



Dear shareholders:

I hereby on behalf of the Board of the Company present the result report of the Group for the year ended 31st December 2006.

REVIEW

The major businesses of the Group are automobile and aviation. For the year ended 31st December 2006, the Group recorded sales revenue of RMB17,111 million, representing an increase of 19.94% over that of 2005. The loss attributable to the equity holders of the Company was RMB331 million caused by the drop in the performance of the automobile business.

The Group's automobile business was met with significant challenges during 2006. For the year ended 31st December 2006, the sales volume of the Group's vehicles was 344,400, representing an increase of 4.05% over that of 2005, and the sales revenue was RMB12,683 million, representing an increase of 18.36% over that of 2005. During the year of 2006, the Group has made many achievements in the independent innovation in its automobile products. The Group has received many awards in China and abroad for a series of automobile models independently developed by it. The cycle time of launching new products to the market was also reduced. In 2006, six new models, including Saibao V series, two compartment Liana, Ideal II sedan, Furuida, Minyi M408 mini-van, Hafei Minyi mini-truck and other three upgraded models were launched into the market. However, the results of the whole automobile segment suffered a loss of RMB620 million during the year due to the great drop in gross margin of the entire vehicle products and the rise in expenses during the period. Based on the products structure, the increase in sales volume was mainly due to the increase in the sales volume of sedans. Despite an increase in the export sales of mini-vans and mini-trucks, the drop in the domestic sales of mini-vans and mini-trucks resulted to a slight increase of the total automobile sales of the Group.



Chairman's Statement

In 2006, the Group's aviation business kept its rapid growth. For the year ended 31st December 2006, the sales revenue of the Group's aviation products was RMB4,428 million, representing an increase of 24.73% over that of 2005, and the results of the Group's aviation segment was RMB404 million, representing an increase of 46.91% over that of 2005. In 2006, the Group attained achievements in research and market development for aviation products. The Group has participated in the research and development of L15 advanced trainer, which performed its first flight successfully in March 2006 and was presented at the 6th China International Aviation & Aerospace Exhibition as a third-generation advanced trainer independently developed and manufactured by China. The development and upgrade of the Group's general aeroplanes has also made some progress. N-5B agricultural aeroplane successfully performed its maiden flight at the end of 2006. Harbin Embraer entered into an agreement relating to the sales of 50 ERJ-145 regional jets. The newly upgraded Y-12E aeroplane has attracted export sales contracts. Changhe Agusta entered into sales contract with Beijing Police Bureau for the sales of two CA109 helicopters. Hafei Aviation and Hongdu Aviation have taken 10% interests respectively in Tianjin Zhongtian Aviation Industry Investment Co., Ltd. which engages in the assembly of Airbus A320 series in China.

In 2006, the proportion accounted for by the sales revenue from the Group's aviation business in the total sales revenue has grown steadily.

SHARE REFORM AND SEPERATION OF AUTOMOBILE BUSINESS FROM AVIATION BUSINESS

Share reform was a significant event in China's securities market during 2006. The Company actively pushed forward the share reforms of its four A share listed subsidiaries, including Dongan Motor, Changhe Auto, Hafei Aviation and Hongdu Aviation, according to the regulations and rules issued by relevant Chinese authorities. During the share reforms, the Group also restructured its assets to optimize the business organization. The interests of Changhe Auto held by Changhe Aviation were transferred to being directly held by the Company, thus realizing the seperation in operation between automobile business and aviation business in Jiangxi area. The interests in Hafei Auto held by Harbin Aviation Group were transferred to Harbin Hafei Automobile Industry Group Co., Ltd. ("Harbin Auto Group"), a newly established company, thus realizing the seperation in operation between automobile business and aviation business as well as the intergration of automobile business with auto engine business in Harbin area. All the assets of Jiangxi Hongdu Aircraft Industry Co., Ltd. ("Hongdu Aircraft") were injected into Hongdu Aviation, a listed company, and Hongdu Aircraft was deregistrated, which has reduced the number of management tiers within the Group. Through the share reforms, the Company reached an agreement with the A shareholders of its four A share listed subsidiaries to gain the tradable right of its originally unlisted shares of those four A share listed subsidiaries, creating a favorable condition for future industry restructuring of the Group. The business structure of the Group after the share reform and the separation in operation between automobile business and aviation business is set out in the section "Company Profile" of this Annual Report. In the announcement dated 18th September 2006, the Company disclosed that the share reforms would result in a reduction of the Shareholders' equity for the year ended 31st December 2006. Details of the accounting treatment of the financial impact of the share reforms is set out in the financial statements of this Annual Report.

CHANGE OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Pursuant to the Articles of Association of the Company, the terms of office of the first Board and the first Supervisory Committee expired at the date when the annual general meeting of the Company for the year 2005 ("AGM") was held, and the retired directors and supervisors of the Company may offer themselves for re-election. The directors and supervisors of the Company for the new term were re-elected/elected at the AGM held on 16th June 2006. Mr. Wu Xiandong, Mr. Tan Ruisong, Mr. Liang Zhenhe, Mr. Song Jingang, Mr. Tian Min, Mr. Wang Bin, Mr. Chen Huaiqiu, Mr. Wang



Yong, Mr. Maurice Savart, Mr. Guo Chongqing, Mr. Li Xianzong and myself were re-elected as directors of the second session of the Board of the Company. Dr. The Hon. Li-Kwok-Po, David resigned his position as independent non-executive director of the Company due to personal reasons and the resignation had become effective since the end of the AGM. Mr. Lau Chung Man, Louis was appointed as an independent non-executive director of the Company at an extraordinary general meeting of the Company held on 28th August 2006.

Mr. Tang Jianguo, Mr. Wang Shouxin, Mr. Li Shentian, Ms. Bai Ping, Mr. Yu Yan, Ms. Zheng Li and Mr. Xie Zhihua were re-elected as supervisors of the second session of the Supervisory Committee of the Company. Ms. Liu Xianping and Ms. Lu Liubao resigned their positions as supervisors of the Company due to personal reasons. Their resignations became effective since the end of the AGM. Mr. Li Deqing and Mr. Han Xiaoyang were elected as supervisors of the Company for the new session. Mr. Tang Jianguo was selected as the chairman of the Supervisory Committee at the first meeting of the second session of the Supervisory Committee held on 28th August 2006.

At the first board meeting of the second Board held on 16th June 2006, Mr. Wu Xiandong was re-appointed as the president of the Company, Mr. Li Hui was re-appointed as vice president of the Company, Mr. Li Yao was re-appointed as vice president and chief financial officer of the Company, Mr. Liu Cheng no longer assumed the position as vice president of the Company. Mr. Yan Lingxi and Mr. Ip Kun Wan, Kiril were both re-appointed as company secretaries of the Company.

The Board comprises 13 directors, including three independent non-executive directors. The Supervisory Committee comprises 9 supervisors, including two independent supervisors. The Board has also re-appointed members and chairmen of the Audit Committee, Remuneration Committee, Aviation Business Development and Strategy Committee and Automobile Business Development and Strategy Committee of the second Board. Members of the Board, special committees of the Board, Supervisory Committee and senior management of the Company and their respective profiles are set out in section "Directors, Supervisors and Senior Management" of the Annual Report.

I hereby express my appreciation to Dr. The Hon. Li Kwok-Po, David, Ms. Liu Xianping, Ms. Lu Liubao and Mr. Liu Cheng for their contributions to the Company during their respective terms of office. I also congratulate Mr. Lau Chung Man, Louis for his appointment as an independent non-executive director of the Company, Mr. Li Deqing and Mr. Han Xiaoyang for their appointments as the supervisors of the Company.

BUSINESS OUTLOOK

In 2007, the Board of the Company believes that China's economy will maintain stable and moderate growth, which will lead to improvements in the automobile manufacturing industry and aviation manufacturing industry.

With the soaring economy in China, the income level of residents is improving constantly, which is anticipated to drive consumption in automobiles up at a high speed. According to the forecast by the China Automobile Industry Association, the total output from China's automobile manufacturers in 2007 is expected to reach 8,500,000, representing an increase of 16.76% over that of 2006. The growth in sedans is expected to outperform the industry growth. The Board believes that the automobiles manufactured by the Group, which feature "safe, environmental-friendly, energy-saving, economical and practical", being in line with the policy direction of China's automobile industry and the development of the world automobile industry, will keep its growth in sales volume in 2007. Meanwhile, however, the Company will also face challenges in improving the gross margin of the entire vehicle products and reducing the loss under ever increasing competition. The Board is confident that, after the share reform and the separation in operation of the Group's automobile business from aviation business, the business structure of the Group has been streamlined by reducing the number of management tiers and the automobile business has been operating according to the model that is desirable for the



Chairman's Statement

development of automobile enterprises in line with the market forces. All these factors are expected to enable the automobile business of the Group to benefit and flourish.

As the largest helicopter manufacturer and a major aeroplane manufacturer in China, the Group has great professional advantages in the aviation manufacturing industry and the Group's aviation products will continue to benefit from the expansion of China's civil aviation market in the following years. In the coming years, both the production and sales volume of the Group's aviation products, especially helicopters, will increase substantially due to the increase in orders from the Chinese government. The fast growth in aviation business of both AVIC II Group and AVIC I Group results in an increase in demand for aviation parts and components manufactured by the Group. As the Group has already made advancement in subcontract production for the world's renowned aviation manufacturers, such as Airbus and Boeing, sales volume of the Group's aviation parts and components is expected to grow steadily. With the gradual opening of civil aviation market and low altitude airspace by the Chinese government, demands for light general aeroplanes are increasing. This will also provide huge room for the development of the Group's general aeroplanes. In addition to ensuring timely deliveries for current aviation products' orders, the Group will endeavor to boost a balanced production and a lean management structure for its aviation business.

We will stand by our motto "operating with integrity and providing products and services of high quality" in our operation. We will work in a practical, innovation and diligent manner with a view 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, 2nd April 2007