



**GREAT WALL**

Management  
Discussion and  
Analysis



# Management Discussion and Analysis

## Operating Environment

In the year 2006, driven by the PRC's booming economy, the PRC automobile industry demonstrated signs of rapid development. According to the China Association of Automobile Manufacturers, the total production volume and total sales volume of automobiles in the PRC for the year 2006 both exceeded 7,000,000 units, reaching 7,280,000 units and 7,220,000 units respectively, representing increases of 27% and 25% from those of 2005 respectively.

There were also signs of continued strength in the export of automobiles. According to the import and export statistics on automobiles provided by the General Administration of Customs of the PRC, automobile export increased by 98.13% at the end of 2006 when compared with that of 2005. The Group had also sustained rapid growth by leveraging its years of experience in automobile export, strong brand effect, high price/performance ratio of products and consumers' confidence.

Following the complete abolition of the automobile import quota system, the tariffs on automobiles and automotive parts and components were lowered to 25% and 10% respectively on 1 July 2006. This implies greater stability will be seen in the price of imported automobiles, with a more rational and regulated competitive environment. On the whole, the domestic automobile market is expected to undergo a healthy development. The Group will augment its overall competitiveness through enhancing its management, reducing production cost and improving product quality.

Increasing stability in the price of petroleum, together with greater demand for quality living driven by the rise in income per capita and the continuous growth in people's purchasing power, fuels demand for automobiles. The



quality, performance, safety, fuel consumption and environmental aspects of automotive products have become the main concerns of consumers. According to the National Bureau of Statistics of China, the ownership of civilian-used vehicles as at the end of 2006 reached 49,850,000 units, representing an increase of 15.2% from that of the previous year, while the vehicle ownership per capita was 0.038 unit, reflecting that the industry still has a giant potential market.

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According to the “11th Five-Year Plan” (the “Plan”) of the PRC, increasing the market share of automobiles of self-owned brands and strengthening the independent innovation ability of the automobile industry are the priority tasks of the automobile industry. The Plan has thus provided supportive direction to the development of self-owned brand manufacturers in the automobile industry. As a representative of self-owned brand automobile makers, the Group will further intensify investment in its research and development capability, enhance its independent innovation ability, speed up the launch of competitive and quality products, and continue to enlarge its market share while consolidating it.

## Financial Review

### Revenue

During the Year, the Group’s revenue amounted to RMB4,918,622,000, representing an increase of 29.1% as compared to that of the previous year. The increase in revenue was mainly due to increase in sales volume of automobiles.

### Sales analysis

	For the year ended 31 December 2006			For the year ended 31 December 2005		
	Sales Volume (units)	Revenue (RMB'000)	Percentage share of revenue (%)	Sales Volume (units)	Revenue (RMB'000)	Percentage share of revenue (%)
Pick-up trucks	44,726	2,245,139	45.6	34,756	1,826,440	47.9
SUVs (CUVs included)	28,568	2,426,455	49.3	22,243	1,726,938	45.3
Other vehicles	286	35,335	0.8	199	28,510	0.8
Automotive parts and components	–	211,693	4.3	–	228,070	6.0
Total	73,580	4,918,622	100.0	57,198	3,809,958	100.0

### Automobile sales

During the Year, the Group sold 73,580 units of automobiles, representing an increase of 28.6% as compared to 57,198 units sold in 2005. Automobiles sold in 2006 included 44,726 units of pick-up trucks, representing an increase of 28.7% as compared to 34,756 units sold in 2005, 28,568 units of SUVs, representing an increase of 28.4% as compared to 22,243 units sold in 2005, and 286 units of other vehicles.

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### Sales of automotive parts and components

In addition to the production of automobiles, the Group also engages in the sales of principal automotive parts and components used in the production of pick-up trucks and SUVs. These mainly include self-manufactured engines, front and rear axles, air-conditioning equipment and drag ball pins, lever assembly and other parts and components for production of automobiles. Sales of automotive parts and components not only enhance the Group's revenue but also secure the availability of parts and components for after-sales services. During the Year, the Group reported a 7.2% decrease in sales of automotive parts and components from RMB228,070,000 in 2005 to RMB211,693,000 in 2006. The drop was mainly attributable to the decrease in the sales of engines to independent third parties. The sales of engines represented 24.6% of the Group's sales of automotive parts and components during the Year.

### Gross profit and gross profit margin

During the Year, the Group's gross profit rose from RMB1,000,690,000 in 2005 to RMB1,236,891,000, representing an increase of approximately 23.6%. The increase in the Group's gross profit was mainly due to the increase in sales volume of automobiles. The Group's gross profit margin decreased from 26.3% last year to 25.1%, mainly due to (1) the increase in the consumption tax rate of SUVs with effective from 1 April 2006, and (2) the proportional increase in the sales of Hover CUVs, with lower gross profit margin.

### Net profit attributable to equity holders of the parent and earnings per share

The Group's profit after tax attributable to equity holders of the parent for the Year increased from RMB441,007,000 to RMB702,844,000, owing to upsurges in sales volume and sales revenue, which led to increase in profit.

For the year ended 31 December 2006, the basic earnings per share of the Company were RMB0.74. The Company did not present diluted earnings per share as it did not have any potential ordinary share for dilution during the Year.

### Selling and distribution costs and administrative expenses

The selling and distribution costs and administrative expenses of the Group rose from RMB374,692,000 in 2005 by 12.1% to RMB419,980,000 in 2006. Selling and distribution costs and administrative expenses as a percentage to total revenue decreased from 9.8% in 2005 to 8.5 % in 2006. The increase in selling and distribution costs and administrative expenses was mainly due to: (1) an increase in transportation expenses as a result of the increase in sales volume of automobiles; (2) an increase in port expenses resulting from increased export volume; and (3) the increase in staff costs and office expenses attributable to the increase in the number of staff for its production expansion.

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### Finance costs

The Group's finance costs for 2006 were approximately RMB1,732,000 as compared with approximately RMB 669,000 in 2005. Increase in finance costs was due to increase in handling charge for letter of credit.

### Liquidity and financial resources

As at 31 December 2006, the Group's current assets mainly included cash and cash equivalents of approximately RMB2,429,188,000, trade receivables of approximately RMB31,085,000, inventories of approximately RMB651,709,000, bills receivable of approximately RMB487,786,000, held-for-trading financial assets of approximately RMB863,000, and other receivables of approximately RMB193,292,000. The Group's current liabilities as at the same date mainly included dividend payables of approximately RMB7,698,000, other payables of approximately RMB654,466,000, tax payables of approximately RMB52,360,000, bills payables of approximately RMB240,465,000, trade payables of approximately RMB968,465,000, and provision for product warranties of approximately RMB32,708,000.

### Acquisitions

During the Year, the Company did not have any material acquisitions.

### Capital structure

The Group generally finances its operation with internally generated cash flows. As at 31 December 2006, the Group was in a debt-free position.

### Exposure to foreign exchange risk

All of the Group's domestic sales were settled in RMB, while sales to overseas customers were settled in US dollars. With respect to the export business, the pricing of the Group's products is relatively competitive and hence its current sales have not been affected.

As the materials and parts and components consumed by the Group are purchased from domestic market, the appreciation of RMB did not constitute any impact on the Group's business.

During the Year, the Group did not experience any material difficulties or negative effects on its operations or liquidity as a result of fluctuations in currency exchange rates.

### Employment, training and development

As at 31 December 2006, the Group employed a total of 8,351 employees. Employees were remunerated on the basis of their performance, experience and prevailing industry practices. The Group's remuneration policies and packages were reviewed on a regular basis. As an incentive for the employees, bonuses and cash awards may also be given based on individual performance evaluation. Total staff cost accounted for 4.2% of the Group's revenue for the Year.

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### Taxation

Tax of the Group decreased by 85.9% from RMB69,659,000 in 2005 to RMB9,799,000 in 2006, mainly due to the fact that the Group enjoyed an increase in tax benefits and there was a change in deferred income tax.

### Segment information

During the Year, over 90% of the Group's revenue and results were derived from the manufacture and sales of automobiles, and therefore no business segmental analysis is presented.

Geographical segmental analysis has been made according to the geographical location of customers. As most of the Group's assets and liabilities are located in the PRC, no geographical segmental analysis of assets, liabilities and capital expenditure information is presented.

	For the year			For the year		
	ended 31 December 2006			ended 31 December 2005		
	PRC	Overseas	Consolidated	PRC	Overseas	Consolidated
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	3,210,472	1,708,150	4,918,622	2,911,804	898,154	3,809,958
Segment result	783,541	453,350	1,236,891	743,230	257,460	1,000,690
Unallocated expenses			(492,503)			(438,453)
Finance costs			(1,732)			(669)
Income tax			(9,799)			(69,659)
Profit after tax			732,857			491,909
Attributable to:						
Equity holders of the parent			702,844			441,007
Minority interests			30,013			50,902

### Contingent liabilities

As at the balance sheet date, the Group did not have any significant contingent liabilities.

## Management Discussion and Analysis

### Business Review

#### Products

The Group's principal products are pick-up trucks and SUVs. The Group also engages in the production and sales of principal automotive parts and components used in the production of pick-up trucks and SUVs.

During the year, the Group's total sales volume was 73,580 units, representing an increase of 28.6% as compared to that of 2005. The rapid growth of the Group's sales volume was attributable to the strong brand effect and continued improvement of product mix. The Group was able to tap into the fragmented market and established a leadership through reliable product quality, good brand image, premium after-sales service and extensive distribution network, etc.

(1) *Pick-up trucks*

According to China Association of Automobile Manufacturers, the sales volume of the Group's pick-up trucks continued to rank first in the PRC market for the ninth consecutive year (including the year 2006), reflecting its consolidated leading market position. During the Year, the sales volume of pick-up trucks reached 44,726 units with sales revenue of RMB2,245,139,000, representing increases of 28.7% and 22.9% respectively when compared with those in 2005.

(2) *SUVs*

During the Year, the Group's SUVs continued to lead the market. The sales volume of SUVs remained stable with an increasing trend, rising by 28.4% to 28,568 units when compared with that of the previous year. The sales revenue of SUVs rose to RMB2,426,455,000, representing an increase of approximately 40.5% from that of 2005.

(3) *Automotive parts and components*

During the Year, the revenue of automotive parts and components amounted to RMB211,693,000, representing a decrease of approximately 7.2% as compared to that in 2005 and accounting for 4.3% of the total revenue.

(4) *Other vehicles*

Revenue of the Group's other vehicles (including buses and special vehicles) amounted to RMB35,335,000 during the Year, representing an increase of 23.9% when compared to that of 2005.

## Management Discussion and Analysis

### Domestic market

#### Clientele

During the Year, the Group's domestic sales volume and revenue amounted to 46,075 units and RMB2,998,779,000, representing increases of 7.5% and 11.7% respectively. Of the Group's domestic sales, 24,765 units and 21,066 units of pick-up trucks and SUVs were sold respectively, with revenue amounting to RMB1,237,757,000 and RMB1,728,815,000 respectively. The revenue from the two main groups of customers, namely (1) dealers; and (2) government entities and individual customers amounted to RMB2,864,944,000 and RMB133,835,000 respectively.

	For the year ended 31 December 2006			For the year ended 31 December 2005		
	Sales volume (units)	Revenue (RMB'000)	As a percentage to domestic automobile sales (%)	Sales volume (units)	Revenue (RMB'000)	As a percentage to domestic automobile sales (%)
Dealers	43,989	2,864,944	95.5	40,993	2,560,361	95.4
Government entities and individual customers	2,086	133,835	4.5	1,879	123,373	4.6
Total	46,075	2,998,779	100.0	42,872	2,683,734	100.0



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### The Group's domestic sales by geographical distribution

The following table sets out the geographical breakdown of the Group's domestic sales in 2005 and 2006:

	2006	As a percentage to domestic automobile sales	2005	As a percentage to domestic automobile sales
	Sales revenue (RMB'000)	(%)	Sales revenue (RMB'000)	(%)
Northern Region	564,345	18.8	511,605	19.0
Northeastern Region	250,403	8.4	231,956	8.6
Northwestern Region	290,976	9.7	251,037	9.4
Southwestern Region	352,583	11.8	219,351	8.2
Eastern Region	828,959	27.6	786,462	29.3
Central Region	711,513	23.7	683,323	25.5
Total	2,998,779	100.0	2,683,734	100.0

Eastern region:	Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong
Central region:	Henan, Hubei, Hunan, Guangdong, the Guangxi Zhuangzu Autonomous Region, Hainan
Northern region:	Beijing, Tianjin, Hebei, Shanxi, the Inner Mongolia Autonomous Region
Northwestern region:	Shaanxi, Gansu, Qinghai, the Ningxia Hui Autonomous Region, the Xinjiang Uygur Autonomous Region
Northeastern region:	Liaoning, Jilin, Heilongjiang
Southwestern region:	Chongqing, Sichuan, Guizhou, Yunnan, the Tibet Autonomous Region

### Overseas markets

During the Year, the automobile export market of the Group had displayed outstanding performance with a continuous growth. The Group's export volume of automobiles continued to set new records. For the year ended 31 December 2006, the export volume reached 27,505 units, representing an increase of 92.0% from that of the previous year. The total export value amounted to RMB1,708,150,000, representing an increase of 90.2% from that of the previous year and accounting for approximately 34.7% of the total revenue of the Group. The Group thus became the largest automobile export enterprise in the PRC in terms of export value. The export volume of pick-up trucks and SUVs during the Year amounted to 19,961 units and 7,502 units respectively, with export value amounting to RMB1,007,382,000 and RMB697,640,000 respectively, representing increases of 53.3% and 191.2% from those of the previous year respectively. Pick-up trucks and SUVs accounted for 59.0% and 40.8% of the total export value respectively.

## Management Discussion and Analysis

The Group's export markets were mainly concentrated in four regions, namely Eastern Europe, Middle East, America and Africa, spanning across 107 countries and regions including Russia, Iraq, Saudi Arabia, Venezuela, Algeria, etc. During the Year, the Group continued to expand its international markets and achieved satisfactory results. Newly-tapped international markets included South Africa, Malaysia, Italy, Chile, Peru, Madagascar, Syria, Romania etc.

The State is keeping a rein on export-oriented automobile makers through manufacturing companies authorisation, which is expected to regulate the automobile export market. The State will restrict automobile exports of manufacturers with unstable product quality and incomprehensive after-sales service in overseas markets. In early August 2006, the Group was named by the State as "China's Automobiles and Automotive Parts Export Manufacturing Base", which will benefit the Group to further expand its export business.

During the Year, the Group successfully participated in a number of international motor shows, including Beijing International Automotive Exhibition, Paris Motor Show, Moscow International Motor Show and Bologna Motor Show. The automobiles exhibited by the Group at the shows received positive response and wide recognition from the industry and among the consumers. The successful participation in overseas automotive exhibitions had strengthened the Group's brand effect in those overseas markets and neighbouring markets, as well as increased consumers' confidence in the Group's products, leading to rapid growth in the Group's overseas orders. At the Beijing International Automotive Exhibition, the Group exhibited three brand new economical sedans, signifying a "triple jump" the Group made from pick-up trucks to SUVs then to sedans, and a milestone in the Group development.

In order to satisfy the strong market demand for the Group's products in Eastern Europe, the Group had established Russia Great Wall Company Limited in Moscow, which principally engages in the export business, related sales and after-sales services in the local market. In addition, the Group had taken an active role in seeking investment opportunities for the construction of production plants in Russia in order to provide stable automobile supply for the Russian and the peripheral markets. In January 2007, the establishment of a joint venture, Great Wall Alabuga Motor Open Joint Stock Company, was approved. Located in Elabuga City of the Republic of Tatarstan, the Russian Federation, this new joint-venture marks a new progress in the Group's investment plan for the construction of a plant in Russia.

## Management Discussion and Analysis

### Launch of new products

During the Year, the Group modified and upgraded various existing products, for instance, the launch of new four-wheel drive vehicles based on the original two-wheel drive models, reduction of fuel consumption, enhancement of emission standard, and introduction of various right-hand drive models to satisfy the demand of some overseas markets. All these new models are designed to create a new standard, a new milestone of the Group.

Hover•π – the first domestic stretch limousine leading the avant-garde of fashion and trend for uniqueness launched during the Year had attracted the attention of the automobile industry, and gained positive response from the ceremony services, rental services, wedding planners, and foreign trading markets.

The newly launched high-end pick-up trucks – Wingle – has been installed with a diesel engine with a high-pressure common rail system. Wingle boasts excellent design and production quality, and combines the features of a tractor, a cross-country vehicle and a passenger car, with advantages of strong power performance, low fuel consumption, noise reduction and low emission.

The 2006 version of Hover CUV launched in the market has a fresh and a trendier appearance. The interior is decorated with mature colours, giving the passengers a feel of tranquillity and comfort. New features such as MP3 player and electronically powered four-wheel-drive system have been added to further increase the comfort level. The re-installation of diesel engine enhances the car's fuel economy.

In the second half of 2006, the Group launched a new model of vehicle – “Proteus” van. “Proteus” van is equipped with excellent passenger seats and load-carrying ability to satisfy the needs for carrying both passengers and cargo. It has a high price/performance ratio.

During the Beijing International Automotive Exhibition in 2006, the Group made a debut of three brand new economical sedans – Great Wall Perey, Florid and Coolbear, which have been developed by the Group on its own.

“Great Wall Perey” is a petite, two-box sedan, meeting Euro IV emission standards, with excellent power performance and safety system. The top speed of the car is 160 km/h, with fuel consumption as low as 5L/100 km. Young consumers aged between 20 and 40 are the main targeted consumers for Perey. This model was first launched with a 1.3-litre gasoline engine, whereas future versions will be equipped with a 1.0-litre engines.

“Great Wall Florid” is a compact 5-door sedan, equipped with a 1.3-litre gasoline engine. It has a sporty look, glitzy exterior and an energetic appearance. This model is targeted at young consumers who pursue individual styles. The car was first launched with a 1.3-litre gasoline engine, whereas future versions may be equipped with a 1.5-litre gasoline engine or 1.2-litre diesel engine.

“Great Wall Coolbear” is equipped with a 1.5-litre gasoline engine and comes with luxurious and advanced features. The “square” look becomes its distinguished characteristic, providing it with greater room for usage and modification to suit one's style. The car was first launched with a 1.5-litre gasoline engine, whereas the future versions may be equipped with a 1.3-litre gasoline engine or 1.2-litre diesel engines.

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### New technology

The Group has increased its investment in research and development over the past two years. The Group purchased world-class research and development facilities, and established a testing centre, a proving centre, a styling centre and a prototyping workshop of advanced international level. The Group also has the ability to conduct inspection and testing analysis on automobiles and automotive parts and components, computer-aided engineering (CAE) analysis, and possesses styling capability. The Ministry of Personnel of the PRC approved the Group's technical research and development centre to establish a post-doctoral scientific research and development workshop, thereby laying a solid foundation for the Company's sustainable independent innovation ability.

During the year, the Group received five awards at the "China Automobile Independent Innovation Awards" organised by China Automotive News: Great Wall's Intelligence Fuel Economy Technology INTEC (GW2.8TC electronically control high pressure common rail diesel engine) received "Award for Original Innovation", Great Wall Hover CUV automobiles and Great Wall's Golden Deer pick-up truck as well as Great Wall Hover•π – luxurious limousine received "Award for Integrated Innovation", Great Wall Safe SUV received "Award for Secondary Innovation Through Introduction and Adaptation of Technology".

In March 2006, the Group conducted crash tests on its Hover CUV in accordance with the standards of EuroNCAP (European New Car Assessment Programme). Hover CUV got a 4-star rating for the test result, which reflected that the safety performance of Hover CUV – a China indigenous brand – has reached international advanced level, and that it is the safest SUV in the PRC. During the Year, Hover CUV received the Award of 2006 Best SUV under Self-owned Brands in the PRC (the "Award") at the Annual CCTV CCTV's (China Central Television) Choice of Automobile Awards.

During the year, the Group developed an energy-saving and environmentally friendly diesel engine with an electronically controlled high-pressure common rail system, employing the latest high pressure common rail fuel injection technology. This engine meets Euro III emission standards, and is a technological breakthrough in diesel engine with a self-owned brand name. The Hover CUV series and the brand new high-end pick-up trucks – Wingle series launched to the market during the Year were installed with this engine and received enthusiastic market response.

### Outlook

#### New products

The high-end pick-up trucks – Wingle were launched to the market at the end of 2006. Wingle possesses the advantages of strong power performance, low fuel consumption, noise reduction, low emission and advanced features, including four-wheel drive and right-hand drive models.

In view of the right-hand drive market, a new model of Hover CUV will be developed based on the left-hand drive model, with enhancement in the general layout, the quality of mechanical features, the maneuverability, the comfort of seats, the safety and practicability of installed equipment in the automobiles.

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The current research and development focus will be on enriching and improving the mechanical features of existing products, as well as enhancing emission standards of some of the existing products. In 2007, the Group will start to launch the Sailor and Sing product series, which come with a 2.8 TC- turbocharged diesel engines with electronically controlled direct-injection system and which meet the Euro III emission standards.

The Group is currently conducting research and development and trial production of a number of models for small passenger vehicles and MPVs. It is expected that the Group will start to launch the models of “Great Wall Perey”, “Great Wall Florid” and “Great Wall Coolbear” to the market.

With respect of automotive parts and components, the Group will enhance the development of core components like engines and gearboxes etc.

### Export markets

On the front of export, with the continued improvement in overseas certification process and the Group's continued market expansion, the Group's market coverage had extended to a number of countries and regions previously untapped. In the future, the Group will not only focus on tapping into new markets, but will also continue to consolidate and improve its existing markets through careful selection and rationalisation, to further enhance its sales in overseas markets.

### New facilities

To cater to the needs for the production of new models, the Group has commenced the construction of Phase 3 of Great Wall Industrial Zone. At present, construction of infrastructure has been basically completed. Production facilities will be delivered to the plant and be installed and tested this year. It is expected that production will commence in the second half of 2007.

### Establishing a factory in Russia

The establishment of a factory in Russia by the Group is making good progress. The building of a joint venture, Great Wall Alabuga Motor Open Joint Stock Company, in Elabuga City of the Republic of Tatarstan, the Russian Federation, has been approved. The joint venture has a registered capital of RUB420,000,000 (equivalent to approximately RMB121,800,000). The joint venture is scheduled to commence production in 2007, with a planned annual production capacity of 50,000 units.

## Management Discussion and Analysis

### Future objectives

The PRC automobile market is expected to continue to move towards a quality and regulated development, with continued growth in market demand. According to related statistics, both the production volume and sales volume of automobiles in the PRC market are expected to surpass 8 million units in 2007.

The Group will continue to consolidate its leading position as the PRC's largest automobile exporter with self-owned brands through increasing its exports, actively enlarging its overseas client base, securing a larger share in the overseas markets and expanding its presence in the global market.

Parallel to strengthening its positions in the pick-up truck and SUV markets, the Group will further penetrate the sedan market. The launch of sedans will facilitate the optimisation and diversification of the Group's automobile product lines and product mix. The Group will enlarge its market share through adopting flexible pricing strategies, and leverage its high price/performance ratio to strengthen its competitiveness and further consolidate its market position. With regard to the development of the sedan market, the Group will continue taking advantage of its brand equity and expanding its sales network to become one of the major sedan manufacturers in the PRC.

In the face of rapid growth in the economical automobiles market, the Group strives to enhance its own research and development capability, technology and product mix as well as to improve its product quality. The Group will develop new models to satisfy consumers' demand by studying and further penetrating the fragmented market. The Group will continue to strengthen the production and sales of CUVs by developing and launching new models with low engine displacement to cater to the market demand, thereby strengthening the overall competitiveness of the Group.

### FINAL DIVIDEND

The Board recommends the payment of a final dividend of RMB0.16 per share for the year ended 31 December 2006.

As at 31 December 2006, there were 99 units of unclaimed final dividends for 2005, amounting to HK\$14,795.10.