



Dear Shareholders,

2005 is the third year after the listing of the Company. Under the joint efforts of the investors and staff of the Company, coupled with the steady growth of China's economy, both the automobile and aviation business of the Group have made significant progress. For the year ended 31st December 2005, the Group recorded sales revenue of RMB14,266 million, representing an increase of 10.79% over that of 2004. Net profit attributable to the equity holders of the Company amounted to RMB118 million, representing an increase of 66.20% over that of the previous year. Basic and diluted earnings per share attributable to the equity holders of the Company amounted to RMB0.025 for 2005.

The Board of Directors recommended the payment of a final dividend of RMB0.0105 per share for the year ended 31st December 2005, subject to the approval at the annual general meeting (the "AGM") of the Company to be held on 16th June 2006.

AUTOMOBILE PRODUCT: BACK TO THE INCREASING TRACK

During the year of 2005, facing intense competition in the automobile market, the Group took active marketing measures to optimize the sales network and enhance promotion, and has successfully reversed the declining sales volume of vehicles in 2004 back to an upward trend, achieving automobile sales volume of 331,000 units. The turnover in automobile products amounted to RMB10,716 million, representing an increase of 4.35% over that of 2004. Besides, the Group has also improved its development strategy, manufacture configuration and products mix.

Development strategy: The Group improved its development strategy for its automobile business. The cooperation between Changhe Auto and Suzuki has been extended to form a closer tie in their strategic cooperation. Hafei Auto has actively pushed forward its cooperation with international automobile groups while reinforcing its capability in independent innovation, research and development. The ultimate goal of the Group is to firmly establish the "three pillars" in its automobile business: i.e. proprietary brands of AviChina, cooperation between Changhe Auto and Suzuki and the Hafei international cooperation.



Manufacture configuration: Shenzhen branch and Weihai branch of Hafei Auto have been established to produce sedans and mini-sized trucks and vans respectively, thus the automobile production plants of the Group now have a more rational and market-oriented coverage of Northeast China, Central China, East China and South China.

Product mix: The Group has insisted on the integration of proprietary development and international cooperation. New vehicle models, Hafei Saibao and Changhe Liana, were launched in 2005 and two new engine models, K14B and 4G9, were put into production, which have enriched the automobile and engine products series of the Group.

AVIATION PRODUCT: RAPID DEVELOPMENT

In 2005, the revenue from the Group's aviation products exceeded RMB3,500 million, representing an increase of 36.12% when compared with that of 2004, taking up 24.88% of the total revenue of the Group. The increase was mainly attributable to the increase in sales volume of helicopters and aviation parts and components.

In 2005, the Group sped up its pace in the research, manufacture and upgrade of aviation products and enhanced its production capability to meet domestic and overseas market demands. In addition, the Group improved its capabilities in research, development and production of helicopters and aviation parts and components. The Group has also made significant progress in the cooperation with international partners: according to the plan of AVIC II, the controlling shareholder of the Company, the Group will play a key role in the execution of the cooperation contracts entered into between AVIC II and Eurocopter in relation to the development of a new advanced medium-sized general-purpose helicopter; Jiangxi Changhe-Agusta Helicopter Co., Ltd., a joint venture between Changhe Aviation and Agusta was established to manufacture an advanced and popular twin-engine helicopter—model CA109; besides, the Group entered into agreements with Boeing and Airbus respectively on subcontracting the manufacture of aviation parts and components, lastly, the Group also diligently pushed forward the subcontract production of Bell430 parts and components, thus increasing its share in the global aviation production chain.

CORPORATE MANAGEMENT: REFORM AND ADJUSTMENT

In 2005, the Group streamlined part of its non-core assets and employees to improve the efficiency based on the formal reviews of the businesses and human resources.

With regard to the automobile business, the Group continued its business integration through centralization of purchasing, development and marketing based on the principles of centralising its planning and decision making. The cost control measures have begun to bear fruits. For the aviation business, the enhancement of management by objective and the coordination of components production have accomplished a balanced production schedule and timely aviation products delivery throughout the year.

CORPORATE GOVERNANCE: CONTINUOUS IMPROVEMENT

The Company has strictly complied with the applicable laws and regulations as well as the Articles of Association of the Company, and insisted on disciplined and stable operations. In 2005, the annual general meeting for 2004, two extraordinary general meetings and six board meetings were convened to consider and decide significant issues including: operation results, changes of directors, purchasing and sale of assets, continuing connected transactions and project investments.



Chairman's Statement

In 2005, the Board considered and passed the resolutions relating to changes of directors, and appointed Mr. Tan Ruisong, Mr. Wang Bin and Mr. Wang Yong as non-executive directors of the Company whose appointments were subsequently approved at the following annual general meeting of the Company. The compositions of the Audit Committee and the Remuneration Committee of the Board have also been adjusted to comply with requirements of the Listing Rules. In order to comply with the Code on Corporate Governance Practices of the Listing Rules, the Company has also improved the terms of reference of the Board and its special committees and revised the regulations of the Company. Details of corporate governance have been set out in the section headed "Corporate Governance Report" of the annual report.

BUSINESS PROSPECT

The Board believes that, in 2006, China's economy will continue its stable and moderate growth leading to a steady growth in both the automobile industry and the aviation industry in China.

A forecast made by the State Information Center shows that, in 2006, the total output and sales volume of China's automobile manufacturers will increase by 10% to 15%, and the economy sedans will achieve the highest growth rate within the industry. Under the State's policy to build a conservation-minded society and to encourage the manufacture and utilization of energy-saving, environmental-friendly and low-emission vehicles, various positive measures have been promulgated in succession, resulting in an unprecedented opportunity for the development of low-emission economy cars, the main products of the Group.

The Group will continue the strategy of developing "safe, environmental-friendly, energy-saving, economical and practical" low-emission vehicles, adhere to the principle of giving priority to mini-sized vehicles while enlarging its share in the sedan market, maintain a balanced effort in independent research and development as well as the cooperation with international partners, and further improve its operation in the automobile business and rationalize the locations of manufacturing plants. On that, the Group will evolve into a leading mini-sized vehicle manufacturing group in China with comparative competitive advantages. In 2006, the Group will increase its marketing efforts, strengthen the research and development on low-emission vehicles and vehicles using alternative power source from cooperation with international partners and enhance its cost control by way of lean manufacturing so as to achieve a stable growth in both the output and sales volume of automobile products.

As the largest helicopter manufacturer and a major aeroplane manufacturer in the PRC, the Group will continue to benefit from the large potential demand in the Chinese market for helicopters and aeroplanes in the next few years. The output and sales volume of the Group's aviation products, especially helicopters, will increase substantially due to increasing purchase orders from the Chinese government. Sales volume of aviation parts and components will also maintain a steady growth due to the following factors: (i) the fast growth in aviation business of both AVIC II Group and AVIC I Group will result in an increasing demand for aviation parts and components manufactured by the Group; (ii) as the Group has made an impressive progress in the subcontract production for the world's renowned aviation manufacturers, such as Boeing and Airbus, sales volume of aviation parts and components will increase accordingly.

We will stand by our motto of "operating with integrity and providing products and services of quality" in our operation, and work in a practical, innovative and diligent manner with the goal to providing all shareholders with satisfactory returns.

On behalf of the Board, I would like to thank all our employees for their efforts and extend our gratitude to the Group's shareholders and customers.

Zhang Hongbiao
Chairman

Beijing, 4th April 2006