

# MANAGEMENT DISCUSSION AND ANALYSIS

## ANALYSIS OF FINANCIAL RESULTS

For the year ended 31 December 2005, the Group recorded a turnover of RMB4,765,828,000, representing an increase of 12.2% over the same period last year. Loss for the year attributable to equity holders of the parent amounted to RMB50,436,000. Gross profit margin was basically the same as the same period last year.

The decrease in profit was mainly attributable to:

1. A loss in construction machinery business as a result of a year-on-year considerable reduction in sales volume of the Group's large construction machinery products;
2. Operating loss of the Group's certain associates

The management of the Group will strengthen assets and capital management, reduce accounts receivable and inventories, lower the cost of manufacturing and open up new markets, so as to cater for the significantly changing demands for agricultural and construction due to construction of a new countryside, new opportunities and increasing product sales, in order to promote the operating results of 2006.

### The Group's turnover by business classification for 2004 - 2005

Classification by business	31 December	Year Ended	Increase / decrease (+/-)
	2005 RMB'000	31 December 2004 RMB'000	
Agricultural machinery business	<b>3,751,521</b>	3,064,060	+22.44%
Construction machinery business	<b>1,013,898</b>	1,182,482	-14.3%
Others	<b>409</b>	12	+33.08 times
Total	<b>4,765,828</b>	4,246,554	+12.23%

Note: The business segment for turnover was changed to four categories in 2005 from six categories in 2004, details of which are set out in notes 2.4 and 4 to the financial statements.

# MANAGEMENT DISCUSSION AND ANALYSIS

## 1. Analysis of Sales Volume of Agricultural Machinery Products

During the reporting period, the Group sold 166,053 units of agricultural machinery in various types, of which:

- the sales volume of large / medium wheeled tractors was 28,388 units, increased by 81.50% over the same period last year;
- the sales volume of small wheeled tractors was 131,200 units, decreased by 9.37% over the same period last year;
- the sales volume of harvesters was 2,319 units, increasing by 30.80% over the same period last year;
- the sales volume of agricultural machinery was 4,146 sets / units, increasing by 89.40% over the same period last year;

The year-on-year increase in sales volume of the Group's agricultural machinery products including large and medium wheeled tractors, harvesters, and agricultural machinery was mainly due to: (1) the relative improvement in farmers' grain revenue by virtues of such policies as the State's exemption and cancellation of agricultural tax and the grain direct subsidy; (2) the increasing market demand as stimulated by the central and local governments' subsidies for purchasing large and medium wheeled tractors and agricultural machinery; (3) achievement on the effective results from the Group's adoption of flexible marketing portfolio, upgrade of old products, launch of new products and improvement of after-sales services.

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## 2. Analysis of Sales Volume of Construction Machinery Business

During the reporting period, the Group sold 9,180 units of construction machinery products in various types, of which:

- the sales volume of road construction machinery was 2,316 units, decreasing by 9.25% over the same period last year;
- the sales volume of shovelling and moving machinery was 1,359 units, decreasing by 21.90% over the same period last year;
- the sales volume of maintenance machinery was 49 units, increasing by 4.26% over the same period last year;
- the sales volume of small construction machinery was 5,456 units, decreasing by 58.65% over the same period last year;

The decline in operating results of the Group's large construction machinery was mainly attributable to: the decrease in the construction business and earthwork construction and the insufficient demand for construction machinery because of the low confidence of potential purchasers of construction machinery as affected by the continuation of the State's Macro-economic control. However, with weak growth in the industry demand, the Group's subsidiaries for manufacturing large construction machinery lacked of the ability and measures to address the market change, had insufficient ability of controlling cost and failure in promotion for sales, resulting in the decline in operating results of the Group's large construction machinery.

# MANAGEMENT DISCUSSION AND ANALYSIS

## CAPITAL LIQUIDITY AND FINANCIAL ANALYSIS

The detailed table of the Group's major current assets

	31 December 2005 RMB'000	31 December 2004 RMB'000	Increase/ decrease (+ / -)
Cash and bank deposits	663,553	466,643	+42.2%
Trade and bills receivables	448,641	490,690	-8.6%
Inventories	755,227	865,110	-12.7%

The cash and bank deposits of the Group increased approximately RM196,910,000 in 2005, which was mainly due to the decrease in the trade receivable and inventories of the Group when compared with last year, together with a decrease in the use of capital, resulting in an increase in cash and bank deposit.

The trade receivable and inventories of the Group reduced 8% and 12% respectively in 2005, which mainly due to the implementation of a series of measures to reduce the trade receivable and inventories by the Group.

As at 31 December 2005, the short term bank loans of the Group was RMB172,250,000, representing an increase of RMB75,590,000 from 2004, whereas the long term bank loan of the Group was RMB1,000,000 (2004: Nil).

For further details on the borrowings of the Company, please refer to note 32 to the financial statements.

### Disposal of subsidiary

During the reporting period, the Company entered into an agreement on 25 October 2005 with China Yituo Group Corporation Limited ("China Yituo") for disposing its 65% of the equity interests in Yituo (Luoyang) Standard Component Company Limited ("YLSC") at the consideration of approximately RMB5.65 million. For further details, please refer to the paragraph headed "Connected Transactions" in the Report of the Directors of this annual report.

### Investments income

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

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.

# MANAGEMENT DISCUSSION AND ANALYSIS

## ANALYSIS OF ASSETS AND FINANCIAL POSITION OF THE GROUP

### Financial Statistics

Items	Basis of calculation	31 December 2005	31 December 2004
Gearing ratio	Total liabilities/total assets x 100%	<b>43.02%</b>	38.71%
Current ratio	Current assets/current liabilities	<b>1.52</b>	1.66
Quick ratio	(Current assets - inventories)/current liabilities	<b>1.06</b>	1.05
Debt equity ratio	Total liabilities/Shareholders' equity(note) x 100%	<b>80.96%</b>	68.02%

Note : Exclusive of minority interests.

### Analysis of Equity and Reserves

Items	31 December 2005 RMB'000	31 December 2004 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>68,817</b>	65,597	3,220
Statutory public welfare fund	<b>64,744</b>	63,171	1,573
Reserve fund	<b>2,525</b>	2,398	127
Enterprise expansion fund	<b>2,153</b>	2,974	(821)
General and statutory reserve	<b>2,217</b>	—	2,217
Exchange fluctuation reserve	<b>(1,357)</b>	—	(1,357)
Accumulated losses	<b>(272,020)</b>	(220,849)	(51,171)

## 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 2006. There was no significant investment held in 2005.

# MANAGEMENT DISCUSSION AND ANALYSIS

## EXCHANGE RATE RISK MANAGEMENT

The Group manages its foreign exchange revenue and expenditure in accordance with the relevant laws and regulations about foreign exchange issued by the State, and has established internal foreign exchange flows with cash balances usually deposited with financial institutions in the form of deposits. As 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. Bank loans required for the Group's operating activities and technological renovation were borrowed in Renminbi and such loans can be repaid out of the income received in Renminbi. Therefore, the movement in exchange rate has minor impact on the Group's operating results

As at 31 December 2005, there was no pledge of any deposit of foreign currency of the Group.

## PLEDGE OF ASSETS

As at 31 December 2005, the Group's certain buildings and machinery with an aggregate net carrying value of approximately RMB18,806,000 (2004: RMB27,147,000) were pledged to banks for securing certain short term bank loans granted to the Group.

In addition, the Group's deposits and bills receivable amounting to approximately RMB121,124,000 (2004: RMB69,206,000) and RMB7,400,000 (2004: Nil), respectively, were pledged to banks for securing certain banking facilities (including issuance of bills payable) of the Group.

## CONTINGENT LIABILITIES

As at 31 December 2005, China First Tractor Group Finance Company Limited ("FTGF"), acting as the second guarantor, had given guarantee to the extent of RMB52 million to a financial institution for securing the loans granted to Yituo (Luoyang) Fuel Jet Co. Ltd.

As at 31 December 2005, FTGF, acting as the guarantor, had given guarantee to the extent of RMB100 million to a financial institution for securing the loans granted to China Yituo.

As at 31 December 2005, Zhenjiang Huachen Huatong Road Machinery Company Limited ("ZHHRM"), a subsidiary of the Group, had provided a guarantee to the extent of RMB20 million to a bank for securing the loan granted to a related company of the minority shareholder of ZHHRM.

Details of contingent liabilities as at 31 December 2005 are set out in note 39 to the financial statements.

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## THE COMPANY'S STAFF AND TRAINING FOR STAFF

As at 31 December 2005, the Company had a total of 11,199 staff of whom 6,147 were production staff, 514 were engineering technicians, 152 were financial staff, 403 were administrative staff, and 3,983 were marketing and other staff.

In 2005, the Company conducted "training as required" in a number of ways. 15,703 in different areas were trained so that the professional quality of the staff was raised.