased to 14.3% from 4.12% in 2003. Therefore, industry position of the Company rose to No. 3 in 2004 from No. 7 in 2003.

# MANAGEMENT DISCUSSION AND ANALYSIS

## Construction machinery business and road machinery business

Due to the influence of the PRC macro-control policy in 2004, the serious decline in demand in the nationwide market of construction machinery business and road machinery business, together with the increase in competitive pressure, the growth of construction machinery and road machinery businesses of the Group were seriously affected. As a result, the growth rate of the Group's turnover dropped to 2.86% in 2004 from 47.15% in 2003.

By developing new products, improving product quality, reducing production cost and adopting differentiated marketing strategies, the Group realised a significant increase in the sales volume of small excavator and loader.

## ANALYSIS OF OPERATING RESULTS

In 2004, the consolidated profit of the Group after tax and minority interests amounted to RMB11,961,000, representing a decrease of 26.75% over last year. Gross profit of the Group decreased by 3.1 percentage point over last year. The reasons for downfall of operating results of the Group are as follows:

- (1) It is affected by the increase in the price of steel materials, resulting in an increase in the cost of raw materials;
- (2) It is affected by market competition in construction machinery and road machinery. For market development, the Group adopts the measure of decreasing sales price for products with high pressure market competition.

## CAPITAL LIQUIDITY AND FINANCIAL ANALYSIS

### The detailed table of the Group's major current assets

	31 December 2004 RMB'000	31 December 2003 RMB'000	Increase/ decrease (+/-)
Cash and bank deposits	466,643	800,584	-41.71%
Trade receivable and bills receivable	490,690	410,611	+19.50%
Inventories	865,110	773,847	+11.79%

In 2004, the Group recorded a year-on-year decrease of approximately RMB333,941,000 in cash and bank deposits, mainly attributable to the growth in external loans granted by the Company's subsidiary, China First Tractor Group Finance Company Limited ("FTGF"), for developing its financing business. In addition, the increase in inventories of the Group also contributed to the decrease in cash and bank deposits of the Group.

The accounts receivable and inventories of the Group for 2004 increased by 19.5% and 11.79% respectively, mainly attributable to the impact of PRC macro-control policy. Some unmarketable construction machinery and road machinery resulted in the decreased collection rate of trade receivables from product sales, leading to the increase in accounts receivable and inventories level.

As at 31 December 2004, the bank loans of the Group amounted to RMB96,660,000, an increase of RMB31,363,000 over last year. The long-term bank loan of the Group is zero.

# MANAGEMENT DISCUSSION AND ANALYSIS

## INVESTMENTS

During the reporting period, Yituo (Luoyang) Diesel Co., Ltd. and First Tractor Ningbo C.S.I. Tractor & Automobile Corp. Ltd. (associates of the Group) contributed profits to the Group.

Other associates of the Group, Yituo (Luoyang) Casting and Forging Company Limited and Luoyang First Motors Company Limited incurred loss for the Group.

The Company believed that the operating results of these associates will be improved continuously due to the improvement in the management standard and the quality of the products.

## ANALYSIS OF ASSETS AND FINANCIAL POSITION OF THE GROUP

### Financial Statistics

Items	Basis of calculation	31 December 2004	31 December 2003
Gearing ratio	Total liabilities/total assets x 100%	<b>43.09%</b>	43.58%
Current ratio	Current assets/current liabilities	<b>1.66</b>	1.76
Quick ratio	(Current assets - inventories)/current liabilities	<b>1.05</b>	1.23
Debt equity ratio	Total liabilities/Shareholders' equity x 100%	<b>75.71%</b>	77.23%

### Analysis of Equity and Reserves

Items	31 December 2004 RMB'000	31 December 2003 RMB'000	Increase/ (decrease) RMB'000
Share capital	<b>785,000</b>	785,000	—
Share premium account	<b>1,378,840</b>	1,378,840	—
Statutory surplus reserve	<b>65,597</b>	61,699	3,898
Statutory public welfare fund	<b>63,171</b>	62,749	422
Reserve fund	<b>2,398</b>	1,759	639
Enterprise expansion fund	<b>2,974</b>	1,515	1,459
Retained profits/(accumulated losses)	<b>(220,849)</b>	(226,392)	5,543

## PLAN FOR SIGNIFICANT INVESTMENT AND ACQUISITION OF CAPITAL ASSETS OF THE GROUP IN FUTURE

There was no plan for significant investment and acquisition of capital assets of the Group in 2005.

# MANAGEMENT DISCUSSION AND ANALYSIS

## CURRENCY EXCHANGE RISK

The Group carries out its day-to-day business activities mainly in the PRC. A large amount of capital income and expenditure is principally denominated in Renminbi, with a small amount of expenditure being denominated in Hong Kong dollars. The Group's foreign exchange debt is mainly applied to the payment of commissions outside the PRC and payment of dividends to holders of H Shares of the Company. The Group's cash balances are usually deposited with financial institutions in the form of short-term deposits. Bank loans were borrowed in Renminbi and such loans can be repaid out of the income received in Renminbi.

As at 31 December 2004, there was no pledge of any deposit of foreign currency of the Group.

## PLEDGE OF ASSETS

As at 31 December 2004, the Group's certain buildings and machinery with an aggregate net carrying value of approximately RMB27,417,000 (2003: buildings and machinery of RMB27,779,000; time deposits of RMB13,233,000 and inventories of RMB8,967,000) were pledged to banks to secure certain short term bank loans granted to the Group.

In addition, the Group's deposits amounting to approximately RMB69,206,000 (2003: deposits of RMB103,714,000 and bills receivable of RMB16,000,000) were pledged to banks to secure certain banking facilities (including issuance of bills payable) of the Group.

## CONTINGENT LIABILITIES

As at 31 December 2004, FTGF, acting as the second guarantor, had given guarantee to the extent of RMB52 million to a financial institution for securing the loans to Yituo (Luoyang) Fuel Jet Co. Ltd.

Details of contingent liabilities as at 31 December 2004 are set out in note 37 to the financial statements.

## THE COMPANY'S STAFF AND TRAINING FOR STAFF

As at 31 December 2004, the Company had a total of 11,908 staff of whom 7,232 were production staff, 454 were engineering technicians, 160 were financial staff, 261 were administrative staff, and 3,801 were marketing and other staff.

In 2004, the Company conducted "training as required" in a number of ways. 12,180 staff in different areas were trained so that the professional quality of the staff was raised.