

## Management Discussion and Analysis



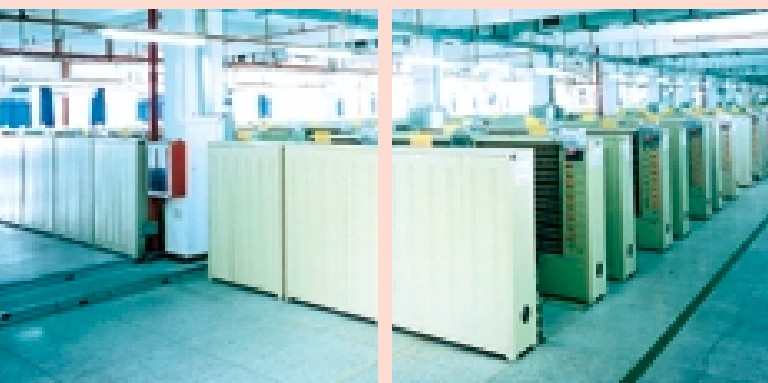
### Operating Environment Review

In 2006, the global handset market continued to post strong growth. According to the latest statistics of the market research company, Gartner, global handset output in 2006 was approximately 980 million units, representing an increase of approximately 21% from 810 million in 2005. Leveraging on their extensive industry experience and strong brand advantages as well as more competitive selling prices and multi-functional products, leading international handset suppliers have further increased their market share in the global handset market. Other handset suppliers have experienced a decline in their market share and faced difficulties. Therefore, competition in the global handset market has become more intense with the profitability of handset suppliers being suppressed.

In the global handset market, the growth in global handset output was mainly attributable to emerging markets such as India, China and Brazil, the demand in emerging markets for low- and medium-end handsets was enormous. In order to meet the growing demand in the emerging markets so as to increase their global market share, leading international handset suppliers have actively launched various series of low- and medium-end handset products and successfully developed ultra low cost handsets, which drove rapid growth in their global handset output. A decline in the average selling price of handsets as a result of the increase in the production of low-and-medium-end handset has urged leading international handset suppliers to implement more stringent cost control measures and seek for more cost-effective component suppliers or sub-contractors in order to ensure their profitability and competitiveness.

As for the domestic handset market, facing the immense competition from international handset suppliers in expanding their market share and the large portion of illegal handsets selling in the market, domestic handset suppliers continued to face an overall difficult operating environment. In view of this, some domestic handset manufacturers developed the emerging markets with low-end low-grade handsets and made efforts in maintaining their existing market share.

During the Year, international metal prices continued to increase. In particular, the price of nickel has rocketed, resulting in an increase in the production cost of nickel batteries and creating substantial pressure on the product's gross profit.



The vigorous development of economy has driven a continued increase in people's living standard and stimulated market demand for automobiles. The automobile industry in China was affected by unfavourable factors such as an increase in vehicle sales tax, oil prices and import tariff for vehicles and vehicle components. However, market demand for automobiles maintained a healthy upward trend with satisfactory growth in the overall production and sales volume. In 2006, production and sales volume of sedan in China's automobile market reached 3,830,000 vehicles, representing a growth of more than 37% year on year. Domestic automobile brands accounted for a market share of 26%, demonstrating that domestic self-owned brands have successfully occupied a position in the market.

## Business Review

The two major businesses of BYD are IT part business and the automobile business. The IT part business is mainly divided into rechargeable batteries and handset components. During the Year, the Group's rechargeable battery business maintained steady growth. The handset component business recorded a rapid growth. The automobile business also started to contribute to the Group's profits.

### IT Parts — Rechargeable Batteries

In 2006, the Group's rechargeable battery business posted satisfactory growth and recorded sales of RMB4,499,223,000, representing an increase of 16% over 2005. Sales of lithium-ion battery products recorded a strong growth, with sales increasing by 37% over the last year to RMB2,872,769,000. Affected by high raw material price, the nickel battery product business experienced a decline, with sales dropping 8% over last year to RMB1,626,454,000.

During the Year under review, the Group continued to maintain its global leading position in rechargeable batteries.

As for the lithium-ion batteries, the Group has made efforts in developing long term relationship with the leading international handset suppliers and increased its global market share by leveraging on its excellent product quality and cost-effective competitive edge. On one hand, through strengthening its partnership with existing leading international handset suppliers, the Group further increased the number of orders received from existing customers. On the other hand, the Group has actively developed relationship with new leading international handset suppliers and secured new orders. This resulted in the global supply of lithium-ion batteries highly concentrated in a few manufacturers, including BYD, while other small manufacturers and new entrants found it difficult to compete in the market, thus creating tremendous opportunities for the Company to further expand its market share. Meanwhile, the Group has made a breakthrough in the research and development of power batteries.

Being one of the few manufacturers with the capability of providing high-quality nickel batteries, BYD is also a global leading nickel battery supplier. In 2006, with sustained high raw material price, some major customers of nickel batteries

## Management Discussion and Analysis



# Novel Design



tended to be prudent and conservative when placing their orders and postponed non-urgent orders, leading to a decline in sales of nickel batteries. In terms of the sales of nickel batteries, the Group continued to occupy a leading position in the market by capitalizing on its competitive edge and pricing capability. During the Year under review, the upsurge in the price of nickel directly increased the production cost of nickel batteries, which created pressure on the gross profit of the product.

### IT Parts — Handset Components

The Group provides one-stop handset component supply services for its customers. This has effectively helped customers reduce their purchasing cost and increase their operating efficiency while shortening the time for the launch of new handset products in the market, resulting in wide recognition from customers. In 2006, the Group's handset component business posted remarkable growth with sales of

more than RMB5,134,509,000, representing an increase of 169% over last year.

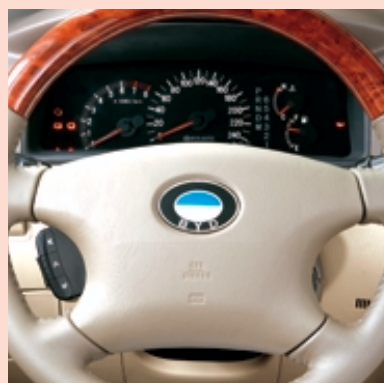
The Group's handset component business provides diversified product portfolio for customers, including plastic cases, key-pads, camera modules, LCD/LCM and flexible printed circuits. In 2006, the handset component business posted a strong growth. The growth of plastic cases and key-pads was particularly remarkable. This fully demonstrated the Group's strong capability in the research and development, innovation of precision plastic parts as well as excellent service standards, and successfully established the Group's market position as a crucial "one-stop handset component supplier" in the world.



By leveraging on its good and long-term partnership with the international global handset suppliers, the Group has successfully grasped continuously emerging market opportunities to become one of the handset component providers most well received by the international handset suppliers. During the Year under review, the Group not only secured new orders for handset components from various leading international handset suppliers but also secured more orders from other leading international handset suppliers, making the handset component business as one of the major driving forces for the growth of the Group during the Year.

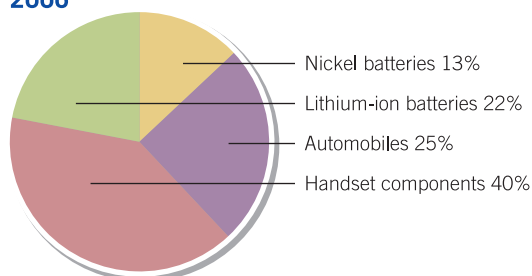
#### Automobile Business

In 2006, through the continued optimization of the production technique, the improvement of the sales network and the implementation of a cost-effective sale strategy, the Group had maintained a strong growth momentum for the automobile business. During the Year under review, the automobile business recorded a turnover of RMB3,232,178,000, representing a tremendous increase of 414% year on year. Total sales of the Group amounted to 55,038 vehicles, representing an increase of 244% year on year. A total of 46,307 F3 were sold. Being a self-owned brand automobile with the fastest growth in 2006, BYD's F3

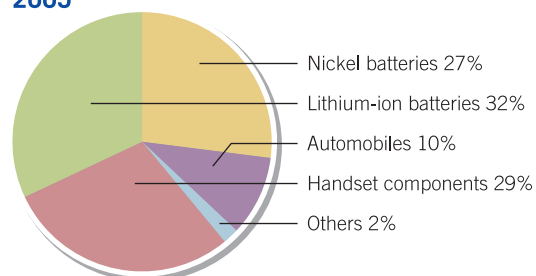


#### Turnover Breakdown by Product Categories

2006



2005



## Management Discussion and Analysis

has maintained monthly sales of approximately 4,000 vehicles and became one of the best single automobile models among self-owned brand mid-grade vehicles with splendid sales.

BYD's F3 has excellent quality that meets international standards and a competitive edge of high value for money. With its excellent quality, competitive pricing and sound after-sales services, BYD's F3 series has been well received by consumers. During the Year under review, the Group's F3 has become one of the best-selling automobiles under domestic brands for several consecutive months, making F3 the major automobile model in the domestic market. It gained wide recognitions from the industry, including awards such as "Automobile with the Highest Value for Money" (最佳性價比汽車), "Automobile with the Best Appearance" (最佳外形設計汽車), and "CCTV Self-innovation Award" (CCTV 自主創新獎).

Currently, the Group is well coordinated in management, research and development and production. Given its wholly independent research and development capability, the Group has not only enjoyed significant cost advantages but also possesses strong capability, enabling it to launch new products and respond to the market promptly. During the Year under review, given the great demand for the Group's

automobile products in the market, the Group's automobile production capacity increased each month, with the production capacity utilization reaching the highest level at the end of the Year.

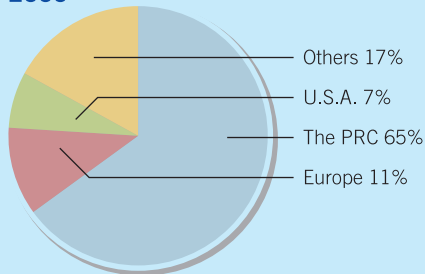
### Future Prospects and Strategies

#### IT Parts — Rechargeable Batteries

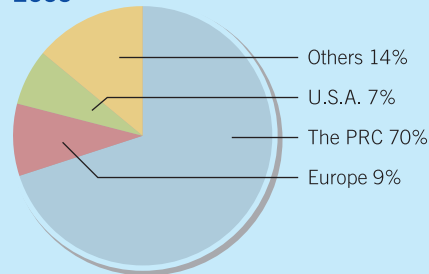
Looking ahead, the Group anticipates that the growth of the global handset market will remain strong. International handset suppliers will further expand their market share by actively exploring the emerging markets. The strong momentum in the industry has provided tremendous business opportunities for the future development of the Group. The Group will continue to strengthen its cooperation with international customers and focus on developing relationships with new international handset suppliers and increasing the supply volume so as to ensure the steady growth of the lithium-ion battery business. As for the nickel battery market, through the consolidation process of eliminating small players during the Year, it is envisaged that global market demand will stabilize in 2007. Meanwhile, the Group will strive to increase its battery product applications and step up its efforts in cost control with a view to increasing its market share and strengthening its leading market position in the rechargeable battery industry.

### Turnover Breakdown by Geographical Segments

2006



2005



### IT Parts — Handset Components

BYD will continue to cooperate closely with both domestic and overseas handset suppliers to secure more orders for supplying handset components and will actively develop relationships with new international handset suppliers and leading domestic handset suppliers other than the existing leading international handset suppliers. To consolidate its leading market position as a one-stop handset component provider, the Group anticipates that the handset component business will continue to grow rapidly and become a major revenue driver and profit contributor of the Group. The Group also plans to further develop its handset assembly services for customers in 2007 to further drive the growth of the handset component business, thereby strengthening its leading position as a one-stop component provider for domestic and overseas handset manufacturers.

### Automobile Business

As the GDP continues to increase, the penetration rate of automobiles will also increase. This presents a vast space for the development of the automobile industry in China. The F3 series has gained extensive support from consumers. This marks the recognition of the Group's automobile business by the market. Therefore, the Group anticipates that the automobile business will continue to post satisfactory growth in 2007. The Group will promptly increase its production capacity, establish highly effective sale channels and further optimize the system for after-sales services with a focus on driving technological improvement and innovation so as to launch new models of automobiles in a timely manner. In addition, the Group plans to enrich its product lines and launch three new models of automobiles in 2007 so as to meet the various needs of consumers. The Group is confident that overall sales will keep rising and the development of the automobile business will gradually improve. BYD will pursue a development path of "self-development, self-production and self-owned brands" and is aimed at providing quality services for consumers and enhancing its brand reputation. BYD is determined to become one of the leaders in the automobile market of the PRC.

## Financial Review

### Turnover and Profit Attributable to Equity Holders of the Company

Turnover increased substantially during the Year mainly due to the strong growth brought by the handset component business and automobile business. Strong growth in handset component business and turnaround in automobile business contributed to the substantial increase in profit attributable to equity holders of the Company.

### Segmental Information

During the Year, the proportion of revenue from handset component business increased due to substantial increase in sales of handset component products. Handset component business became the greatest turnover contributor of the Group. Regarding the automobile business, brought by the impressive sales of F3, the automobile business recorded a strong growth in sales in 2006, creating a major contributor to the Group's turnover. Despite a slight increase in turnover contribution from the rechargeable battery business, the proportion of revenue from the rechargeable battery business decreased due to the substantial growth in the handset component business and the automobile business.

### Gross Profit and Margin

The Group's gross profit increased by approximately 88% to approximately RMB2,738,183,000 for the year ended 31st December 2006. Gross profit margin dropped from 22.4% in 2005 to 21.2% in 2006. Decrease in gross profit margin was mainly brought about by (1) decrease in proportion of revenue from higher margined lithium-ion battery products, (2) sharp increase in cost of nickel battery production due to soaring of raw material price and (3) increase in proportion of automobile sales.

### Liquidity and Financial Resources

BYD generated net operating cash inflow of approximately RMB2,501,828,000 for the year ended 31st December 2006, compared with RMB1,514,858,000 for the year ended 31st December 2005. Total borrowings as at 31st December 2006, including all bank loans were approximately RMB5,736,859,000, compared with approximately RMB4,024,693,000 as at 31st December 2005. The maturity profile spread over a period of five years, with

## Management Discussion and Analysis

RMB4,223,713,000 repayable within one year, RMB665,000,000 in the second year and RMB848,146,000 within three to five years. On 15th March 2007, the Group entered into a loan extension agreement with several banks in China, RMB700 million of current portion of long term bank loans have been rolled-over for over one year. The increase in total borrowings was to fund numerous projects, research and development and production capacity expansion. The Group maintains adequate daily liquidity management and capital funding expenditure requirements to regulate internal operating cashflow.

Accounts receivable turnover days were about 72 days for the year ended 31st December 2006 as compared to approximately 106 days for the year ended 31st December 2005. Inventory turnover days decreased from 135 days for the year ended 31st December 2005 to 96 days for the Year.

### 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 31st December 2006, 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 were to ensure an efficient capital structure during the Year. The loans remaining outstanding as at 31st December 2006 were at fixed interest rates or floating interest rates for RMB loans and floating interest rates for foreign currency loans.

### 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 31st December 2006, the Group had over 90,000 employees. During the Year, total staff cost accounted for approximately 11% 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 31st December 2006, 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

### Purchase, Sale or Redemption of Shares

The Company has not redeemed any of its shares since the listing on 31st July 2002 and up to 31st December 2006. During the Year, neither the Company nor any of its subsidiaries purchased or sold any of the Company's shares.



### Capital Commitment

As at 31st December 2006, the Group had capital commitment of RMB1,504,852,000 (31st December 2005: RMB757,845,000).

### Contingent Liabilities

Please refer to note 33 to the audited consolidated financial statements for contingent liabilities as at 31st December 2006.

### Financing

The management is confident of the prospects of the overall business development of the Group. To meet the need for sustained development in the future, the Group has actively undertaken studies to consider taking diversified and effective financing measures to finance the long-term development of all businesses and develop an even larger development platform and space in the capital market for the Group. This will enable the Group's business structure to be professional and increase the transparency of operation. This will also enable the intrinsic value of the Group's operations to be more fully reflected.

### Restatement of Accounts

The Company undertook intensive effort in 2006 to enhance its operation system and refine upon the techniques applied in the production process of its automobile business, which involved extensive review of various research and development stages in 2006 and earlier periods. As a result of such review, certain of the research and development expenditure capitalised in prior years are expensed as then incurred in accordance to Hong Kong Accounting Standards 38 Intangible Assets. Corresponding adjustments have been applied retrospectively and certain comparative amounts have been restated. Development costs capitalised were decreased by RMB25,738,000 as at 31st December 2005 and the basic earning per share was decreased by RMB0.05 for the year 2005.

