Management's Discussion & Analysis

BUSINESS REVIEW

The consolidated net sales of the Company and its subsidiaries (the "Group"), including Shenyang Brilliance JinBei Automobile Co., Ltd. ("Shenyang Automotive"), Shenyang XingYuanDong Automobile Component Co., Ltd. ("Xing Yuan Dong"), Ningbo Yuming Machinery Industrial Co., Ltd. ("Ningbo Yuming"), Ningbo Brilliance Ruixing Auto Components Co., Ltd. ("Ningbo Ruixing"), Mianyang Brilliance Ruian Automotive Components Co., Ltd. ("Mianyang Ruian"), Shenyang Brilliance Dongxing Automotive Component Co., Ltd. ("Dongxing Automotive"), Shenyang ChenFa Automobile Component Co., Ltd. ("Shenyang ChenFa"), Shenyang Jindong Development Co., Ltd. ("Shenyang Jindong"), Shanghai Hidea Auto Design Co., Ltd. ("Shanghai Hidea") and Shenyang Brilliance Power Train Machinery Co., Ltd. ("Shenyang Brilliance Power") for the year ended 31st December, 2006 were RMB10,484.8 million, representing a 91.7% increase from RMB5,469.0 million for the year ended 31st December, 2005. The increase in sales was primarily due to increases in unit sales of Shenyang Automotive's minibuses and, especially, Zhonghua sedans in 2006.

Shenyang Automotive sold 66,245 minibuses in 2006, representing a 10.4% increase from approximately 60,000 minibuses sold in 2005. Of these vehicles sold, 52,049 were mid-priced minibuses, representing a 4.0% increase from approximately 50,060 units sold in 2005. Unit sales of deluxe minibuses increased by 42.8% from approximately 9,940 units in 2005 to 14,196 units in 2006. Shenyang Automotive sold 62,281 Zhonghua sedans in 2006, representing a 592.0% increase from approximately 9,000 sedans sold in 2005. 26,496 units of the Zhonghua Zunchi model were sold in 2006, representing a 394.0% increase from 2005, whereas the new Junjie model, which was launched in March 2006, registered a sale of 35,367 units during the year.

Cost of sales rose by 99.8% from RMB4,964.8 million in 2005 to RMB9,918.7 million in 2006. The increase was primarily due to the increase in unit sales of both minibuses and Zhonghua sedans. However, the average unit costs for both the minibuses and Zhonghua sedans decreased in 2006, mainly due to the improvement in production efficiency and economies of scale together with the decrease in cost of components.

Despite the increase in sales and decrease in unit costs, the overall gross profit margin of the Group decreased from 9.2% in 2005 to 5.4% in 2006, as a result of the significant increase in sales of Zhonghua sedans which have yet to reach profitability in 2006, as well as a shift in product mix to lower-margin products.

Other revenue increased by 114.3% from RMB135.9 million in 2005 to RMB291.2 million in 2006. The increase was primarily due to the increase in sales of scrap materials.

Selling expenses increased by 37.8% from RMB436.5 million in 2005, to RMB601.3 million in 2006. The increase was mainly due to the increase in advertising, promotion and marketing expenses as well as transportation costs for finished products resulting from the increase in sales volume of Zhonghua sedans and minibuses in 2006. The selling expenses as a percentage of turnover decreased from 8.0% in 2005 to 5.7% in 2006 as the rate of increase in turnover exceeded that of advertising, promotion and marketing expenses in 2006.

General and administrative expenses increased by 2.6% from RMB616.3 million in 2005 to RMB632.2 million in 2006, mainly as a result of the increase in staff costs.

Other operating expenses increased by 55.7% from RMB89.1 million in 2005 to RMB138.7 million in 2006, resulting mainly from the increase in sales volume of the scrap materials.

Interest expense net of interest income decreased by 17.2% from RMB174.7 million in 2005 to RMB144.7 million in 2006, resulting mainly from the increase in interest income from deposits placed with banks and a financial institution.

In 2006, the Group recognised a loss of RMB73.2 million on the change in fair value of the embedded conversion option of the convertible bonds due 2011 in accordance with the Hong Kong Financial Reporting Standards.

The Group's share of operating results of associates and jointly controlled entities (excluding an impairment loss on goodwill in a jointly controlled entity) increased by 204.7% from RMB49.0 million in 2005 to RMB149.3 million in 2006. This was mainly attributable to the increased profits contributed by BMW Brilliance Automotive Ltd. ("BMW Brilliance"), the Group's 49.5% indirectly owned jointly controlled entity, and an associate in 2006. The Group also recognised an impairment loss on goodwill in a jointly controlled entity in the amount of RMB73.3 million in 2006 in relation to one of our engine joint ventures.

Net profits contributed to the Group by BMW Brilliance increased by 237.7% from RMB31.6 million in 2005 to RMB106.7 million in 2006. The BMW joint venture achieved sales of 23,600 BMW sedans in 2006, an increase of 34.8% as compared to 17,501 BMW sedans in 2005.

The Group recorded a loss before taxation amounting to RMB656.8 million in 2006 as compared to that of RMB1,156.4 million in 2005. Taxation decreased by 46.2% from RMB89.1 million in 2005 to RMB47.9 million in 2006, resulted mainly from the recognition of certain deferred tax assets as expenses in 2005.

As a result, the Group's loss attributable to equity holders of the Company decreased by 38.7% from RMB649.6 million in 2005 to RMB398.4 million in 2006. Basic loss per share in 2006 amounted to RMB0.1086 against that of RMB0.1771 in 2005. Diluted loss per share in 2006 and 2005 were the same as the basic loss per share for the two respective years.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31st December, 2006, the Group had RMB1,468.1 million in cash and cash equivalents, RMB616.8 million in short-term bank deposits and RMB1,625.1 million in pledged short-term bank deposits. The Group had notes payable of RMB2,179.2 million and outstanding short-term bank borrowings of RMB500.0 million, but had no long-term bank borrowings outstanding as at 31st December, 2006.

On 28th November, 2003, the Company, through its wholly owned subsidiary, Brilliance China Automotive Finance Ltd., ("Brilliance Auto Finance") issued zero coupon guaranteed convertible bonds due 2008 (the "Convertible Bonds 2008") with a principal amount of US$200.0 million (equivalent to approximately RMB1,654.3 million at the time of issue). Up to 31st December, 2006, all of the Convertible Bonds 2008 had been repurchased on the Luxembourg Stock Exchange or redeemed by Brilliance Auto Finance. Total consideration for the repurchase and redemption amounted to approximately US$202.5 million (equivalent to approximately RMB1,598.3 million). The Convertible Bonds 2008 had been cancelled and, in January 2007, were delisted from the Luxembourg Stock Exchange.

On 7th June, 2006, the Company, through its wholly owned subsidiary, Brilliance China Finance Limited ("Brilliance Finance"), issued zero coupon guaranteed convertible bonds due 2011 (the "Convertible Bonds 2011") with a principal amount of US$182,678,000 (equivalent to approximately RMB1,460.8 million at the time of issue). The Convertible Bonds 2011 are listed on The Singapore Exchange Securities Trading Limited. Up to 31st December, 2006, none of the Convertible Bonds 2011 had been repurchased or redeemed by Brilliance Finance or converted into ordinary shares of the Company.

CONTINGENT LIABILITIES

Details of the contingent liabilities are set out in note 41 to the financial statements.

DEBT TO EQUITY RATIO

As at 31st December, 2006, the debt to equity ratio, computed by dividing total liabilities by total equity attributable to equity holders of the Company, was approximately 1.50 (31st December, 2005: 1.29). The increase of the ratio is primarily due to the increase in accounts payable balances as at 31st December, 2006 as a result of the increased level of operations in 2006.

USE OF PROCEEDS

On 7th June, 2006, Brilliance Finance issued the Convertible Bonds 2011. The net proceeds of the sale of the Convertible Bonds 2011 were approximately US$178.8 million. As of 31st December, 2006, a portion of the net proceeds had been applied for the on-market repurchase and redemption of the Convertible Bonds 2008. The unused balance of the net proceeds have been placed with banks and financial institutions as interest-bearing, foreign currency denominated short-term deposits.

FOREIGN EXCHANGE RISKS

The Group does not consider exchange rate fluctuations to have any material effect on the overall financial performance of the Group, but may consider entering into hedging transactions through exchange contracts in order to minimise foreign exchange risks, if and when necessary. There were no outstanding hedging transactions as at 31st December, 2006.

EMPLOYEES AND REMUNERATION POLICY

The Group employed approximately 11,000 employees as at 31st December, 2006 (31st December, 2005: approximately 8,900). Employee costs (excluding directors’ emoluments) amounted to approximately RMB419.1 million for the year ended 31st December, 2006 (2005: approximately RMB321.5 million). The Group will endeavour to ensure that the pay levels of its employees are in line with industry practices and prevailing market conditions and that employees are rewarded on a performance-related basis and eligible for share options under the share option scheme adopted by the Company. More details in respect of the Company’s emolument policy and the basis of determining the emolument payable to the Company’s directors are set out in note 12(b) to the financial statements.