

MANAGEMENT DISCUSSION AND ANALYSIS



OPERATING ENVIRONMENT REVIEW

With increasing popularity of various portable devices, the global demand for rechargeable batteries continued to grow. Since handset application accounted for the overwhelming demand for rechargeable batteries, the impact of the handset market on the rechargeable battery industry was particularly significant. The handset component industry was also directly affected.

In the global handset market, handset output continued to grow in 2005. All major international handset providers recorded a satisfactory growth. In order to increase market share, international handset providers continued to actively develop the emerging markets. With their reputable, advanced and quality products and competitive selling prices, they managed to further increase their market shares in the emerging markets and the global handset market.

Highly competitive market conditions have also accelerated consolidation in the industry.

As for the domestic handset market, apart from direct competition from overseas handset manufacturers, domestic handset manufacturers were also faced with threats from illegal handset suppliers. During the year, domestic handset manufacturers experienced a significant decrease in sales and a slow-down in production capacity increment as compared with 2004. This substantially reduced the market share of domestic handset manufacturers in the PRC. Therefore, domestic handset manufacturers were forced to cut selling prices and focused on inventory clearance. Such operating conditions, coupled with sustained high prices of raw materials, created unprecedented challenges to domestic manufacturers of rechargeable batteries and handset components.



As for the automobile industry, given the excessive production capacity and the price reduction caused by intense market competition, domestic automobile manufacturers were faced with difficulty in operation with substantially reduced profit margin. Some of them even recorded losses. However, in the second half of the year, there was a slow pickup in the overall automobile sales in the market.

BUSINESS REVIEW

The two major businesses of BYD comprise the IT parts business and the automobile business. The IT parts business is mainly divided into rechargeable batteries and handset components. In 2005, affected by the difficult operating environment, BYD consolidated both the IT parts business and the automobile business.

IT Parts — Rechargeable Batteries

2005 was a tough year for the rechargeable battery business of BYD. Nevertheless, the battery products of BYD, namely Nickel batteries and Lithium-ion batteries, maintained the leading position in the rechargeable battery industry in 2005.

Regarding Lithium-ion batteries, orders from domestic handset manufacturers have significantly reduced because of a decrease in market share, resulting in a sharp decline in the Group's sales of Lithium-ion batteries in 2005. In order to reduce the negative impact brought by the domestic handset providers, the Group made efforts to secure orders from international handset providers during the year. As a

result, a majority of the Group's orders in 2005 came from international handset providers. In 2005, sales of Lithium-ion battery products were RMB2,102,475,000, down 40% from 2004. The Group also started to supply rechargeable Lithium-ion batteries for other products, further expanding the applications of Lithium-ion batteries and recorded growth in this aspect during the year.

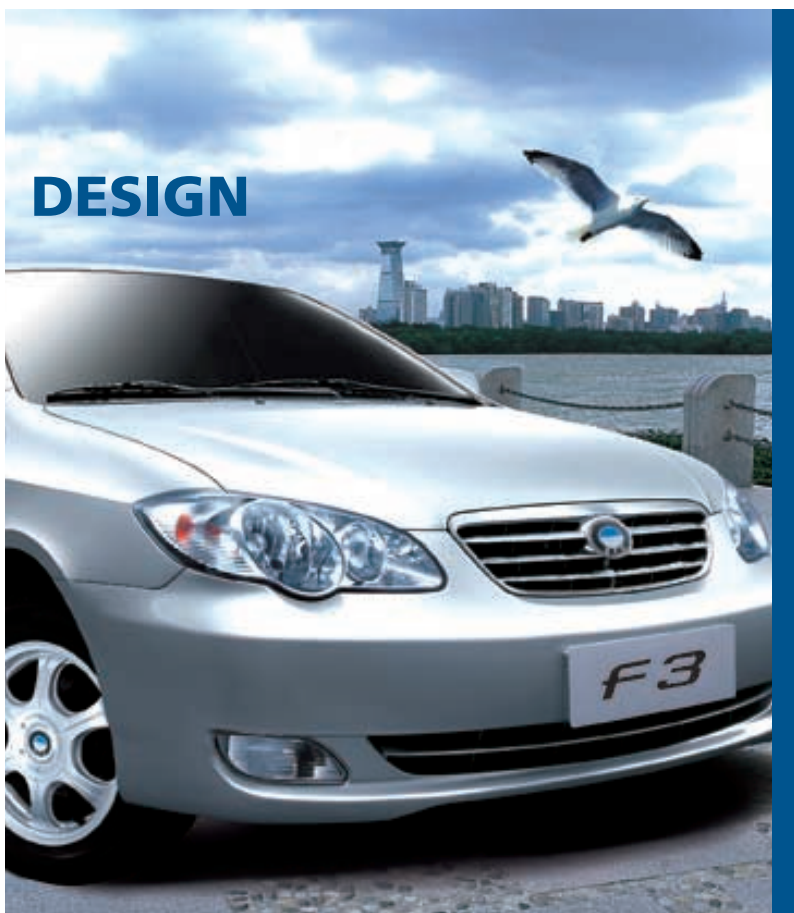
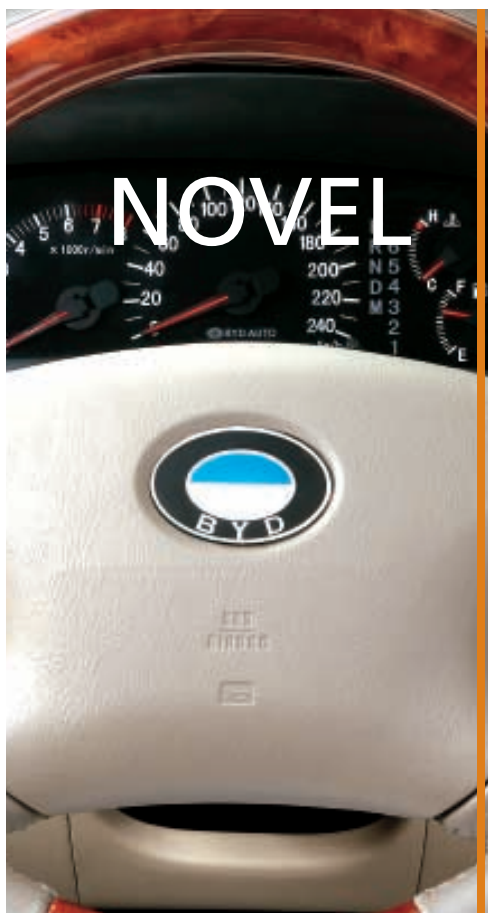
The major sales targets of Nickel batteries are providers of electrical devices. As an industry and a global leading manufacturer of Nickel batteries, BYD is able to provide high-quality Nickel batteries. With steadily growing market demand and relatively less market competition, BYD maintained stable growth in the sales of Nickel batteries when compared with 2004. In 2005, sales of Nickel battery products were RMB1,766,595,000, up 14% from 2004 and the Group's leading position in the market was further consolidated.

IT Parts — Handset Components

In 2005, the Group's handset component business was in the customer incubation and steady growth stage.

The Group's handset component business has a diversified product range, including plastic cases, key-pads, camera modules, LCD screens, flexible printed circuits, to meet customers' demand for one stop supply of handset components. During the year, the Group provided one stop supply services to certain international handset providers. The provision of one stop supply services was well recognized by the Group's customers and propelled the

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growth of the business because it effectively lowered customers' costs and enhanced customers' efficiency. Attracted by the competitive pricing, leading international handset providers placed orders for the Group's plastic cases and key-pads. This will be a driver for the rapid growth of the Group's handset component business in the future. Besides, the Group's flexible printed circuits also achieved outstanding results.

During the year, one of the major customers of the Group's handset component business merged with another international handset provider. The consolidation of these two companies created an adverse effect on the development of the Group's handset component business. The Group's handset component business recorded growth for the year with sales about RMB1,906,298,000, up 103%

from 2004. However, its development was at a slightly slower speed than was expected at the beginning of the year.

Automobile

The launch of the F3 new model was delayed till end of September and the Group sold mainly old models during a large part of the year. The automobile business recorded a turnover of RMB628,594,000, representing an increase of 61% over 2004. Loss before interest and tax was RMB91,305,000. Total sales for the whole year amounted to 15,993 units. A total of 11,059 old model cars were sold during the year, with average selling price of approximately RMB26,139 (excluding tax). The F3 new model was well-received by the market since its launch in the end of September. Among similar products, F3 has a better price



advantage as well as other competitive advantages. There was even a shortage of the product in the market following its launch. The average selling price of F3 was approximately RMB64,957 (excluding tax) and sales amounted to a total of 4,934 units. The F3 model is the first automobile product developed by BYD upon the completion of the acquisition of BYD Automobile Company Limited (formerly named as “Qinchuan Automobile”). The positive response in the market fully reflected BYD’s capability in automobile R&D, production and marketing. This is of great significance to BYD as it is a new starting point for the Group’s automobile business. The F3 model started to make revenue contribution to the Group in November and generated profits to the Group’s automobile business in December.

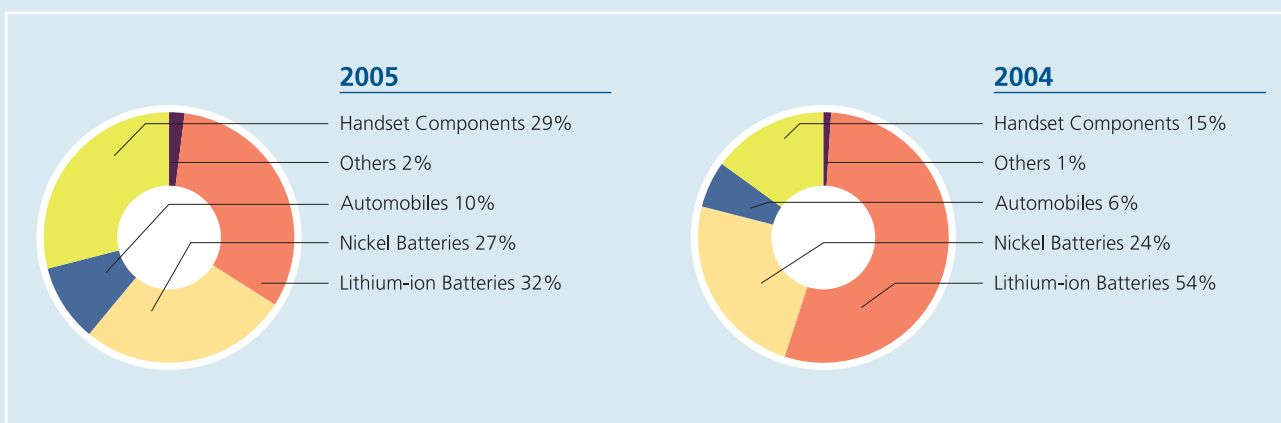
BYD’s automobiles are principally sold in the PRC market. During the year, it also exported the Flyer model to overseas markets. In June 2005, BYD further increased its interests in BYD Automobile Company Limited from 92% of equity interests to 99%.

FUTURE PROSPECTS AND STRATEGIES

IT Parts — Rechargeable Batteries

In terms of Lithium-ion batteries, as the global handset market is expected to continue its growing trend in the future, the favourable development trend of the industry will create a favourable operating environment to the Group’s business development. International handset manufacturers are expected to expand their market share.

Turnover Breakdown by Products



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Meanwhile, the operations of domestic handset manufacturers will be gradually stable. In addition, prices of raw materials have started to decline, which is favourable to the industry. The Group expects that the Lithium-ion battery business will return to normal in 2006 and will have a recovery growth. The future development strategy for the Lithium-ion battery business will be to maintain a stable supply to existing customers, continue to explore new international handset manufacturers as customers, expand the applications of its battery products and enhance profitability. The Group will continue to strengthen its leading position in the Lithium-ion battery industry.

In respect to Nickel batteries, the global market demand is expected to grow steadily. The Group will further consolidate its market share and enhance profitability.

IT Parts — Handset Components

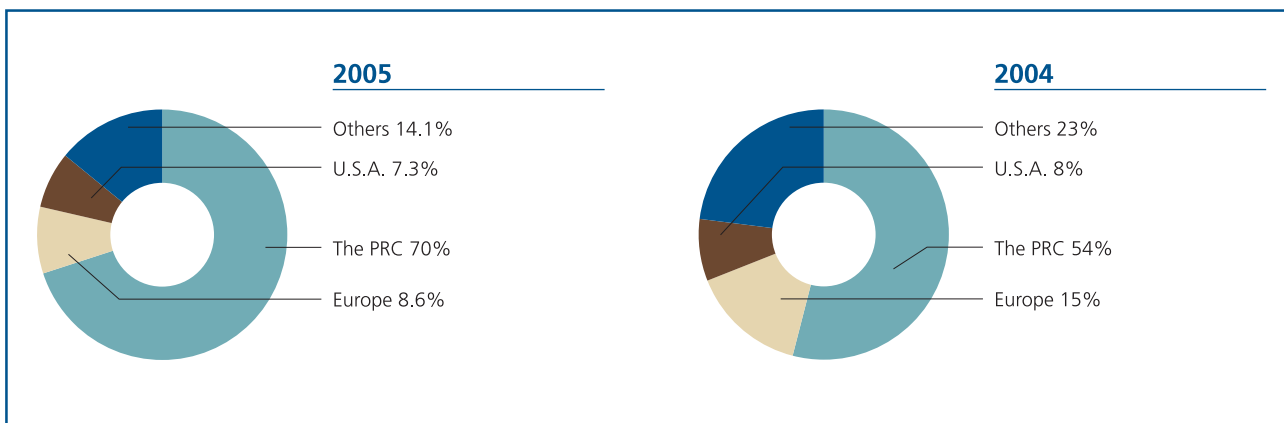
Benefiting from the continued expansion of market share by international handset providers and their increasing need for one-stop handset component suppliers, the Group expects to focus on supplying handset components to large

international handset providers in 2006. The handset component business is expected to become a future growth driver of the Group. The future strategy for the expansion of the handset component business is to continue to seek more overseas handset manufacturer customers for one-stop components supply, further enjoy economies of scale, enhance profitability, increase number of customers and enlarge market share.

Automobile

It is expected that full recovery is yet to be seen in the domestic automobile market and market competition is still intense. However, leveraging on the competitive price advantages of its F3 model, BYD has been successful in securing a large number of orders from end-users, resulting in a shortage of F3 in the market. In 2006, apart from actively meeting existing market demands, the Group will further extend its presence in markets nationwide. The Group’s objective in 2006 is to become a leader in the domestic automobile market through extending the Group’s sales network, providing vertically integrated accessory services, rationalizing the supply flow and reducing costs by mass production.

Turnover Breakdown by Geographical Segments



FINANCIAL REVIEW

Turnover and Profit Attributable to Equity Holders of the Company

Turnover in 2005 was almost the same as in 2004. The sales of Lithium-ion batteries, the Group's major product, dropped but increase in sales of Nickel batteries, handset components and automobile business compensated the loss, resulting in a stable turnover in 2005.

Profit attributable to equity holders of the Company decreased because of the substantial drop in sales of higher margined Lithium-ion batteries and the widened loss of automobile business. The profit growth in handset component business was partly offset.

Segmental Information

In 2005, Lithium-ion batteries remained the Group's largest revenue contributor. However, due to the substantial decrease in sales of Lithium-ion batteries, the ratio of Lithium-ion batteries to total turnover decreased to 32%. The sales of handset components grew and its ratio to total turnover increase to approximately 29%.

Gross Profit and Margin

The Group's gross profit decreased by approximately 15% from RMB1,704,890,000 for the year ended 31 December 2004 to approximately RMB1,454,545,000 for the year ended 31 December 2005. Gross profit margin dropped from 27% in 2004 to 22% in 2005. Decrease in gross profit margin was mainly brought about by the highly competitive operating market.

Liquidity and Financial Resources

BYD generated net operating cash inflow of approximately RMB1,391,156,000 for the year ended 31 December 2005, compared with RMB652,355,000 in 2004. Total borrowings as at 31 December 2005, including all bank loans were approximately RMB4,024,693,000, compared with approximately RMB3,138,753,000 as at 31 December 2004. The maturity profile spreaded over a period of eight years, with RMB2,195,024,000 repayable within one year, RMB669,669,000 in the second year, RMB500,000,000 within three to five years and RMB660,000,000 after five years. The increase in total borrowings was to fund numerous new battery related projects, R&D investment volume and enhance production capacity. The Group maintains adequate daily liquidity management and capital funding expenditure requirements to regulate internal operating cashflow. In addition, BYD has access to significant short-term borrowing facilities of approximately RMB5,293,809,000 from its principal banks.

Accounts receivable turnover days were maintained at about 106 days for the year ended 31 December 2005 as compared to 97 days for the year ended 31 December 2004. Inventory turnover days increased from 91 days for the year ended 31 December 2004 to 135 days for the year ended 31 December 2005. Additional new projects, together with increase in product inventory, resulted in the increase in inventory turnover days.

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Capital Structure

The Group's treasury function is responsible for the Group's financial risk management which operates according to policies implemented and approved by top management. As at 31 December 2005, borrowings were primarily denominated in RMB and USD, while cash and cash equivalents were mainly denominated in RMB and USD. The Group's intentions to maintain an appropriate mix of financial equity and debt are to ensure an efficient capital structure during the year. The loans outstanding as at 31 December 2005 are set out in Note 18 to the consolidated financial statements. The loans remaining outstanding as at 31 December 2005 were at fixed interest rates for RMB loans and floating interest rates for foreign currency loans.

Details of Factoring Business in respect of Accounts Receivable

Please refer to Note 12 to the consolidated financial statements for details of the relevant factoring business in respect of accounts receivable.

USE OF IPO PROCEEDS

According to the Prospectus dated 22 July 2002, apart from the HK\$85,000,000 planned for product R&D and manufacturing of fuel cells and solar cells (HK\$870,000 utilised) and the HK\$189,000,000 planned for potential acquisition(s) not utilised), the rest of the proceeds of HK\$1,075,000,000 has been fully utilised.

EXPOSURE TO FOREIGN EXCHANGE RISK

Most of the Group's income and expenditure are denominated in RMB and USD. During the year, the Group did not experience any significant difficulties in its operations or liquidity, due to fluctuations in currency exchange rates. The directors believe that the Group has sufficient foreign exchange to meet its own foreign exchange requirements.

EMPLOYMENT, TRAINING AND DEVELOPMENT

As at 31 December 2005, the Group had over 55,000 employees, representing an increase of 15,000 employees as compared with 31 December 2004. During the year, total staff cost accounted for approximately 10% of the Group's turnover. Employee remuneration was determined based on performance, experience and prevailing industry practices, with compensation policies being reviewed on a regular basis. Bonuses and commission were also awarded to employees, based on their annual performance evaluation. In addition, incentives and encouragement were offered for personal and career development.



SHARE CAPITAL

As at 31 December 2005, the share capital of the Company was as follows:

	Number of shares issued	Percentage (%)
Domestic shares	390,000,000	72.29
H shares	149,500,000	27.71
	539,500,000	100.00

CAPITAL COMMITMENT

Please refer to Note 31 to the consolidated financial statements for capital commitment.

CONTINGENT LIABILITIES

Please refer to Note 30 to the consolidated financial statements for contingent liabilities as at 31 December 2005.