During the Reporting Period, by the implementation of various measures including adjustment of industry structure and product mix, product research and development, enhancement of financial and marketing management, expansion of export trade channels, the Group experienced an inprovement in business operation and a rising momentum in operating results during the Reporting Period.

ANALYSIS OF OPERATION

During the Reporting Period, the Group recorded a turnover of RMB6,101,451,000, representing an increase of 28.02% over the same period of last year, of which, turnover of agricultural machinery and construction machinery recorded year-on-year increase of 25.26% and 18.22%, respectively. engine machinery contributed RMB203,614,000 to the turnover of the Group.

Table of turnover and segment results of the Group during the Reporting Period

	Analysis of turnover			**Analysis of segment results**		
By business	**2006**	2005	% of change	**2006**	2005	change as compared with the same period last year
	RMB'000	*RMB'000*	%	***RMB'000***	*RMB'000*	*RMB '000*
Agricultural machinery	**4,699,191**	3,751,521	25.26	**148,020**	23,254	124,766
Construction machinery	**1,198,603**	1,013,898	18.22	**(72,642)**	(122,768)	50,126
Engine machinery	**203,614**	—	N/A	**(1,179)**	—	(1,179)
Financial	**—**	—	—	**35,112**	33,477	1,635
Others	**43**	409	(89.49)	**(4,609)**	(3,015)	(1,594)
Total	**6,101,451**	4,765,828	28.02	**104,702**	(69,052)	173,754
Less: not deducted expenses	**—**	—	—	**(17,235)**	(8,430)	(8,805)
Profit (loss) before tax	**—**	—	—	**87,467**	(77,482)	164,949

During the Reporting Period, the Group's turnover was mainly attributable to agricultural machinery business, which accounted for 77.02% of the turnover. Construction machinery business accounted for 19.64% of the turnover and engine machinery only accounted for 3.34% of the turnover.

During the Reporting Period, the Group's profit mainly generated from agricultural machinery business and financial business. Operating results of agricultural machinery business increased by RMB124,766,000 as compared with the same period last year while the operating results of financial business increased by RMB1,635,000 as compared with the same period last year. Although construction machinery business did not turn loss into profit, the loss decreased by RMB50,126,000 when compared with the same period last year as the Group purchased the engine machinery business at fair value price by reference to price to earning ratio and price to book value ratio, and the difference of purchased price in excess of its book value will be eliminated gradually in the cost. Therefore, the engine machinery business did not contribute any profit to the Group from August 2006 to December 2006.

During the Reporting Period, the Group adopted a series of measures in exploring international markets, which included active participation in international fair, adjustment to exported product mix in line with international market demand after studying the market, establishment of international sales networks, upgrade of service awareness and quality to ensure timely delivery of after-sale services. In order to facilitate the development of international markets, the Group enhanced communication with overseas dealers by hosting promotion events for exported products and international business conferences so as to increase overseas dearers' confidence in the Group. During the Reporting Period, export sales of the Group amounted to US$42,141,500, representing an increase of 76.10% over the same period of last year, of which export sales of agricultural machinery and construction machinery amounting to US$24,542,100 and US$17,599,400, representing increase of 49.32% and 134.79%, respectively, over the corresponding period last year.

Analysis of agricultural machinery business

During the Reporting Period, except for a slide in sales of small wheeled tractors, the Group's agricultural machinery products all recorded growth in their respective sales. The growth of the sales, has a led to a growth in the financial result of the agricultural machinery business. During the Reporting Period, the sales of agricultural machinery and its segment results are set out in the table as follows:

Table of sales volume of agricultural machinery products of the Group during the Reporting Period:

Analysis of sales volume	**2006**	2005	% of change
Crawler tractors (unit)	**3,511**	3,418	2.72
Large/medium wheeled tractors (unit)	**42,166**	24,970	68.87
Small wheeled tractors (unit)	**98,674**	131,200	(24.79)
Harvesting machinery (unit)	**2,970**	2,319	28.07
Agricultural machinery (set/unit)	**7,049**	4,146	70.02
Total units of agricultural machinery (unit/set)	**154,370**	166,053	(7.04)

In addition to the increased turnover of agricultural machinery benefiting from market opportunities arising from the State's policies in supporting the agricultural sector, the Group's continued efforts on adjustment to product mix also achieved significant results. Technological renovation and production expansion of high and medium horsepower crawler tractors and harvesters guarantee production and quality. Meanwhile, capitalising on its extensive sales networks and adopting flexible marketing strategies, the Group has expanded its market share and improved after sales services by strengthening sales management and improving its service standard.

An economy of scale was achieved following a significant rise of sales of agricultural machinery. By taking a series of measures such as strategic merchandising and commencement of valuable projects, the Group successfully lowered the production costs and raised gross profit margin of products. During the Reporting Period, the average consolidated profit margin of tractor products increased 2.3% year-on-year to approximately 10.36%. By improving the percentage of self-produced key spare parts of harvesters, unit variable cost fell by RMB532 and the quality and functions of harvesters were also improved.

Due to the charge of the market stature of tractor market, the overall market of small wheeled tractors shrunk, leading to a slide in sales of small wheeled tractors of the Group by 24.79%. However, the fast-growing large/medium wheeled tractors business in turn contributed to the better performance of overall turnover and operating results of agricultural machinery.

Analysis of construction machinery business

Table of sales volume of construction machinery products of the Group during the Reporting Period

Analysis of sales volume	**2006**	2005	% of change
Road machinery (unit)	**2,673**	2,365	13.02
Scraper (unit)	**1,503**	1,365	10.11
Transportation machinery (unit)	**183**	—	N/A
Small construction machinery (unit)	**5,256**	5,456	(3.67)
Total units of construction machinery (unit)	**9,615**	9,186	4.67

(*Note:* Road machinery: road roller, mixing machinery, road pavers, blenders, milling machinery; Scraper: bulldozer, grader, loader, excavator; Transportation machinery: industrial forklift; Small construction machinery: small excavator and small loader)

During the Reporting Period, construction machinery business started to rebound. Given the recovery of the overall industry, the Group has taken a series of measures to address problems such as insufficient adaptability to the market and inadequate marketing strategies, which include enhancing operational ability of the management team, streamlining internal sales network, integrating internal sales resources, increasing investment in research and development of new products in construction machinery business, timely adjusting product mix in response to the market demand. Construction machinery business of the Group is gradually moving out of its bottom which consolidated profit amounted to 7.61%, representing an increase of 2 percentage point, it takes time for the Group to recover and reach its best result of the past. During the Reporting Period, the construction machinery business was still at a loss.

Engine machinery business analysis

Engine machinery business was injected in the Group on 28 July 2006 as a result of assets swap and business reorganization, which offered a strong support to the agricultural machinery business and ancillary support for some of the construction machinery. During the Reporting Period, the consolidated profit for engine machinery amounted to 15.4%. From August to December 2006, the engine machinery business did not contribute any profit to the Group. However, the Group believes that the engine machinery business will become a future new profit driver of the Group.

Analysis on period expenses during the Reporting Period

By business	**31 December 2006** *RMB'000*	31 December 2005 *RMB'000*	Difference *RMB'000*	% of Change
Selling and distribution costs	**229,618**	172,021	57,597	33.48
Administrative expenses	**338,610**	262,482	76,128	29.00
Other operating expenses, net	**28,613**	86,126	(57,513)	(66.78)
Finance costs	**16,593**	11,186	5,407	48.34
Total	**613,434**	531,815	81,619	15.35

Analysis of selling and distribution costs: The group's selling costs increased by 33.48% from the previous year, which is attributable to: 1. an increase of selling costs of RMB18,500,000 as a result of the inclusion of engine machinery business; 2. an increase of transportation costs of RMB26,472,000 arising from the increase of sales of agricultural machinery business and construction machinery business of the Group; 3. a reduction of selling costs of RMB13,000,000, due to change of the charging sales discount in the construction machinery business of the group. Taking into account the aforesaid factors, selling costs of the Group increased by 14.89% when compared with the same period of last year.

Analysis of administrative expenses: The Group's administrative expenses increased by 29% from the previous year, which is attributable to: 1. an increased investment in research and development of the Group's products in 2006, leading to an increase of administrative expenses of RMB37,911,000 in research and development and technology services expenses; 2. the inclusion of engine machinery business gave rise to the increase of administrative expenses of RMB29,174,000; 3. assets and business reorganization led to an increase of administrative expenses of RMB10,000,000 in agency charges.

Other operating expenses, net: Other operating expenses primarily include provisions for impairment, loss from exchange difference, interest expenses for financial institutions and welfare expenses for early retired employees, etc. During the Reporting Period, the Group's other operating expenses decreased by 66.78%, it is attributable to: 1. some of the Group's construction-in-progress experienced favourable changes in their operations during the Reporting Period and provision for impairment on construction-in-progress decreased by RMB12,325,000 over the previous year; 2. during the Reporting Period, the Group strengthened the collection of receivables which improved the condition of receivables and thus provision for receivables decreased by approximately RMB17,203,000 over the previous year; 3. During the Reporting Period, no substantial change in the number of early retired employees, the welfare expenses for early retired employees was at its first time made in 2005, hence the provision decreased by RMB30,914,000 from the corresponding period of last year.

Analysis of Change in Current Assets

	31 December 2006 *RMB'000*	31 December 2005 *RMB'000*	Difference *RMB'000*	% of Change
Cash and cash equivalents	**765,904**	542,429	223,475	41%
Pledged deposits	**122,440**	121,124	1,316	1%
Trade and bills receivable	**744,774**	448,641	296,133	66%
Inventories	**852,366**	755,227	97,139	13%

Cash & bank deposits: As at 31 December 2006, the Group's current cash and bank deposit amounted to RMB765,904,000, of which the Company owns as to RMB290,369,000 and the remaining cash and bank deposit are attributable to the subsidiaries.

Pledged deposits: Pledged deposits is a mean of financing to double the banking facilities. As at 31 December 2006, the Group's pledged deposit is basically the same as the previous year.

Trade and bills receivable analysis: The Group's trade receivable increased by 66%, primarily attributable to: 1. trade receivable of agricultural machinery business increased by approximately RMB30,000,000, mainly because the regional government subsidy for purchasing machineries was not fully used by the end of the year and such receivable was collected up to date; 2. bills receivable of agricultural machinery business increased by approximately RMB97,000,000 and the Group's bills receivable are all in bank acceptance; 3. the inclusion of engine machinery business led to an increase of trade receivables of approximately RMB104,000,000, while bills receivable increased by approximately RMB64,000,000. During the Reporting Period, the Group adopted different approaches to strengthen the management of the trade receivable, including the establishment of order credit management system, application of different credit sales policies to different clients according to their credit ratings so as to lower the risk of trade receivable. "Life-long" accountability is implemented for the inter-segment sales from sales of goods to receivable collection and goods collection are linked to the interest of person-in-charge, and legal actions were taken to enhance the collection of long-term arrears. The term of the trade receivable was improved.

Change in inventory: During the Reporting Period, the Group's inventories increased by 13%, mainly attributable to: 1. the inclusion of engine machinery business led to an increase in inventories of approximately RMB75,000,000, 2. as to neutralise the effect on the increase in the price surge in raw materials, the Group increased its inventories of raw materials by approximately RMB20,000,000 by the end of the year 2006.

The Group's Operating Strategies in 2007

Grasping the opportunities arising from the State's macro-policies, the Group will strengthen every aspect of the operation in deploying a comprehensive management strategy, to improve the cutting-edge of the Group and meet the Board's strategic requirements on the Group's future development.

Reinforcing supply chain management and enhancing merchandising management: The Group will continue to advance and strengthen the centralised merchandising system to further strengthen the management system and internal control. Meanwhile, the Group will strengthen the supply channel to enjoy the benefit of mass merchandising and lower the merchanrdising costs.

Finance management: The Group will strengthen cost management and improve its supply chain to conduct key monitoring in planning, merchandising and cost of sales. It will also put more efforts in the recovery of receivables and promoting utilization efficiency of capital. It plans to adjust national stock to reduce use of capital. The Group will strongly promote the internal assessment system in which return on assets is the core criteria and cash flows is a constraint factor, and strengthen the management of subsidiaries.

Marketing and sales management: The Group will enhance regional market consolidation to reduce marketing expenses and implement a new marketing model that integrates sales of major machinery, provision of spare parts, after-sales services and feedback. By adhering to the marketing philosophy of "services promote sales", a sound file management system of dealers and customers was built to regulate the order of inter-group sales. The Group will also formulate a more personalised mechanism in sales assessment, for the purposes to encourage marketing staff to be more procative to initiate the activeness of sales force, improve the after-sale service standard and raise their service awareness.

Financial business: the Group will make full use of its edges in internal financing resources and centralized financial management and clearing platform. With the mission as "serving the Group where its foothold set", the Group will strengthen research of the capital market and devise a target-based financing scheme based on the Group's production and operation to progressively develop new business in providing buyer's facilities, the Group will further expand itself towards external markets to enhance its sustainability and expansion.

International market: The Group will improve the product mix of its export products and progressively promote and obtain accreditation of its 16 products' from E-mark, CE, EPA, OECD, with a view to laying a solid foundation for expanding to the international market. Apart from that, the Group will set up a unified technical service standard for its export products, establish management system for overseas technical service engineers, improve file management system for export product and international customers, reinforce training for international technical service team, gather talents who possess skills in overseas technical services. Based on the market conditions and the business development situation, the Group will optimise distribution networks and speed up establishment of international marketing outlets by developing export products that meet the requirement of international market.

Investments

For the period from 31 January 2006 to 31 July 2006, Yituo (Luoyang) Diesel Company Limited, an associate of the Company, gained profit for the Company.

Other associates of the Company, namely Yituo (Luoyang) Casting and Forging Company Limited and Luoyang First Motors Company Limited are still making a loss.

ANALYSIS OF ASSETS AND FINANCIAL POSITION OF THE GROUP

Financial Statistics

Items	Basis of calculation	31 December 2006	31 December 2005
Gearing ratio	Total liabilities/total assets x 100%	**52.56%**	43.02%
Current ratio	Current assets/current liabilities	**1.34**	1.52
Quick ratio	(Current assets - inventories)/current liabilities	**0.98**	1.06
Debt equity ratio	Total liabilities/Shareholders' equity (note) x 100%	**119.34%**	80.96%

Note: Shareholders' equity (excluding minority interests)

Analysis of Equity and Reserves

Items	31 December 2006 *RMB'000*	31 December 2005 *RMB'000*	Increase/ (decrease) *RMB'000*
Share capital	**785,000**	785,000	—
Share premium account	**1,378,840**	1,378,840	—
Statutory surplus reserve	**77,570**	68,817	8,753
Statutory public welfare fund	—	64,744	(64,744)
Reserve fund	**2,873**	2,525	348
Enterprise expansion fund	**2,356**	2,153	203
General and statutory reserve	**4,446**	2,217	2,229
General surplus reserve	**64,744**	—	64,744
Available-for-sale investment revaluation reserve	**97,150**	—	97,150
Exchange fluctuation reserve	**(4,244)**	(1,357)	(2,887)
Retained profit/(Accumulated losses)	**(210,704)**	(272,020)	61,316

SIGNIFICANT INVESTMENT OR ACQUISITION OF CAPTIAL ASSETS OF THE GROUP IN THE FUTURE

In 2007, the Company intends to make an additional investment of approximately RMB31,720,000 in Yituo (Luoyang) Transportation Machinery Company Limited ("YLTM") (一拖(洛陽)搬運機械有限公司), and the Company's equity interest in YLTM will represent 91.052% upon investment. Apart from this, the Group does not have any plan for significant investment and capital acquisition in 2007. There was no significant investment in 2006.

EXCHANGE RATE RISK

As the Group carries out its day-to-day business activities mainly in the PRC, a large amount of capital income and expenditure is principally denominated in Renminbi, with a small amount of expenditure being denominated in Hong Kong dollars. The Group's foreign exchange debt is mainly applied to the payment of commissions outside the PRC and dividends to holders of H Shares. The Group's cash balances are usually deposited with financial institutions in the form of short-term deposits. Bank loans were borrowed in Renminbi and such loans can be repaid out of the revenue received in Renminbi.

As at 31 December 2006, there was no pledge of any deposit of foreign currency of the Group.

PLEDGE OF ASSETS

At 31 December 2006, certain of the Group's buildings and machinery with an aggregate net carrying value of approximately RMB91,009,000 (2005: RMB18,806,000) were pledged to secure certain short term bank loans granted to the Group.

At 31 December 2006, certain of the Group's prepaid land premiums with an aggregate net carrying value of approximately RMB8,304,000 (2005: Nil) were pledged to secure bank loans granted to the Group.

At 31 December 2006, certain of the Group's and the Company's bills receivable of RMB75,282,000 (2005: RMB7,400,000) were pledged for the issuance of bills payable.

NUMBER OF STAFF OF THE COMPANY AND TRAINING FOR STAFF

As at 31 December 2006, the Company had a total of 8,591 staff members, of whom 4,233 were production staff, 430 were engineering technicians, 125 were financial staff, 617 were sales staff, 561 were administrative staff, and 2,625 were marketing and other staff.

In 2006, the Company organised staff training in a number of ways with practical measures for effectiveness. Altogether 13,664 staff members in different areas were trained through a total of 940 training courses during the Reporting Period so that the professional quality of the staff was raised.

REMUNERATION POLICY FOR STAFF OF THE COMPANY

The Company implemented a basic salary system based on "the remuneration in accordinance with position" and with reference to the market labour price. It has established a rational and standard remuneration system in line with the work nature of employees in different areas and altered the allocation structure and relationships to fully arouse the enthusiasm and creativity in the staff to support the Company's strategic goals.

In addition to the basic salary system, the Company, with the human resource needs given from corporate development strategy as guidance and focusing on calibre and performance, has opened up channels for staff's growth by outlining promotion prospects given different posts and areas. As such, employees in different areas are able to define their individual goals and directions within the Company and find a platform to bring their talent into full play.

CONTINGENT LIABILITIES

As at 31 December 2006, China First Tractor Group Finance Company Limited ("FTGF"), acting as the guarantor, had given guarantee to the extent of RMB100 million to a financial institution for securing the loans granted to China Yituo.

As at 31 December 2006, Zhenjiang Huachen Huatong Road Machinery Company Limited ("ZHHRM"), a subsidiary of the Group, had provided a guarantee to the extent of RMB20 million to a bank for securing the loan granted to a related company of the minority shareholder of ZHHRM.

Details of contingent liabilities as at 31 December 2006 is set out in note 39 to the financial statements of this annual report.