

Management's Discussion and Analysis of Interim Results

FINANCIAL RESULTS OVERVIEW

The Dongfeng Motor Group has been sticking to its established development tactics, taking full advantage of its scale, networks, business and services, making rational investments and implementing aggressive cost control measures by implementing effective competition strategy and marketing tactics, so as to continue improving budget and evaluation management. For the Period, revenue amounted to approximately RMB23,282 million, representing an increase of approximately RMB2,090 million, or 9.9%, when compared with the figure in the corresponding period in 2005 of approximately RMB21,192 million. During the Period, the profit attributable to shareholders amounted to approximately RMB1,114 million, representing an increase of approximately RMB454 million, or 68.8%, when compared with the figure in the corresponding period in 2005 of approximately RMB660 million.

During the Period, net cash inflows from operating activities of the Dongfeng Motor Group was approximately RMB1,604 million, indicating a strong performance of cash flows generated from operating activities.

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REVENUE

During the Period, total revenue of the Dongfeng Motor Group amounted to approximately RMB23,282 million, representing an increase of approximately RMB2,090 million, or 9.9%, when compared with approximately RMB21,192 million for the corresponding period in 2005, reflecting increases of approximately RMB3,489 million in revenue from the sales of passenger vehicles to external customers of the Dongfeng Motor Group, and decreases of approximately RMB820 million and RMB579 million in revenue from sales of commercial vehicles and other auto-related businesses, respectively.

	For the six months ended 30 June			
	2006		2005	
	<i>Revenue from sales RMB million</i>	<i>units sold</i>	<i>Revenue from sales RMB million</i>	<i>units sold</i>
Passenger vehicles:	16,339	N/A	12,850	N/A
Whole vehicles	13,255	233,057	10,379	164,490
External sales of engines and other auto parts	3,084	N/A	2,471	N/A
Commercial vehicles:	6,534	N/A	7,354	N/A
Whole vehicles	5,787	124,986	6,821	140,758
External sales of engines and other auto parts	747	N/A	533	N/A
Others	409	N/A	988	N/A
Total	23,282	358,043	21,192	305,248

Note: It should be noted that the revenue figures in the above table reflected the proportionate consolidated revenue of the Dongfeng Motor Group. However, the related figures of the units of vehicles sold by the Dongfeng Motor Group in the above table represented the actual units sold by the Dongfeng Motor Group, not adjusted on a proportionate consolidation basis, for the indicated periods.

During the Period, revenue of the Dongfeng Motor Group from sales of passenger vehicles increased by approximately RMB3,489 million, or 27.2%, from approximately RMB12,850 million in the corresponding period in 2005 to approximately RMB16,339 million. Of which, revenue from sales of whole passenger vehicles increased by approximately RMB2,876 million, or 27.7%, from approximately RMB10,379 million in the corresponding period in 2005 to approximately RMB13,255 million. Such increases were mainly due to: (1) revenue growth

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brought about by the increase of sales volume of vehicles, the total sales volumes of whole passenger vehicles increased by 41.7% to 233,057 units from 164,490 units in 2005; (2) revenue growth brought about by changes in the product mix; (3) various passenger vehicle models entering a peak sales period; and (4) the Peugeot 206, C-Triomphe and Civic newly released in 2006 being widely recognised by the market.

Revenue from the sale of passenger vehicle engines and other auto parts increased by approximately 24.8% to RMB3,084 million for the Period from RMB2,471 million in the corresponding period in 2005. This overall increase in revenue was primarily due to the revenue growth from sales of related engines brought about by the increase of the sale volume of vehicles of Guangzhou Honda Automobile Co., Ltd.

During the Period, revenue of the Dongfeng Motor Group from sales of commercial vehicles decreased by approximately RMB820 million, or 11.2%, from approximately RMB7,354 million in the corresponding period in 2005 to approximately RMB6,534 million. Of which, revenue from sales of whole commercial vehicles decreased by approximately RMB1,034 million, or 15.2%, from approximately RMB6,821 million in the corresponding period in 2005 to approximately RMB5,787 million, mainly due to: (1) the impact of changes in the product mix; (2) the decrease of the Dongfeng Motor Group's sales volume of commercial vehicles as a result of that, subject to such factors as the cyclical nature of economic growth, higher oil prices and policy factors, the PRC commercial vehicles market as a whole weakened, resulting in a slight decrease in the demand for commercial vehicles. During the Period, sales volume of the Dongfeng Motor Group's heavy trucks decreased from 41,551 units in the corresponding period in 2005 to 33,000 units, and sales volume of medium trucks decreased from 33,076 units in the corresponding period in 2005 to 23,445 units. However, the Dongfeng Motor Group maintained its competitive advantage in the domestic commercial vehicles market. According to the statistics published by the China Association of Automobile Manufacturers, in terms of the market share in the commercial vehicle market sub-segment, the Dongfeng Motor Group was ranked the first in heavy trucks market while maintaining its top position among the players in the medium trucks market; the Dongfeng Motor Group's sales volume of light trucks in 2006 increased from 45,912 units in the corresponding period in 2005 to 51,566 units, ranking the second. An increase in the sales revenue from light trucks partly offset the decrease in sales revenue of heavy trucks and medium trucks.

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COST OF SALES AND GROSS PROFIT MARGIN

During the Period, the total cost of sales of the Dongfeng Motor Group was approximately RMB19,198 million, representing an increase of approximately RMB772 million when compared with approximately RMB18,426 million in the corresponding period in 2005. This increase was due to: (1) an increase in the sales volume of vehicles and other auto parts, and (2) the rise in the price of raw materials, particularly steel, for automobile production.

The gross profit margin of the Dongfeng Motor Group increased to 17.5% from 13.1% in the corresponding period in 2005, primarily due to a number of aggressive cost reduction measures taken, including increasing the localisation ratio, reducing the use of funds and cutting various costs and expenses.

During the Period, the gross profit margin of whole passenger vehicles increased to 18.9% from 11.7% in the corresponding period in 2005. This increase was primarily due to a number of measures taken, including (1) increasing the localisation ratio; (2) adjusting the product mix; (3) reducing costs.

During the Period, the gross profit margin of passenger vehicle engines and other auto parts increased to 22.6%, from 17.9% in the corresponding period in 2005. This increase was primarily due to a number of measures taken, including (1) increasing the localisation ratio; (2) optimising work processes and cutting inputs.

During the Period, the gross profit margin of whole commercial vehicles decreased to 12.6%, from 13.4% in the corresponding period in 2005, primarily due to (1) changes in the product mix; (2) the rise in the price of raw materials, particularly steel.

OTHER INCOME

During the Period, the total other income of the Dongfeng Motor Group was approximately RMB239 million, representing a decrease of approximately RMB166 million when compared with approximately RMB405 million in the corresponding period in 2005. The decrease in other income was mainly attributable to decreases of the sales of other goods and materials as well as grants received from the government for the purpose of supporting the development of automotive technologies and automobile projects.

SELLING AND DISTRIBUTION COSTS

During the Period, the selling and distribution costs of the Dongfeng Motor Group amounted to approximately RMB939 million, representing an increase of approximately RMB137 million when compared with approximately RMB802 million in the corresponding period in 2005. This was due to higher selling and distribution costs resulting from increased sales volume

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of vehicles and the marketing of many new models. During the Period, the sales and distribution costs of the Dongfeng Motor Group as a percentage of sales revenue increased slightly by 0.2% points to 4.0%, up from 3.8% in the corresponding period in 2005, reflecting an effective control over the sales and distribution costs of the Dongfeng Motor Group in spite of an increase of the sale volume of vehicles and the marketing of a number of new models.

ADMINISTRATIVE EXPENSES

During the Period, the total administrative expenses of the Dongfeng Motor Group amounted to approximately RMB1,009 million, representing an increase of approximately RMB136 million when compared with approximately RMB873 million in the corresponding period in 2005. This was due to the increased business volume. During the Period, the administrative expenses of the Dongfeng Motor Group as a percentage of sales revenue increased slightly by 0.2% points to 4.3%, up from 4.1% in the corresponding period in 2005, reflecting administrative expenses of the Dongfeng Motor Group under control.

STAFF COSTS

During the Period, the staff costs of the Dongfeng Motor Group amounted to approximately RMB1,193 million, representing an increase of approximately RMB117 million when compared with approximately RMB1,076 million in the corresponding period in 2005. This was due to an increase in the sales volume of vehicles resulting in a higher demand for labour.

DEPRECIATION CHARGES

With a view to expanding its business, the Dongfeng Motor Group made greater investments in buildings, machinery and equipment for production purposes. During the Period, the Dongfeng Motor Group's depreciation charges amounted to approximately RMB701 million, representing an increase of approximately RMB27 million when compared with approximately RMB674 million in the corresponding period in 2005.

RESEARCH AND DEVELOPMENT COSTS

During the Period, the Dongfeng Motor Group made higher investments in research and development. The research and development costs incurred by the Dongfeng Motor Group increased by approximately RMB107 million or 35.9% to approximately RMB405 million, from approximately RMB298 million in the corresponding period in 2005.

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FINANCE COSTS

During the Period, the finance costs of the Dongfeng Motor Group amounted to approximately RMB195 million, representing a decrease of approximately RMB21 million when compared with approximately RMB216 million in the corresponding period in 2005. Such a decrease is mainly attributable to the bank loans obtained in 2005 for financing the repurchase of shareholdings held by asset management companies being fully repaid within a month after the listing with the proceeds therefrom.

INCOME TAX

The income tax expenses of the Dongfeng Motor Group during the Period amounted to approximately RMB351 million, representing an increase of approximately RMB93 million when compared with approximately RMB258 million in the corresponding period in 2005. This increase is mainly due to a higher taxable income and an increase in deferred income taxes.

NET PROFIT

Based on the above reasons, the net profit of the Dongfeng Motor Group increased by approximately RMB454 million during the Period to approximately RMB1,114 million from approximately RMB660 million in the corresponding period in 2005.

LIQUIDITY AND SOURCE OF CAPITAL

The Dongfeng Motor Group raises funds through operations, bank loans and listings to meet its working capital requirements. The funds raised by the Dongfeng Motor Group are mainly used for operating activities, capital expenditure and repayment of short and long term loans.

	Six months ended 30 June	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Net cash flows generated from operating activities	1,604	3,016
Net cash used in investing activities	(1,807)	(2,708)
Net cash generated from/(used in) financing activities	(47)	25
Net increase/(decrease) in cash and cash equivalents	(250)	333

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During the Period, net cash inflows from operating activities amounted to approximately RMB1,604 million. This principally represents: (1) profit before tax amounting to approximately RMB1,540 million; (2) an increase of approximately RMB1,420 million in trade receivables, bills receivable and other prepayments, deposits and other receivables; (3) an increase of approximately RMB1,940 million in trade, bills and other payables and accrued liabilities; (4) depreciation and impairment of approximately RMB702 million; and (5) an increase of approximately RMB953 million in inventories.

During the Period, net cash used in investing activities of the Dongfeng Motor Group amounted to approximately RMB1,807 million. This is mainly attributable to the purchase of property, plant and equipment to the value of approximately RMB1,879 million, generally relating to the expansion of capacity and development of new products. During the Period, the above outlays together with an increase of approximately RMB39 million in unsecured time deposits was partly offset by proceeds of approximately RMB257 million from the disposal of obsolete property, plant and equipment.

During the Period, net cash outflow from financing activities of the Dongfeng Motor Group amounted to approximately RMB47 million, mainly reflecting the offsetting of borrowings of approximately RMB176 million by repayment of borrowings of approximately RMB205 million.

During the Period, the net decrease in cash and cash equivalents of the Dongfeng Motor Group amounted to approximately RMB250 million. As at 30 June 2006, cash and cash equivalents of the Dongfeng Motor Group amounted to approximately RMB5,336 million.

CHANGES IN SHAREHOLDINGS

During the Period, there were no significant changes in the shareholdings of the Dongfeng Motor Group.

RISK FACTORS

The Dongfeng Motor Group's business, financial condition and results of operations are subject primarily to such external factors as global economic activities, the price of raw materials, exchange rate fluctuations, policies on taxes and duties, regulation in the automobile industry and finance costs, which are not wholly within the Dongfeng Motor Group's control.