

REPORT OF DIRECTORS

The directors herein present the report and the audited financial statements of the Company and the Group for the year ended 31 December 2006.

1. PRINCIPAL BUSINESS

The principal activities of the Company comprise the production and sale of agricultural tractors. Details of the principal activities of the subsidiaries of the Company are set out in note 17 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

2. RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2006 and the state of financial affairs of the Company and the Group as at 31 December 2006 are set out in the financial statements in pages 63 to 166.

The Directors do not recommend the payment of any final dividend for the year of 2006.

3. FIVE YEARS FINANCIAL SUMMARY

A summary of the published results and assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the published audited financial statements with, is set out below. This summary does not form part of the audited financial statements.

The financial summary has been prepared in accordance with Hong Kong accounting standards:

Consolidated results

	Year ended 31 December				
	2006 RMB'000	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000
Turnover	6,101,451	4,765,828	4,246,554	3,277,297	2,300,223
Profit/(loss) before tax	87,467	(77,482)	23,813	54,666	(36,784)
Tax	(15,251)	17,183	(13,953)	(21,641)	(15,088)
Profit/(loss) before minority interests	72,216	(60,299)	9,860	33,025	(51,872)
Minority interests	633	9,863	2,101	(16,697)	(7,618)
Net profit/(loss) from ordinary activities attributable to equity holders of the parent	72,849	(50,436)	11,961	16,328	(59,490)

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Consolidated assets, liabilities and minority interests

	Year ended 31 December				
	2006 RMB'000	2005 RMB'000	2004 RMB'000	2003 RMB'000	2002 RMB'000
Total assets	4,991,222	3,821,630	3,649,665	3,660,072	3,334,388
Total liabilities	(2,623,173)	(1,644,175)	(1,412,889)	(1,465,153)	(1,180,321)
Minority interests	(170,018)	(146,536)	(159,645)	(129,749)	(105,225)
Total equity attributable to equity holders of the parent	2,198,031	2,030,919	2,077,131	2,065,170	2,048,842

4 PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the Group during the year are set out in note 13 to the financial statements.

5. SHARE CAPITAL, CONVERTIBLE SECURITIES, OPTIONS AND WARRANTS

There was no change in the registered or issued share capital of the Company during the year.

During the year of 2006, the Company did not issue any convertible securities, options, warrants or similar rights.

6. PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Articles of Association or the laws of the PRC which would oblige the Company to offer new shares ("Shares") of the Company on a pro rata basis to its existing Shareholders.

7. PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

Neither the Company, nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the Reporting Period.

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8. RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 35 to the financial statements.

9. DISTRIBUTABLE RESERVES

Details of the distributable reserves of the Company as at 31 December 2006 are set out in note 35(b) to the financial statements.

10. MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2006, the five largest customers and suppliers of the Group respectively accounted for less than 30% of the total sales and purchases of the Group so far as the Directors who own 5% of the share capital of the Company or above are aware, none of the Directors, Supervisors, their associates or any Shareholder had an interest in the major suppliers or customers of the Group.

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11. DIRECTORS AND SUPERVISORS

During the year, the Directors and Supervisors of the Company are as follows:

Executive Directors:

Mr. Liu Dagong
Mr. Zhao Yanshui
Mr. Liu Wenying
Mr. Yan Linjiao
Mr. Li Tengjiao
Mr. Shao Haichen
Mr. Zhang Jing
Mr. Li Youji
Mr. Liu Shuangcheng
Mr. Zhao Fei

Independent non-executive Directors:

Mr. Lu Zhongmin
Mr. Chan Sau Shan, Gary
Mr. Chen Zhi
Mr. Luo Xiwen (appointed on 1 July 2006)

Supervisors:

Mr. Liu A Nan (resigning on 22 December 2006)
Mr. Zheng Luyu (appointed on 22 December 2006)
Mr. Zhao Zhonghai (resigning on 30 June 2006)
Mr. Kong Lingfu (appointed on 1 July 2006)
Mr. Xu Weilin
Ms. Wang Aiyong (resigning on 30 June 2006)
Mr. Zhao Shengyao (appointed on 1 July 2006)
Mr. Shao Jianxin

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12. SERVICE CONTRACTS OF THE DIRECTORS AND THE SUPERVISORS

Mr. Liu Dagong, Mr. Zhao Yanshui, Mr. Liu Wenyong, Mr. Yan Linjiao, Mr. Li Tengjiao, Mr. Shao Haichen, Mr. Zhang Jing, Mr. Li Youji, Mr. Liu Shuangcheng, Mr. Zhao Fei, Mr. Kong Lingfu, Mr. Zhao Shengyao, Mr. Xu Weilin and Mr. Shao Jianxin entered into service contract with the Company on 1 July 2006. Mr. Zheng Luyu entered into a service contract with the Company on 22 December 2006. These service contracts are the same in all material respects, details of which are set out as below:

- (i) Each service contract commences from the date of contract to 30 June 2009.
- (ii) The total annual salaries payable to each of the executive Directors each year for the three years term from 1 July 2006 will be RMB60,000, RMB66,000 and RMB72,600 respectively; the total annual salaries payable to each of the Supervisors each year for the three years term will be RMB36,000, RMB39,600 and RMB43,560 respectively; and
- (iii) Furthermore, each executive Director or Supervisor is entitled to a bonus upon completion of each full year of service. The bonuses payable to each of the executive Directors each year for the three years term will not be more than RMB30,000, RMB33,000 and RMB36,300 respectively. The bonuses payable to each of the Supervisors each year for the three years term will not be more than RMB18,000, RMB19,800 and RMB21,780 respectively.

Save as aforesaid, none of the Directors or Supervisors has entered into any service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

The Company has received the annual confirmation letter issued by all independent non-executive Directors in respect of their independence in accordance with Rule 3.13 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules"). The Company considers that all the independent non-executive Directors are independent.

13. DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

During the year, no Director or Supervisor had any direct or indirect material interest or any other interest in any contract of significance to the business of the Group to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party.

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14. DIRECTORS', SUPERVISORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2006, save as disclosed below, none of the Directors, Supervisors or chief executives of the Company had any interests or short positions in any shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO, or as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies:

Name	Name of associated corporation	Capacity	Registered capital held (Note 2)	Approximate percentage in the entire registered capital of the associated corporation
Yan Linjiao (Director)	Yituo (Luoyang) Lutong Construction Machinery Co., Ltd. ("Lutong Company") (Note 1)	Beneficial owner	RMB290,000 (L)	0.5%

Notes:

- (1) Lutong Company is a limited company established in the PRC. Its total registered capital is RMB58,000,000. Mr Yan Linjiao contributed RMB290,000 to the total registered capital of Lutong Company and therefore hold 0.5% of the total registered capital of Lutong Company.
- (2) The letter "L" represents the person's long position in the registered capital of the subsidiaries.

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15. CONTRACTS OF SIGNIFICANCE

Neither the Company nor any of its subsidiaries has entered into any contract of significance, other than those as disclosed in the paragraph headed “Connected Transactions”, with the controlling Shareholder or any subsidiary of the Company at any time during the year ended 31 December 2006.

16. CHANGE IN SHAREHOLDING AND STRUCTURE OF EQUITY INTERESTS OF SHAREHOLDERS

As at 31 December 2006, the total issued Shares of the Company amounted to 785,000,000 Shares. Its structure of equity interests was as follows:

Type of Shares	Number of Shares	Percentage (%)
(1) Non-circulating state-owned legal-person Shares (the “Domestic Shares”)	450,000,000	57.32
(2) Circulating Shares listed in the Stock Exchange (the “H Shares”)	335,000,000	42.68
Total number of Shares	785,000,000	100.00

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17. SUBSTANTIAL SHAREHOLDERS

As at 31 December 2006, the following Shareholders (other than a Director, Supervisor or chief executive of the Company) of the Company had interests or short positions in the shares and underlying shares in the Company as recorded in the register required to be kept by the Company pursuant to section 336 of the SFO:

Domestic Shares

Name of Shareholder	Nature of interests	Number of Shares (Note)	Approximate percentage of the total issued H Shares of the Company
China Yituo	Beneficial owner	450,000,000(L)	57.32%

H Shares

Name of Shareholder	Nature of interests	Number of Shares (Note)	Approximate percentage of the total issued H Shares of the Company
Fidelity International Limited	Investment manager	24,216,600 (L)	7.23%

Note:

The letter "L" represents the entities' long position in the shares of the Company.

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Save as disclosed, there was no other person (other than a Director, Supervisor or chief executive of the Company) who, as at 31 December 2006, had an interest or a short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under section 336 of the SFO.

On the basis of published information and to the best knowledge of the Directors, the Company has maintained the prescribed public float under the Listing Rules of the Stock Exchange of Hong Kong Limited (the "Listing Rules") as at the date of this report.

18. DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the Reporting Period were any rights to acquire benefits by means of the acquisition of Shares in or debentures of the Company granted to any Directors, Supervisors, or their respective spouse or minor children, or were any rights exercised by them; nor was the Company, its holding company, or any of its subsidiaries a party to any arrangement to enable the Directors or Supervisors to acquire such rights in any other corporation.

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19. CONNECTED TRANSACTIONS

Details of the Group's connected transaction (within the meaning under the Listing Rules) are set out in note 43 to the financial statements.

On 13 October 2006, upon expiry of the five continuing connected transaction agreements entered into between the Company and China Yituo including the Financial Services Agreement dated 2 June 2004, the Group entered into five continuing connected transaction agreements namely the Composite Services Agreement, Material Supply Agreement, Energy Supply Services Agreement, First Tractor Supply Agreement and Financial Services Agreement with China Yituo. The respective terms of these five agreements are for a term of three years from 1 January 2007 to 31 December 2009. China Yituo beneficially owns approximately 57.32% of the issued share capital of the Company, and is the controlling shareholder of the Company. Thus, China Yituo and its subsidiaries are regarded as connected person of the Company under the Listing Rules. Accordingly the transactions contemplated under these five agreements and the respective proposed cap amounts constitute continuing connected transactions or financial assistance under Chapter 14A of the Listing Rules. These five agreements were subject to independent Shareholders' approval. The aforesaid five agreements of non-exempted continuing connected transactions and new caps related to the connected transactions were approved by the Shareholders at the extraordinary general meeting of the Company on 22 December 2006. Pursuant to the Composite Services Agreement, Material Supply Agreement and Energy Supply Services Agreement, China Yituo agreed to supply certain goods and services to the Company. Pursuant to the First Tractor Supply Agreement and Financial Secrecies Agreement, the Company agreed to supply certain goods and services to the Company. The consideration of the subject matter under the aforesaid agreements is determined with reference to the mandatory price in respect of welfare and supporting services, raw materials and components and utilities set by the central government of the PRC (the "State Price") or with reference to the market price taking into consideration of the cost. Pursuant to the Financial Services Agreement entered into between China First Tractor Group Finance Co., Ltd. and China Yituo, various financial services will be provided to China Yituo Group.

The Company and China Yituo entered into three agreements in relation to continuing connected transactions on 13 December 2006, namely the First Tractor Properties Lease Agreement, Yituo Facilities Lease Agreement and Yituo Properties Lease Agreement, which were exempt from independent Shareholders' approval. The Company has made disclosures pursuant to the relevant requirements of the Listing Rules.

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Save as the above transactions, the Group also entered into the following connected transactions:

On 8 May 2006, the Company entered into the Assets Swap Agreement with China Yituo pursuant to which the Company agreed with China Yituo to exchange for the casting factories interests at an aggregate consideration of RMB158.24 million for the 58.80% equity interest in Yituo (Luoyang) Diesel Co., Ltd. (“Yituo Diesel”) and 70% equity interest in Yituo (Louyang) Fuel Jet Company Limited (“Yituo Fuel Jet”) as a consideration of RMB154.75 million and RMB43.27 million respectively. At Completion, the net consideration payable by the Company to China Yituo pursuant to the Assets Swap Agreement is approximately RMB39.78 million.

On 8 May 2006, Yituo Diesel and Yituo Fuel Jet respectively entered into the Diesel Repayment Agreement and the Fuel Jet Repayment Agreement with China Yituo, pursuant to which, each of the Yituo Diesel and Yituo Fuel Jet has agreed the repayment terms for China Yituo to repay the existing financial assistances provided from Yituo Diesel and Yituo Fuel Jet of approximately RMB81 million and RMB26 million respectively following the completion of the assets swaps pursuant to Assets Swap Agreement.

The aforesaid agreements of continuing connected transactions and matters related to the connected transactions were approved by the Shareholder at the extraordinary general meeting of the Company on 28 July 2006. The asset swap transactions mentioned in note 43 to financial statements of this report are related to the continuing connected transactions.

After reviewing the above current year’s connected transactions, the independent non-executive Directors confirmed that such connected transactions were:

- (1) entered into in the ordinary and usual course of business of the Group;
- (2) conducted either (a) on normal commercial terms (as compared with transactions of similar nature carried out by similar entities in the PRC) or (b) (if no available comparison) on terms no less favourable than those available to or from independent third parties; and
- (3) entered into on terms that are fair and reasonable so far as the Shareholders are concerned.

After reviewing the above current year’s connected transactions, the auditors of the Company confirmed the matters stated in rule 14A.38 of the Listing Rules

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Save as aforesaid, none of the "Related Party Transactions" as disclosed in note 43 to the financial statements for the year ended 31 December 2006 constituted discloseable non-exempted connected transaction or non-exempted continuing connected transaction under the Listing Rules.

The Company confirms that it has complied with the disclosure requirements in accordance with the Listing Rules for the above connected transactions.

20. SHARE PLEDGE

1. On 29 September 2006, China Yituo (the controlling Shareholder of the Company) pledged its own 50,000,000 domestic shares in the Company to Zhengzhou Branch, Shanghai Pudong Development Co., Ltd. ("Pudong Bank") as a security to secure a one-year loan facility for a maximum amount of RMB50,000,000 granted by Pudong Bank to Yituo (Luoyang) Fuel Jet Company Limited, a non-wholly owned subsidiary of the Company. Upon the Company receiving the notice of the corporate substantial shareholder of the Company from Pudong Bank and China Yituo, the Company made an announcement in relation thereto.
2. On 31 December 2006, China Yituo (the controlling shareholder of the Company) pledged the 100,000,000 domestic shares in the Company held by it to Bank of China Limited ("Bank of China") Luoyang Branch as a security for the loan of RMB311,710,000 granted by Bank of China to China Yituo. Being an authorised financial institution in Hong Kong, Bank of China was exempted from submission of the "notice from the corporate substantial shareholder of the Company".

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21. APPLICATION OF THE PROCEEDS FROM THE H SHARES ISSUE

The Company raised approximately RMB1,615,500,000 (approximately HK\$1,507,500,000) through the issue of 335,000,000 new H Shares under the initial public offering of the H Shares listed on the Stock Exchange on 23 June 1997 and two subsequent partial exercises of over-allotment option.

The proceeds, other than those amounting to RMB1,472,435,000 which had been used and disclosed in the previous annual reports of the Company, were also applied to the following purposes during the year:

- Approximately RMB79,345,000 was continued to be used for financing projects including large/medium wheeled tractors, 125MN hotdie forging, flexible line of gear shells and forklifts, construction of building for gear sub-factory and technological renovations thereof; and
- The remaining balance of the proceeds was used as additional working capital of the Company.

22. DIRECTORS' AND SUPERVISORS' INTERESTS IN COMPETING BUSINESS

During the year and up to the date of this report, none of the Directors or Supervisors is considered to have interests in a business which competes or is likely to compete, either directly or indirectly, with the businesses of the Group.

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23. SIGNIFICANT EVENTS

Save for the connected transactions disclosed in paragraph 19 of this report, the Company had the following significant events during 2006:

1. On 8 May 2006, the Board of the Company approved the acquisition of 58.8% equity interests in Yituo (Luoyang) Diesel Co., Ltd. (“Yituo Diesel Company”) and 70% equity interests in Yituo (Luoyang) Fuel Jet Company Limited (“Yituo Fuel Jet Company”) by the Company from China Yituo at a consideration of RMB154,750,000 and RMB43,270,000 respectively, which were determined based on the evaluated net assets of Yituo Diesel Company and Yituo Fuel Jet Company and with reference to the two companies’ profitability, and meanwhile the Company was approved to dispose the assets and interests of its four casting factories (assets and liabilities under the Asset Swap Agreement) to China Yituo with the evaluated netvalue of RMB158,240,000 as consideration. The difference between the acquisition of equity interests and the disposal of assets and interests was RMB39,780,000 which was payable to China Yituo by the Company. The aforesaid transactions were approved by the Shareholders at the extraordinary general meeting of the Company on 28 July 2006.
2. On 29 December 2006, the Board of the Company approved the joint establishment of Yituo Shunxing (Luoyang) Spare Parts Company Limited (“Shunxing Spare Parts Company”) with Liaoning Shunxing Combustion Engine Crankshaft Company Limited (“Liaoning Shunxing Company”) and 17 natural persons with registered capital of RMB40,000,000, of which the company contributed RMB16,000,000 in cash, representing 40% equity interests, Liaoning Shunxing Company contributed RMB15,200,000 in cash, representing 38% equity interests, and such natural persons contributed RMB8,800,000 in cash, representing 22% equity interests. Shunxing Spare Parts Company mainly engaged in production of forged steel crankshafts.

24. POST BALANCE SHEET EVENT

Details of the significant post balance sheet event of the Group are set out in note 45 to the financial statements.

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25. CODE ON CORPORATE GOVERNANCE PRACTICES

The Board is of the opinion that the Company has complied with the requirements of all code provisions of the Code on Corporate Governance Practices in Appendix 14 of the Listing Rules during the Reporting Period. Details are set out in the Corporate Governance Report of this annual report.

26. MATERIAL LITIGATION

During the Reporting Period, none of the Company, the Directors, Supervisors nor the Chief executives the Company was involved in any material litigation or arbitration.

27. AUDITORS AND QUALIFIED ACCOUNTANTS

Ernst & Young will be retired and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting of the Company.

Pursuant to Rule 3.24 of the Listing Rules, the Company shall employ an individual with the specified qualifications set out in Rule 3.24 of the Listing Rules as a qualified accountant (the "Qualified Accountant") of the Company. As at the date of this report, the Company has not yet been able to find a suitable candidate to work as the Qualified Accountant. The Company will use every endeavour to recruit a suitable candidate to assume such position as soon as possible. The Company will keep the Shareholders informed of the progress of appointment.

By order of the Board

Liu Dagong
Chairman

Luoyang, the PRC
20 April 2007