

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 2005.

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 of the Company are set out in note 17 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 2005 and the state of financial affairs of the Company and the Group as at 31 December 2005 are set out in the financial statements on pages 68 to 166.

The Directors do not recommend the payment of any final dividend for the year of 2005.

3. FIVE YEARS FINANCIAL SUMMARY

A summary of the published results and assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the published audited financial statements with appropriate category, is set out below. This summary does not form part of the audited financial statements.

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

Consolidated results

	Year ended 31 December				
	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000	2001 RMB'000
Turnover	4,765,828	4,246,554	3,277,297	2,300,223	1,863,824
Profit/(loss) before tax	(77,482)	23,813	54,666	(36,784)	(97,737)
Tax	17,183	(13,953)	(21,641)	(15,088)	(16,656)
Profit/(loss) before minority interests	(60,299)	9,860	33,025	(51,872)	(114,393)
Minority interests	9,863	2,101	(16,697)	(7,618)	(3,406)
Net profit/(loss) from ordinary activities attributable to equity holders of the parent	(50,436)	11,961	16,328	(59,490)	(117,799)

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Consolidated assets, liabilities and minority interests

	As at 31 December				
	2005	2004	2003	2002	2001
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Total assets	3,821,630	3,649,665	3,660,072	3,334,388	3,088,579
Total liabilities	(1,644,175)	(1,412,889)	(1,465,153)	(1,180,321)	(914,200)
Minority interests	(146,536)	(159,645)	(129,749)	(105,225)	(66,047)
Total equity attributable to equity holders of the parent	2,030,919	2,077,131	2,065,170	2,048,842	2,108,332

4. PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of 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 reporting period.

During the year of 2005, the Company and its subsidiaries 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 Articles of Association or the laws of the PRC which would oblige the Company to offer new shares of the Company 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.

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8. RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 35(b) to the financial statements, and in the consolidated statement of changes in equity, respectively.

9. DISTRIBUTABLE RESERVES

Details of the distributable reserves of the Company as at 31 December 2005 are set out in note 35 to the financial statements.

10. MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2005, the five largest customers and suppliers of the Group respectively accounted for less than 30% of the total sales and purchases of the Group so far as the Directors are aware, none of the Directors, Supervisors, their associates or any Shareholder who owns more than 5% of the share capital of the Company had an interest in the major suppliers or customers of the Group.

11. DIRECTORS AND SUPERVISORS

During the year, the Directors and Supervisors of the Company are as follows:

Executive Directors:

Mr. Liu Dagong
Mr. Liu Wenying
Mr. Zhao Yanshui
Mr. Yan Linjiao
Mr. Li Tengjiao
Mr. Shao Haichen
Mr. Zhang Jing
Mr. Li Youji
Mr. Liu Shuangcheng
Mr. Zhao Fei

Independent non-executive Directors:

Mr. Lu Zhongmin
Mr. Chan Sau Shan
Mr. Chen Zhi

Supervisors:

Mr. Liu A Nan
Mr. Zhao Zhonghai
Mr. Xu Weilin
Ms. Wang Aiyang
Mr. Shao Jiangxin

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12. DIRECTORS', SUPERVISORS' AND THE GENERAL MANAGER'S BIOGRAPHIES

Biographical details of the Directors, Supervisors and the general manager of the Company are set out on pages 21 to 25 of the Annual Report.

13. SERVICE CONTRACTS OF THE DIRECTORS AND THE SUPERVISORS

Mr. Liu Dagong, Mr. Liu Wenying, Mr. Zhao Yanshui, Mr. Li Tengjiao, Mr. Shao Haichen, Mr. Zhang Jing, Mr. Liu Shuangcheng, Mr. Liu A Nan, Mr. Zhao Zhong Hai, Mr. Xu Wei Lin, Ms. Wang Ai Ying and Mr. Shao Jian Xin entered into service contract with the Company on 30 June 2003. Mr. Yan Linjiao entered into a service contract with the Company on 28 October 2004. Mr. Li Youji and Mr. Zhao Fei entered into a service contract with the Company on 28 October 2004. 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 contract 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; 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 or Supervisors has entered into any service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

The Company has received the annual confirmation letter issued by all independent non-executive Directors in respect of their independence in accordance with Rule 3.13 of the Rules (the "Listing Rules") Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The Company considers that all of the independent non-executive Directors are independent.

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14. DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

During the year, no Director or Supervisor had a material interest or any other interest (either directly or indirectly) in any contract of significance or any other contract 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, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, save as disclosed below, none of the Directors, Supervisors or chief executives of the Company had any interests or short positions in any shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571, Laws of Hong Kong) (the "SFO"), which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO, or 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 pursuant to the Model Code for Securities Transactions by Directors of Listed Companies:

Name	Name of associated corporation	Capacity	Registered capital held (Note 2)	Approximate percentage in the entire registered capital of the associated corporation
Yan Linjiao (Director)	Yituo (Luoyang) Lutong Construction Machinery Co., Ltd. ("Lutong Company") (Note 1)	Beneficial owner	RMB290,000 (L)	0.5%

Notes:

1. Lutong Company is a limited company established in the PRC. Its total registered capital is RMB 58,000,000. Mr Yan Linjiao contributed RMB 290,000 to the total registered capital of Lutong Company and therefore holding 0.5% of the total registered capital of Lutong Company.
2. The letter "L" represents the person's long position in the registered capital of the associated corporation.

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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 paragraph headed “connected transactions”, with the controlling Shareholder of the Company at or any of its subsidiaries any time during the year ended 31 December 2005.

17. CHANGE IN SHAREHOLDING AND STRUCTURE OF EQUITY INTERESTS OF SHAREHOLDERS

As at 31 December 2005, the total issued Shares amounted to 785,000,000 Shares. Its structure of equity interests was as follows:

Type of Shares	Number of Shares	Percentage(%)
(1) Non-circulating state-owned legal-person Shares (the “Domestic Shares”)	450,000,000	57.32
(2) Circulating Shares listed in the Stock Exchange (the “H Shares”)	335,000,000	42.68
Total number of Share	785,000,000	100.00

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18. SUBSTANTIAL SHAREHOLDERS

As at 31 December 2005, the following shareholders (the "Shareholders") (other than a Director, Supervisor or chief executive of the Company) of the Company have interests or short positions in the shares and underlying shares in the Company as recorded in the register required to be kept by the Company pursuant to section 336 of the SFO:

Domestic Shares

Name of Shareholder	Nature of interest	Number of Shares (Note 1)	Approximate percentage of the total issued H Shares of the Company
China Yituo	Beneficial owner	450,000,000(L)	57.32%

H Shares

Name of Shareholder	Nature of interest	Number of Shares (Note 1)	Approximate percentage of the total issued H Shares of the Company
GE Asset Management Incorporated	Investment manager	22,991,788(L)	6.86%

Notes:

1. The letter "L" represents the entities' long position in the shares of the Company.
2. According to the Corporate Substantial Shareholder Notice submitted by State Street Corporation to the Company dated 23 September 2005, State Street Corporation is the holding company of an approved lending agent and 15,639,756 H Shares are held in a lending pool.

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Save as disclosed, there is no other person (other than a Director, Supervisor or chief executive of the Company) who, as at 31 December 2005, had an interest or a short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under section 336 of the SFO.

On the basis of published information and to the best knowledge of the Directors, the Company has maintained the prescribed public float under the Listing Rules as at the date of this report.

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

At no time during the year were any 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; nor 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.

20. CONNECTED TRANSACTIONS

The Company and China Yituo (a controlling Shareholder of the Company) had entered into four continuing connected transactions such as Yituo Supply Agreement, Group Supply Agreement, Composite Service Agreement and Energy Supply Services Agreement for a term of three years and had entered into the Import and Export Agency Agreement for a term of three years with Yituo International Economic and Trade Company Limited ("Yituo Trade"), the subsidiary of China First Tractor Group, on 19 August 2004. The Company had made disclosures pursuant to the relevant provision under the Listing Rules. As at 28 October 2004, the aforesaid five agreements of continuing connected transactions and new caps related the connected transactions were approved by the Shareholder at the extraordinary general meeting of the Company on 28 October 2004.

Details of the above Group's continuing connected transaction are set out in note 43 to the financial statements.

After reviewing the above current year's continuing connected transactions, the independent non-executive Directors confirmed that such continuing 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 available comparison) on terms no less favorable than those available to or from independent third parties; and
- (3) entered into on terms that are fair and reasonable so far as the Shareholders are concerned.

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After reviewing the above current year's continuing connected transactions, the auditors of the Company confirmed the matters stated in rule 14A.38 of the Listing Rules.

Save as the above continuing connected transactions, the Group also entered into the following connected transactions:

The Company entered into an agreement on 25 October 2005 with China Yituo, pursuant to which the Company transferred to China Yituo 65% of the equity interests in YLSC at the consideration of approximately RMB5.65 million (determined with reference to 65% of the appraised net asset value of YLSC as stated in the valuation report provided by Luoyang Tiancheng Certified Public Accountants Company Limited. The registered capital of YLSC amounts to RMB8,000,000.

Details of the Group's connected transactions are set out in note 43 to the financial statements of this annual report.

After reviewing the above current year's connected transactions, the independent non-executive Directors 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 available comparison) on terms no less favorable than those available to or from independent third parties; and
- (3) entered into on terms that are fair and reasonable so far as the Shareholders are concerned.

After reviewing the above current year's connected transactions, the auditors of the Company confirmed the matters stated in rule 14A.38 of the Listing Rules.

The Company confirms that it has complied with the disclosure requirements in accordance with the Listing Rules for the above connected transactions.

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21. 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 under the initial public offering of the H Shares listed on the Stock Exchange on 23 June 1997 and two subsequent partial exercises of over-allotment option.

The proceeds, other than those amounting to RMB1,343,415,000 which have been used and disclosed in the previous annual reports of the Company, were also applied to the following purposes during the year:

- approximately RMB129,020,000 was continue to use for financing projects including large and medium wheeled tractors, 125MN hotdie forging, flexible line of gear shells and forklifts, construction of building for gear sub-factory and technological renovations thereof; and
- the remaining balance of the proceeds were used as additional working capital of the Company.

22. DIRECTORS' AND SUPERVISORS' INTERESTS IN COMPETING BUSINESS

During the year and up to the date of this report, none of the Directors or Supervisors 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.

23. EMOLUMENT POLICY

As at 31 December 2005, the Company had 11,119 employees, and the total remuneration thereof amounted to RMB155,510,000, which is the sum of employee's salary for the reporting period. The pay levels of the employees are commensurate with their responsibilities, performance and contribution. The emolument policy of the employees of the Group is set up by the personnel department on the basis of their merit, qualification and competence.

Remuneration of the Company's executive Directors is subject to their positions, performance and contribution and is linked with the operating results of the Group.

24. STAFF QUARTER

As all staff quarters have been retained by the controlling Shareholder of the Company, 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 of the Company).

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25. HOUSING POLICY

Regarding the allocation of housing subsidies policy promulgated by the State, 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 2005.

26. STAFF'S BASIC MEDICAL INSURANCE

Since September 2001, the Company has implemented 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.

27. DESIGNATED DEPOSIT AND DEPOSIT DUE

The Company deposited a sum of RMB240,980,000 with 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 the group members of China Yituo. Save as the aforesaid deposits, the Company did not have any deposits deposited with any non-banking financial institution.

The Company granted a loan of RMB52,000,000 to its subsidiaries. The loan was granted in the form of designated deposits deposited with FTGF. The Company did not have any designated deposit other than the aforesaid. Save for the above-mentioned deposits 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.

28. POLICIES ON UNIFIED INCOME TAX

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

29. LAND USE RIGHTS

Under the land leasing agreement entered into between the Company and its controlling Shareholder, 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.

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30. AUDIT COMMITTEE

The Company has set up an audit committee of the Company 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.

The Audit Committee has reviewed the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters of the Group including a review of the audited accounts of the Group for the year ended 31 December 2005.

31. SIGNIFICANT EVENTS

Save for the connected transactions disclosed in the 2005 annual report, the Company had the following significant events during 2005:

1. On 23 November 2005, the Board approved the project for technological renovation of large/mid wheeled tractor projects with estimated investment of RMB354,405,000 (including the investment of RMB150,000,000 approved by the Board on 2 July 2004). Upon completion of the projects, the Company will be able to enhance its annual production. This is a significant initiative of the Company in adjusting the product mix to satisfy the surge of agriculture machinery business.
2. On 30 November 2005, the Board approved the transaction to transfer its 40% equity interests in NCSIT at a consideration of RMB40,000,000. NCSIT is mainly engaged in manufacturing and sale of tractor, automobile, transportation devices, mechanical and electrical product and mould tools. China Tractor and Automobile Group Company Limited (Hong Kong) (中國拖拉機汽車集團有限公司) holds 55% equity interests of NCSIT, and Ningbo Industrial and Trade Asset Management Company Limited (寧波市工貿資產經營有限公司) holds 5% equity interests of NCSIT.
3. On 10 December 2005, the Board resolved to invest RMB50,880,000 in Yituo (Luoyang) Transportation Machinery Company Limited ("YLTM") (一拖(洛陽)搬運機械有限公司). Following the investment, the registered capital of YLTM increased from RMB5,000,000 to RMB55,880,000, and 91.05% of its equity interests was held by the Company after the capital increase. The relevant work of capital increase is now processing. YLTM is principally engaged in manufacturing and sales of forklifts and mechanical machinery.
4. On 29 December 2005, the Board resolved to increase its investment in Si Chuan Southwest Stainless Steel Company Limited ("Stainless Steel Company") by RMB9,360,000 in cash. Following the investment, the registered capital of Stainless Steel Company was increased to RMB250,000,000, in which the Company contributed RMB23,360,000, holding 9.344% of the equity interests in Stainless Steel Company. Stainless Steel Company is mainly engaged in smelting and rolling of stainless steel and carbon steel as well as exploring and supply of raw materials.

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5. The Company entered into an agreement with China Yituo Group Corporation Limited (“China Yituo”) on 25 October 2005, pursuant to which the Company disposed YLSC to China Yituo.

32. POST BALANCE SHEET EVENT

Details of the significant post balance sheet event of the Group is set out in note 45 to the financial statements.

33. CODE ON CORPORATE GOVERNANCE PRACTICES

The Board is of the opinion that the Company has complied with the requirements of all code provisions of the Code on Corporate Governance Practices in Appendix 14 of the Listing Rules during the reporting period of the 2005 annual report, details of which are set out in page 40-44 of the 2005 annual report.

The Board has conducted review of the effectiveness of the internal control system of the Company and its subsidiaries. However, due to (i) the large number of Company’s subsidiaries; (ii) complicated shareholding structure; and (iii) large geographical coverage, the management and control of the Company and its subsidiaries are relatively difficult and as a result of which one of the subsidiaries of the Company failed to make the relevant disclosure requirement to the public before the connected transaction with minority Shareholders of the Company is conducted. In this regard, the Company will adopt effective measures to improve the internal control system of the Company and its subsidiaries, and to remedy the deficiency.

34. MODEL CODE FOR SECURITIES TRANSACTIONS BY THE DIRECTORS

The Company has adopted a code of practice (the “Model Code”) with standards not less competent than those prescribed in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules for securities transactions conducted by the Directors. During the reporting period, all Directors have complied with the Model Code in relation to securities transactions conducted by the Directors.

35. MATERIAL LITIGATION

During the reporting period, none of the Company, the Directors, Supervisors nor senior officers of the Company was involved in any material litigation or arbitration.

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36. AUDITORS AND QUALIFIED ACCOUNTANT

Ernst & Young will be retired and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting of the Company. There was no change in the auditors of the Company in the last 3 financial years.

Pursuant to Rule 3.24 of the Listing Rules, the Company must employ an individual with the specified qualifications set out in Rule 3.24 of the Listing Rules as a qualified accountant (the "Qualified Accountant") of the Company. As at the date of this report, the Company has not yet been able to find a suitable candidate to work as the Qualified Accountant. The Company will continue to find a suitable candidate to assume such position. The Company will keep the Shareholders informed of the progress of appointment.

By order of the Board

Liu Dagong

Chairman

Luoyang, the PRC
21 April 2006