CHINA YUCHAI INTERNATIONAL LTD
Form 20-F
August 08, 2006

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 20-F

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report _____

Commission file number 1-13522

China Yuchai International Limited
(Exact Name of Registrant as Specified in Its Charter)

N/A	Bermuda
(Translation of Registrant s Name Into English)	(Jurisdiction of Incorporation or Organization)

16 Raffles Quay #26-00
Hong Leong Building
Singapore 048581
65-6220-8411
(Address and Telephone Number of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value US$0.10 per share	The New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2005, 37,267,673 shares of common stock, par value US$0.10 per share, and one special share, par value US$0.10, were issued and outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes o No þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 o Item 18 þ

If this report is an annual report, indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

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Certain Definitions and Supplemental Information

All references to China , PRC and the State in this Annual Report are references to the People s Republic of China. Unless otherwise specified, all references in this Annual Report to U.S. dollars , dollars , US$ or $ are to United Stat dollars; all references to Renminbi or Rmb are to Renminbi, the legal tender currency of China; and all references to S$ are to Singapore dollars, the legal tender of Singapore. Unless otherwise specified, translation of amounts from Renminbi to U.S. dollars for the convenience of the reader has been made in this Annual Report at the rate of Rmb 8.0702 = US$1.00, the rate quoted by the People s Bank of China on December 30, 2005. No representation is made that the Renminbi amounts or Singapore dollar amounts could have been, or could be, converted into U.S. dollars at rates specified herein or any other rate.

The consolidated financial statements of China Yuchai International Limited, its subsidiaries and affiliates are presented in Renminbi. All consolidated financial statements of the Company presented herein have been prepared in conformity with accounting principles generally accepted in the United States of America (US GAAP). Totals presented in this Annual Report may not correctly total due to rounding of numbers.

As used in this Annual Report, unless the context otherwise requires, the terms the Company , CYI , we , us , our our company refer to China Yuchai International Limited, its subsidiaries and affiliates. All references herein to Yuchai are to Guangxi Yuchai Machinery Company Limited, its consolidated subsidiaries and affiliates and, prior to its incorporation in July 1992, to the machinery business of its predecessor, Guangxi Yulin Diesel Engine Factory (Yulin Diesel), which was founded in 1951 and became a state-owned enterprise in 1959. In the restructuring of Yulin Diesel in July 1992, its other businesses were transferred to Guangxi Yuchai Machinery Holdings Company, also sometimes referred to as Guangxi Yuchai Machinery Group Company Limited (the State Holding Company), which became a shareholder of Yuchai. In addition, TCL refers to Thakral Corporation Ltd and LKN refers to LKN-Primefield Limited, each of which are minority investees of the Company.

As of December 31, 2005, 37,267,673 shares of common stock, par value US$0.10 per share of the Company (Common Stock), and one special share, par value US$0.10, of the Company were issued and outstanding. The weighted average common shares outstanding during the year is 36,459,635. Unless otherwise indicated herein, all percentage share amounts with respect to the Company are based on the weighted average number of shares of 36,459,635 for 2005.

Cautionary Statements with Respect to Forward-Looking Statements

The Company wishes to caution readers that the forward-looking statements contained in this Annual Report, which include all statements which, at the time made, address future results of operations, are based upon the Company s interpretation of factors affecting the business and operations of the Company. The Company believes the following important factors, among others, in some cases have affected, and in the future could affect, the Company s actual consolidated results and could cause the Company s actual consolidated results for 2006, and beyond, to differ materially from those described in any forward-looking statements made by, or on behalf of, the Company:

- political, economic and social conditions in China, including the Chinese government s specific policies with respect to foreign investment, economic growth, inflation and the availability of credit, particularly to the extent such current or future conditions and policies affect the truck and diesel engine industries and markets in China, the Company s diesel engine customers, the demand, sales volume and sales prices for the Company s diesel engines and the Company s levels of accounts receivable;

- the effects of competition in the diesel engine market on the demand, sales volume and sales prices for the Company s diesel engines;

- the Company s ability to collect and control its levels of accounts receivable;

- the Company s dependence on the Dongfeng Automobile Company and other major diesel truck manufacturers controlled by or affiliated with the Dongfeng Automobile Company;

the Company s ability to successfully manufacture and sell its 4108, 4110, 4110Q, 4110ZQ, 4112, 6105, 6108, 6112, 6L/6M (formerly referred to as 6113) heavy-duty diesel engines and any new products;

the Company s ability to finance its working capital and capital expenditure requirements, including obtaining any required external debt or other financing;

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the effects of inflation on the Company s financial condition and results of operations, including the effects on Yuchai s costs of raw materials and parts and labor costs;

the Company s ability to successfully implement the reorganization agreement which it entered into with Yuchai and Coomber Investments Limited (Coomber) on April 7, 2005 (the Reorganization Agreement), as amended in December 2005, relating to the implementation of the restructuring contemplated in the earlier agreement dated July 19, 2003 between the Company and Yuchai with respect to the Company s investment in Yuchai (the July 2003 Agreement);

the Company s ability to control Yuchai and consolidate Yuchai s financial results;

the effects of China s political, economic and social conditions on the Company s financial condition, results of operations, business or prospects;

the effects of uncertainties in the Chinese legal system, which could limit the legal protections available to foreign investors, including with respect to the enforcement of foreign judgments in China; and

the impact on the Company s business and results of operations as a result of China s membership with the World Trade Organization (WTO).

Incorporation by Reference

This Annual Report on Form 20-F shall be deemed to be incorporated by reference in the Prospectus, dated March 24, 2004, included in the Registration Statement (File No. 333-111106) on Form F-3 of the Company and to be a part thereof from the date on which this Annual Report is filed, to the extent it is not superseded by documents or reports subsequently filed or furnished.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS.

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE.

Not Applicable.

ITEM 3. KEY INFORMATION.

Selected Financial Data

The selected financial information set forth below should be read in conjunction with, and is qualified in its entirety by reference to, Item 5. Operating and Financial Review and Prospects and the Company s audited consolidated financial statements and the notes thereto included in this Annual Report. The consolidated financial statements of the Company are prepared in conformity with US GAAP.

The Company s main operating asset is its 76.4% ownership interest in Yuchai. As a result, the Company s financial condition and results of operations depend primarily upon Yuchai s financial condition and results of operations, and the implementation of the Reorganization Agreement with respect to the restructuring of the Company s investment in Yuchai, described elsewhere herein (see Item 4. Information on the Company Recent Developments and Item 8. Financial Information Legal Proceedings).

On February 7, 2005, the board of directors of the Company announced its approval of the implementation of a business expansion and diversification plan by the Company. Pursuant to this plan, the Company has looked for new business opportunities to seek to reduce its financial dependence on Yuchai, which has historically been the Company s main operating asset.

In March 2005, the Company completed an acquisition of approximately 14.99% of TCL, a China-focused electronics distribution company, for approximately S$30.9 million (approximately $18.9 million, based on an exchange rate of S$1.637 to US$1.00). The Company subsequently increased its minority stake in TCL, and as of December 31, 2005 the Company s shareholding in TCL was

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15.99%. The Company has also recently invested in LKN, a company primarily engaged in the business of investment holding and hospitality-related businesses, pursuant to the Company s business expansion and diversification plan.

In February 2006, the Company acquired debt and equity in LKN for an aggregate consideration of approximately S$131.6 million (approximately $81.2 million, based on an exchange rate of S$1.62 to US$1.00), divided into 191,413,465 ordinary shares representing approximately 29.13% of the total number of ordinary shares in issue; 123,010,555 redeemable convertible preference shares in the capital of LKN; and approximately S$129.4 million (approximately US$79.9 million, based on an exchange rate of S$1.62 to US$1.00) in principal amount of outstanding secured non-convertible bonds issued by LKN. For further information on the TCL and LKN minority investments, see Item 4. Information on the Company History and Development Minority Investments .

The selected balance sheet data as of December 31, 2004 and 2005 and the statement of income data and cash flow statement data of the Company set forth below for the years ended December 31, 2003, 2004 and 2005 are derived from the consolidated financial statements of the Company included in this Annual Report, which have been audited by KPMG, Independent Registered Public Accounting Firm (the Consolidated Financial Statements). The selected balance sheet data of the Company set forth below as of December 31, 2001, 2002 and 2003 and the statement of income data and cash flow statement data for the years ended December 31, 2001 and 2002 are derived from the consolidated financial statements of the Company, which have been audited by KPMG, but which are not included in this Annual Report.

	As of and for the Year Ended December 31,					
	2001 Rmb	2002 Rmb	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$[3]
	(in thousands)					
Statement of Income Data:						
Revenues, net	1,783,329	3,513,047	4,569,950	5,582,095	5,829,431	722,340
Gross profit	599,926	1,141,967	1,377,156	1,575,209	1,302,385	161,382
Research and development costs	(44,721)	(75,532)	(94,594)	(136,960)	(123,876)	(15,350)
Provision for uncollectible loans to a related party					(205,000)	(25,402)
Operating income	295,115	640,307	721,411	779,929	168,692	20,903
Income before income taxes and minority interests	269,189	625,450	696,906	753,854	117,242	14,528
Income tax benefit/(expense)	63,584	(83,242)	(112,924)	(105,165)	(20,875)	(2,587)
Income before minority interests	332,773	542,208	583,982	648,689	96,367	11,941
Minority interests in income of consolidated subsidiaries	(82,386)	(129,775)	(145,800)	(157,292)	(27,880)	(3,455)
Net income	250,387	412,433	438,182	491,397	68,487	8,486
	7.09	11.67	12.40	13.90	1.88	0.23

Basic and diluted earnings per common share						
Weighted average number of shares	35,340	35,340	35,340	35,340	36,460	36,460
Balance Sheet Data (at year end):						
Working capital[(1)]	1,100,462	1,340,832	1,031,830	1,402,226	959,401	118,882
Goodwill	212,636	212,636	212,636	212,636	212,636	26,348
Total assets	3,262,868	3,985,459	4,033,632	5,384,248	6,613,785	819,532

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	As of and for the Year Ended December 31,					
	2001 Rmb	2002 Rmb	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$[3]
	(in thousands)					
Long-term bank loans, excluding current instalments	180,000	50,000		100,000	50,000	6,196
Minority interests	420,545	487,491	544,526	724,311	685,514	84,944
Common stock	30,349	30,349	30,349	30,349	31,945	3,958
Stockholders equity	1,805,045	2,161,903	1,991,687	2,483,084	2,667,041	330,480
Statement of Cash Flows Data:						
Net cash provided by operating activities	59,273	659,500	1,075,274	589,608	242,674	30,070
Capital expenditures[2]	43,043	174,850	372,775	552,902	515,359	63,860
Depreciation and amortization	113,680	118,872	125,519	132,789	139,720	17,313

(1) Current assets (including cash) less current liabilities.

(2) Purchase of property, plant and equipment, lease prepayment and payment for construction in progress.

(3) The Company s functional and reporting currency is Renminbi, and the translation of amounts from Renminbi to U.S. dollars is solely for the convenience of the reader. Translation of amounts from Renminbi to

U.S. dollars has been made at the rate of Rmb 8.0702 = US$1.00, the rate quoted by the People s Bank of China at the close of business on December 30, 2005. No representation is made that the Renminbi amounts could have been, or could be, converted into U.S. dollars at that rate or at any other rate prevailing on December 30, 2005 or any other date.

Dividends

The following table sets forth a five-year summary of dividends paid by the Company to its shareholders and by Yuchai to the Company, respectively:

Period	Dividend paid by the Company to its shareholders (per share)	Dividend Paid by Yuchai to the Company[1] (in thousands)
2001	US$0.02	Rmb 72,284 (US$8,720)
2002	US$0.19	Rmb 245,766 (US$29,694)[2]
2003	US$2.08	Rmb 61,433 (US$7,422)
2004	US$0.39	Rmb 231,309 (US$27,906)[3]
2005	US$ Nil	Rmb 72,282 (US$8,957)[4]

(1) Dividends paid by Yuchai to the Company, as well as to other shareholders of Yuchai, were declared in Renminbi and paid in U.S. dollars (as shown in the parentheses)

based on the exchange rates at local designated foreign exchange banks on the respective payment dates. For dividends paid for 2001, 2002, 2003, 2004 and 2005, the exchange rate used was Rmb 8.2894 = US$1.00, Rmb 8.2767 = US$1.00, Rmb 8.2767 = US$1.00, Rmb 8.2765 = US$1.00 and Rmb 8.0702 = US$1.00, respectively.

(2) The dividends declared for 2002 by Yuchai were paid to the Company in 2003 following execution of the July 2003 Agreement.

(3) The dividends declared for 2004 by Yuchai were paid to the Company in 2005 following execution of the Reorganization Agreement.

(4) On June 26, 2006, Yuchai has declared dividends to all

shareholders in respect of the financial year ended December 31, 2005 and the amount attributable to the Company is Rmb 72.3 million (US$9.0 million). This dividend was received by the Company on July 28, 2006.

Historical Exchange Rate Information

On June 30, 2006, the noon buying rate was Rmb 7.9943 = US$1.00.

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The following tables set forth certain information concerning exchange rates between Renminbi and U.S. dollars for the periods indicated:

	Noon Buying Rate[1] (Rmb per US$1.00)	
Period	**High**	**Low**
December 2005	8.0808	8.0702
January 2006	8.0702	8.0596
February 2006	8.0616	8.0415
March 2006	8.0505	8.0167
April 2006	8.0248	8.0040
May 2006	8.0300	8.0005
June 2006	8.0225	7.9943
July 2006	8.0018	7.9690

		Noon Buying Rate[1] (Rmb per US$1.00)		
Period	**Period End**	**Average**	**High**	**Low**
2001	8.2766	8.2772	8.2786	8.2763
2002	8.2800	8.2772	8.2800	8.2765
2003	8.2767	8.2771	8.2800	8.2765
2004	8.2765	8.2768	8.2774	8.2764
2005	8.0702	8.1734	8.2765	8.0702
2006 (through July 31, 2006)	7.9690	8.0200	8.0702	7.9690

(1) The noon buying rate in New York for cable transfers payable in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. Since April 1994, the noon buying rate has been based on the rate quoted by the People s Bank of China. As a result, since April 1994, the noon buying

rate and the People s Bank of China rate have been substantially similar. The People s Bank of China rate at the end of 2005 was Rmb 8.0702, compared with Rmb 8.1734 for the noon buying rate (average).

(2) Determined by averaging the rates on the last business day of each month during the relevant period.

Risk Factors

Risks relating to our company and our business

Our financial condition, results of operations, business and prospects may be adversely affected if we are unable to implement the Reorganization Agreement.

Our main operating asset is our ownership interest in Yuchai, and our primary source of cash flow continues to be our share of the dividends, if any, paid by Yuchai and investment earnings thereon. As a result of the agreement reached with Yuchai and its related parties pursuant to the July 2003 Agreement, we discontinued legal and arbitration proceedings initiated by us in May 2003 relating to difficulties with respect to our investment in Yuchai. In furtherance of the terms of the July 2003 Agreement, we, Yuchai and Coomber entered into the Reorganization Agreement in April 2005, as amended in December 2005, and agreed on a restructuring plan for our company intended to be beneficial to our shareholders (see Item 4. Information on the Company Recent Developments). No assurance can be given as to when the corporate governance requirements relating to Yuchai and the restructuring plan in respect of our ownership of Yuchai, both as contemplated by the Reorganization Agreement, will be fully implemented, or that implementation of the Reorganization Agreement will effectively resolve all of the difficulties faced by us with respect to our investment in Yuchai.

In addition, the Reorganization Agreement contemplates the continued implementation of our business expansion and diversification plan adopted in February 2005. One of the goals of this business expansion and diversification plan is to reduce our financial dependence on Yuchai. Thus far, we have acquired strategic stakes in TCL and LKN (see Item 3. Key Information and Item 4. Information on the Company Recent Developments). Nonetheless, no assurance can be given that we will be able to successfully expand and diversify our business. We may also not be able to continue to identify suitable acquisition opportunities, or secure funding to consummate such acquisitions or successfully integrate such acquired businesses within our operations. Any failure

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to implement the terms of the Reorganization Agreement, including our continued expansion and diversification, could have a material adverse effect on our financial condition, results of operations, business or prospects.

We have and may continue to experience disagreements and difficulties with the Chinese Shareholders in Yuchai.

Although we own 76.4% of Yuchai s shares, and believe we have proper legal ownership of our investment and a controlling financial interest in Yuchai, in the event there is a dispute with Yuchai s Chinese Shareholders regarding our investment in Yuchai we may have to rely on the Chinese legal system for remedies. The Chinese legal system may not be as effective as compared to other more developed countries such as the United States (see Risks relating to Mainland China The Chinese legal system embodies uncertainties which could limit the legal protections available to foreign investors). We have in the past experienced problems from time to time in obtaining assistance and cooperation of Yuchai s Chinese Shareholders in the daily management and operation of Yuchai. We have in the past also experienced problems from time to time in obtaining the assistance and cooperation of the State Holding Company in dealing with other various matters, including the implementation of corporate governance procedures, the payment of dividends, the holding of Yuchai board meetings and the resolution of employee-related matters. Examples of these problems are described elsewhere in this Annual Report. The July 2003 Agreement and the Reorganization Agreement are intended to resolve certain issues relating to our share ownership in Yuchai and the continued corporate governance and other difficulties which we have had with respect to Yuchai. As part of the terms of the Reorganization Agreement, Yuchai agreed that it would seek the requisite shareholder approval prior to entering into any material transactions (including any agreements or arrangements with parties related to Yuchai or any of its shareholders) and that it would comply with its governance requirements. Yuchai also acknowledged and affirmed CYI s continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai s board of directors. However, no assurance can be given that disagreements and difficulties with Yuchai s management and/or Yuchai s Chinese Shareholders will not recur, including implementation of the Reorganization Agreement, corporate governance matters or related party transactions (such as, for example, the Rmb 205.0 million loan from Yuchai to Yuchai Marketing and Logistics Company, see Note 5 to our company s Consolidated Financial Statements appearing elsewhere herein). Such disagreements and difficulties could ultimately have a material adverse impact on the company s consolidated financial position, results of operations and cash flows.

Our exposure to the Dongfeng Group has had, and could continue to have, a material adverse effect on our business, financial condition and results of operation.

Our sales are concentrated among the Dongfeng Group, which includes the Dongfeng Automobile Company, one of the largest state-owned automobile companies in China, and other major diesel truck manufacturers controlled by or affiliated with the Dongfeng Automobile Company. In 2005, the Dongfeng Group accounted for 19.8% of our gross sales, out of which sales to our two largest customers, Liuzhou Dongfeng Automobile and Hubei Dongfeng Automobile, accounted for 12.3%. Although we consider our relationships with the Dongfeng Group to be good, the loss of one or more of the companies within the Dongfeng Group as a customer would have a material adverse effect on our financial condition, results of operations, business or prospects.

In addition, we are dependent on the purchases made by the Dongfeng Group and have exposure to their liquidity arising from the high level of accounts receivable from them. We cannot assure you that the Dongfeng Group will be able to repay all the money they owe to us. In addition, the Dongfeng Group may not be able to continue purchasing the same volume of products from our company, which would reduce our overall sales volume.

The Dongfeng Group also competes with us in the diesel engine market in China. Although we believe that the companies within the Dongfeng Group generally make independent purchasing decisions based on end-user preferences, we cannot assure you that truck manufacturers affiliated with the Dongfeng Automobile Company will not preferentially purchase diesel engines manufactured by companies within the Dongfeng Group over those manufactured by us.

Competition in China from other diesel engine manufacturers may adversely affect our financial condition, results of operations, business or prospects.

The diesel engine industry in China is highly competitive. We compete with many other domestic companies, most of which are state-owned enterprises. Some of our competitors have formed joint ventures with or have technology assistance relationships with foreign diesel engine manufacturers or foreign engine design consulting firms and use

foreign technology that is more advanced than ours. We expect competition to intensify as a result of:

improvements in competitors products;

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increased production capacity of competitors;

increased utilization of unused capacity by competitors; and

price competition.

In addition, if import restrictions on motor vehicles and motor vehicle parts are reduced, foreign competition could increase significantly. See Risks relating to Mainland China The admission of China into the WTO could lead to increased foreign competition .

In the medium-duty diesel engine market, our 6108 medium-duty engine, introduced in 1997, has been competing with the 6110 medium-duty engine offered by our competitors. We cannot assure you, however, that we will be able to maintain or improve our current market share or develop new markets for our medium-duty diesel engines. Based on current industry trends, there is a perceived shift in the market demand from medium-duty engines to heavy-duty diesel engines. Therefore, we would expect declining sales volume of our 6108 medium-duty engines in the coming years. In 2005, we experienced lower unit sales volume of 6108 medium-duty engines due principally to the effects of the general credit tightening by banks in China.

In the heavy-duty diesel engine market, we introduced the 6112 heavy-duty engine in late 1999. Due to a delay in the commercial production of the 6112 engine; however, we were not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is price-sensitive. We commenced engine development of the 6L heavy-duty engine (formerly referred to as 6113) in 2003, with a rated power ranging from 280 to 350 horsepower, and we also introduced the 6M heavy-duty engine family for heavy-duty trucks and passenger buses, with a rated power ranging from 280 to 390 horsepower, in 2004. We had limited initial sales of 963 and 818 units of the 6L and 6M engines, respectively, in 2004. We sold 782 units of the 6L engines and 3,471 units of the 6M engines in 2005. We cannot assure you that our 6112, 6L or 6M heavy-duty engines will be able to compete successfully in the heavy-duty diesel engine market in China with the existing producers or any new entrants.

In the light-duty diesel engine market, our 4108, 4110 and 4112 light-duty engines introduced in 2000 were met with weak consumer demand due to strong competition and a high pricing structure. The 4F diesel engine is a four-cylinder, four-stroke engines with a rated power ranging from 90 to 115 horsepower. Yuchai s first sales of the 4F engines occurred in March 2005 and sold 4,510 units in 2005. Yuchai expects growth of this new engine to strengthen over the few years and become a significant contributor to sales growth for Yuchai. Yuchai produced 7,009 units of the 4F engines in 2005 and embarked upon major capital expenditures to increase the production capacity to 50,000 units per year by 2007. The expansion is expected to enable Yuchai to enter into light duty diesel engines market for light duty trucks and buses. Although there had been an increase in sales of our 4-Series engines in 2003, 2004 and 2005, this has been primarily due to the average selling price of the 4-Series engines being lower than the medium and heavy-duty diesel engines, thereby making the 4-Series more affordable to the buyers especially due to the credit tightening by banks in China. Accordingly, we cannot assure you that we will be able to continue to improve our market share for light-duty diesel engines, and we may, in the future, decide to cease production of one or more of the models we are currently producing.

Our long-term business prospects will depend largely upon our ability to develop and introduce new or improved products at competitive prices. Our competitors in the diesel engine markets may be able to introduce new or improved engine models that are more favorably received by customers. Competition in the end-use markets, mainly the truck market, may also lead to technological improvement and advances that render our current products obsolete at an earlier than expected date, in which case we may have to depreciate or impair our production equipment more rapidly than planned. Failure to introduce, or delays in the introduction of, new or improved products at competitive prices could have a material adverse effect on our financial condition, results of operations, business or prospects.

Our financial condition, results of operations, business or prospects may be adversely affected to the extent we are unable to continue our sales growth or adequately manage our growth.

We have achieved consistent growth in net sales during the last four fiscal years, with net sales increasing by 22.0% to Rmb 5,582.1 million in 2004 and by 4.4% to Rmb 5,829.4 million in 2005. We cannot assure you that we

can continue to increase our net sales or maintain our present level of net sales. For example, during 2005, we have increased production capacity to approximately 290,000 units after the completion of our second foundry and the new 6L and 6M heavy-duty engines lines, and we may not be able to increase our net sales commensurate with our increased levels of production capacity. Moreover, our future growth is dependent in large part on factors beyond our control, such as continued economic growth in China.

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In addition, we cannot assure you that we will be able to properly manage any future growth, including:

obtaining the necessary supplies;

hiring and training skilled production workers and management personnel;

manufacturing and delivering products for increased orders in a timely manner;

maintaining quality standards and prices; and

controlling production costs.

Furthermore, we have acquired in the past, and may acquire in the future, equity interests in engine parts suppliers and logistics and marketing companies. If we are unable to effectively manage or assimilate these acquisitions, our financial condition, results of operations, business or prospects could be adversely affected. See Item 4. Information on the Company Business Overview Manufacturing .

The diesel engine business in China is dependent in large part on the performance of the Chinese economy, as well as Chinese government policy. As a result, our financial condition, results of operations, business and prospects could be adversely affected by slowdowns in the Chinese economy, as well as Chinese government policies that de-emphasize the use of diesel engines.

During periods of economic expansion, the demand for trucks, construction machinery and other applications of diesel engines generally increases. Conversely, during economic slowdowns the diesel engine industry is generally adversely affected by a decline in demand. As a result, the performance of the Chinese economy will likely affect, to a significant degree, our financial condition, results of operations, business and prospects. For example, the various austerity measures taken by the Chinese government from time to time to regulate economic growth and control inflation have in prior periods significantly weakened demand for trucks in China, and may have a similar effect in the future. In particular, austerity measures that restrict access to credit and slow the rate of fixed investment (including infrastructure development) adversely affect demand for, and production of, trucks and other commercial vehicles. These adverse market conditions, together with increased competition in the diesel engine market, result in various degrees of financial and marketing difficulties for diesel engine producers, including our company.

The business and prospects for the diesel engine industry, and thus the business and prospects of our company, may also be adversely affected by Chinese government policy. For example, in 1998, the Chinese government announced a major initiative to boost consumer demand through investments in infrastructure projects and increased availability of bank credit. As a result, demand for trucks and other commercial vehicles, and thus demand for diesel engines, continued to increase from 2002 to 2004. In 2005, truck and the commercial vehicles declined by approximately 1.0%. However, we cannot assure you that the Chinese government will not change its policy in the future to de-emphasize the use of diesel engines, and any such change will adversely affect our financial condition, results of operations, business or prospects. For example, the Chinese government has recently announced measures to avoid overheating in certain sectors of the economy, which may include tight bank lending policies and increases in bank interest rates (see Risks relating to Mainland China Adverse changes in the economic policies of the Chinese government could have a material adverse effect on the overall economic growth of Mainland China, which could reduce the demand for our products and adversely affect our competitive position).

If we are not able to continuously improve our existing engine products and develop new diesel engine products, we may become less competitive, and our financial condition, results of operations, business and prospects will be adversely affected.

As the Chinese automotive industry continues to develop, we will have to continuously improve our existing engine products and develop new diesel engine products in order to remain competitive. As a result, our long-term business prospects will largely depend upon our ability to develop and introduce new or improved products at competitive prices. Future products may utilize different technologies and may require knowledge of markets that we do not currently possess. Moreover, our competitors may be able to introduce new or improved engine models that are more favorably received by customers than our products. Any failure by our company to introduce, or any delays in

the introduction of, new or improved products at competitive prices could have a material adverse effect on our financial condition, results of operations, business or prospects.

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We may be unable to obtain sufficient financing to fund our capital requirements, which could limit our growth potential.

We believe that our cash from operations, together with any necessary borrowings, will provide sufficient financial resources to meet our projected capital and other expenditure requirements. If we have underestimated our capital requirements or overestimated our future cash flows, additional financing may be required. Financing may not be available to us on acceptable terms or at all. Our ability to obtain external financing is subject to various uncertainties, including our results of operations, financial condition and cash flow, economic, political and other conditions in Mainland China, the Chinese government s policies relating to foreign currency borrowings and the condition of the Chinese and international capital markets. If adequate capital is not available, our financial condition, results of operations, business and prospects could be adversely affected.

Our controlling shareholder s interests may differ from those of our other shareholders.

Our parent company is Hong Leong Asia Ltd., or HLA, which indirectly owns 7,913,769, or 21.2%, of the outstanding shares of our common stock, as well as a special share that entitles it to elect a majority of our directors. HLA controls us through its wholly-owned subsidiary, Hong Leong (China) Limited, or HLC, and through HL Technology Systems Pte Ltd, or HLT, a wholly-owned subsidiary of HLC. HLT owns approximately 21.0% of the outstanding shares of our common stock and is the registered holder of our special share since December 1994. HLA also owns through another wholly-owned subsidiary, Well Summit Investments Limited, approximately 0.2% of the outstanding shares of our common stock since May 2005. HLA is a member of the Hong Leong group of companies. Prior to August 2002, we were controlled by Diesel Machinery (BVI) Limited, or DML, which, until its dissolution, was a holding company controlled by HLC and was the prior owner of our special share. Through HLT s stock ownership and various agreements among shareholders, HLA is able to effect most corporate transactions without the concurrence of any of our other shareholders. See Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Shareholders Agreement . In addition, our shareholders do not have cumulative voting rights. We cannot assure you that HLA s actions will be in the best interests of our other shareholders. See also Item 6. Directors, Senior Management and Employees Compensation Yuchai .

We may experience a change of control as a result of offerings of shares by our controlling shareholders.

As described above, HLT, a subsidiary of HLA, owns 7,831,169 shares of our common stock, as well as our special share. In March 2004, HLT and Coomber, each registered shares for offer and sale from time to time on a shelf registration statement which we filed on their behalf pursuant to a registration rights agreement. If HLT reduces its shareholding to less than 7,290,000 shares of our common stock as a result of such offering, our Bye-Laws provide that the special share held by HLT will cease to carry any rights, and HLA may as a result cease to have control over us. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders The Special Share . We believe that our only other significant shareholder is Coomber. If HLT sells all of the shares being registered for sale by HLT in such offering, HLT will cease to own any of our shares. As a result, we cannot determine what control arrangements will arise as a result of such offering (including changes in our management arising therefrom), or assess what effect those control arrangements may have, if any, on our financial condition, results of operations, business, prospects or share price.

We could be exposed to the impact of interest rates and foreign currency movements with respect to our future borrowings. In addition, a devaluation of the Renminbi will increase the Renminbi cost of repaying our foreign currency denominated indebtedness and, therefore, could adversely affect our financial condition, results of operations, business or prospects.

We may use borrowings from time to time to supplement our working capital requirements and to finance our business expansion and diversification plans (See also Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources). A portion of our borrowings may be structured on a floating rate basis and denominated in U.S. dollars or other foreign currencies. An increase in interest rates, or fluctuations in exchange rates between the Renminbi and other currencies, may increase our borrowing costs or the availability of funding and could affect our financial condition, results of operations, business or prospects. In particular, our financial condition, results of operations, business or prospects could be adversely affected by a devaluation of the Renminbi.

The value of the Renminbi is subject to changes in Chinese government policies and to international economic and political developments. Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People s Bank of China. The official exchange rate for the conversion of Renminbi into U.S. dollar has generally been stable during the past ten years. On July 21, 2005, China reformed its foreign exchange regime by moving into a managed floating exchange rate system based on market supply and demand with reference to a basket of currencies. Renminbi would no longer be pegged to the U.S. dollar. From that day to December 31, 2005, Renminbi appreciated about 2.5% against the U.S. dollar, and has appreciated slightly further since then. Substantially all of our operating revenue is denominated in Renminbi, while a major portion of our capital expenditures is denominated in U.S. dollars and Euros. An appreciation of Renmimbi against the U.S. dollar and other currencies

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would also result in foreign currency translation losses for financial reporting purposes when we translate our U.S. dollar or other foreign currency denominated financial assets into Renmimbi, as Renmimbi is our reporting currency. Since we may not be able to hedge effectively against Renminbi devaluations, future movements in the exchange rate of Renminbi and other currencies could have an adverse effect on our financial condition and results of operations.

We may be adversely affected by environmental regulations.

We are subject to Chinese national and local environmental protection regulations which currently impose fees for the discharge of waste substances, require the payment of fines for pollution, and provide for the closure by the Chinese government of any facility that fails to comply with orders requiring us to cease or improve upon certain activities causing environmental damage. Due to the nature of our business, we produce certain amounts of waste water, gas, and solid waste materials during the course of our production. We believe our environmental protection facilities and systems are adequate for us to comply with the existing national, provincial, and local environmental protection regulations. However, Chinese national, provincial, or local authorities may impose additional or more stringent regulations which would require additional expenditure on environmental matters or changes in our processes or systems.

Our insurance coverage may not be adequate to cover risks related to our production and other operations.

The amount of our insurance coverage for our buildings and equipment is at cost which could be less than replacement value, and we have no plans to increase the coverage. The amount of our insurance coverage for our inventory is at book value which could be less than replacement value, and we also have no plans to increase this coverage. In accordance with what we believe is customary practice among industrial equipment manufacturers in China, we insure only high risk assets, such as production property and equipment and certain inventory. However, our underinsurance of other properties, facilities and inventory in accordance with this Chinese practice exposes us to substantial risks so that in the event of a major accident, our insurance recovery may be inadequate. We do not currently carry third party liability insurance to cover claims in respect of bodily injury, property or environmental damage arising from accidents on our property or relating to our operations. We also do not carry business interruption insurance as such coverage is not customary in China. Losses incurred or payments required to be made by us which are not fully insured could have a material adverse effect on our financial condition.

The market price for our common stock may be volatile.

In recent periods, there has been volatility in the market price for our common stock. The market price could fluctuate substantially in the future in response to a number of factors, including:

our interim operating results;

the public s reaction to our press releases and announcements and our filings with the Securities and Exchange Commission, or SEC;

changes in financial estimates or recommendations by stock market analysts regarding us, our competitors or other companies that investors may deem comparable;

operating and stock price performance of our competitors or other companies that investors may deem comparable;

changes in general economic conditions;

future sales of our common stock in the public market, or the perception that such sales could occur;

the announcement by us or our competitors of a significant acquisition; and

increases in labor and other costs.

Recent market activity of our stock price on the New York Stock Exchange, or NYSE, has been unpredictable. See Item 9. The Offer and Listing below. We cannot assure you that such volatility in the trading price and volume for our

shares will stabilize in the future. In addition, in recent years, the stock market in general has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to their operating performance. These broad market fluctuations may materially adversely affect our stock price.

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Risks relating to Mainland China

Substantially all of our assets are located in Mainland China, and substantially all of our revenue is derived from our operations in Mainland China. Accordingly, our financial condition, results of operations, business or prospects are subject, to a significant degree, to economic, political and legal developments in Mainland China. The economic system of Mainland China differs from the economies of most developed countries in many respects, including government investment, the level of development, control of capital investment, control of foreign exchange and allocation of resources.

Adverse changes in the economic policies of the Chinese government could have a material adverse effect on the overall economic growth of Mainland China, which could reduce the demand for our products and adversely affect our competitive position.

Since the late 1970s, the Chinese government has been reforming the Chinese economic system from a planned economy to a market-oriented economy. In recent years, the Chinese government has implemented economic reform measures emphasizing decentralization, utilization of market forces in the development of the Chinese economy and a higher level of management autonomy. These reforms have resulted in significant economic growth and social progress, but the growth has been uneven both geographically and among various sectors of the economy. Economic growth has also been accompanied by periods of high inflation. The Chinese government has implemented various policies from time to time to restrain the rate of such economic growth, control inflation and otherwise regulate economic expansion. For example, the Chinese government has announced that it is considering introducing measures on certain sectors to avoid overheating of the economy, which may include tighter bank lending policies, increases in bank interest rates, and measures to curb speculation. In addition, the Chinese government has also in the past attempted to control inflation by controlling the prices of basic commodities. Severe measures or other actions by the Chinese government, such as placing additional controls on the prices of diesel and diesel-using products, could restrict our business operations and adversely affect our financial position. Although we believe that the economic reforms and macroeconomic policies and measures adopted by the Chinese government will continue to have a positive effect in the longer term on economic development in Mainland China and that we will continue to benefit in the longer term from these policies and measures, these policies and measures may, from time to time, be modified or reversed. Adverse changes in economic and social conditions in Mainland China, in the policies of the Chinese government or in the laws and regulations in Mainland China, could have a material adverse effect on the overall economic growth of Mainland China and in infrastructure investment in Mainland China. These developments could adversely affect our financial condition, results of operations and business, by reducing the demand for our products, for example.

Adverse economic developments in China or elsewhere in the Asian region could have a material adverse effect on our financial condition, results of operations, business or prospects.

Since the late 1990s, many Asian countries have experienced significant changes in economic conditions, including, for example, substantial depreciation in currency exchange rates, increased interest rates, reduced economic growth rates, corporate bankruptcies, volatility in the market values of shares listed on stock exchanges, decreases in foreign currency turnover and government-imposed austerity measures. To date, China s economy has generally been affected to a lesser extent than most other major Asian countries. However, we cannot assure you that China s economy will not suffer more serious difficulties in the future. Demand for trucks, construction machinery and other applications of diesel engines generally increases during periods of economic expansion and decreases during periods of economic slowdown. In the event that adverse economic developments occur in China, our sales may decrease and our financial condition, results of operations, business or prospects could therefore suffer.

The Chinese legal system embodies uncertainties which could limit the legal protections available to foreign investors.

The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the Chinese government began to promulgate a comprehensive system of laws and regulations governing economic matters in general including, for example, with respect to corporate organization and governance, foreign investments, commerce, taxation and trade. Legislation over the past 25 years has significantly enhanced the protections afforded to various forms of foreign

investment in Mainland China. However, these laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties which may limit the legal protections available to foreign investors.

At the National People s Congress held in March 2006, the Chinese government confirmed it intends to continue to implement a prudent fiscal and monetary policy so as not to over stimulate domestic demand. The Chinese government has also on various occasions reiterated its policy of furthering reforms in the socialist market economy and to increase the wealth of the rural population

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through development and subsidies programs. No assurance can be given that these changes will not have an adverse effect on business conditions in China generally or on our business in particular.

We may not freely convert Renminbi into foreign currency, which could limit our ability to obtain sufficient foreign currency to satisfy our foreign currency requirements or to pay dividends to shareholders.

Substantially all of our revenues and operating expenses are generated by our Chinese operating subsidiary and are denominated in Renminbi, while a portion of our capital expenditures and indebtedness is, or in the future may be, denominated in U.S. dollars and other foreign currencies. The Renminbi is currently freely convertible under the current account , which includes dividends, trade and service-related foreign exchange transactions, but not under the capital account , which includes foreign direct investment, except with the prior approval of the State Administration for Foreign Exchange, or SAFE.

Our Chinese operating subsidiary, as a foreign invested enterprise, may purchase foreign currency without the approval of SAFE for settlement of current account transactions , including payment of dividends, by providing commercial documents evidencing these transactions. Our Chinese operating subsidiary may also retain foreign exchange in its current account (subject to a cap approved by SAFE) to satisfy foreign currency liabilities or to pay dividends. However, the relevant Chinese government authorities may limit or eliminate our Chinese operating subsidiary s ability to purchase and retain foreign currencies in the future. Our Chinese operating subsidiary, therefore, may not be able to obtain sufficient foreign currency to satisfy its foreign currency requirements to pay dividends to us for our use in making any future dividend payments or to satisfy other foreign currency payment requirements. Foreign currency transactions under the capital account are still subject to limitations and require approvals from SAFE. This could affect our Chinese operating subsidiary s ability to obtain foreign currency through debt or equity financing, including by means of loans or capital contributions from us.

The admission of China into the WTO could lead to increased foreign competition.

As a result of China becoming a member of the WTO, import restrictions on both motor vehicle components, including diesel engines and motor vehicles, are expected to be gradually reduced. The WTO also requires China to lower its import tariffs as a condition for membership. Reduced import restrictions and/or lower tariffs may lead to increased imports of foreign diesel engines and therefore lead to increased competition in the domestic diesel engine markets. Similarly, reduced import restrictions and/or lower tariffs on automobiles may affect the competition in the end-use markets of our customers and indirectly affect our sales to such customers. Currently, China is encouraging foreign investments into the motor vehicle engine manufacturing industry.

Outbreaks of infectious diseases, such as severe acute respiratory syndrome (SARS) and the bird flu, in various parts of China and other countries may materially and adversely affect our business and operations, as well as our financial condition and results of operations.

In 2003, several countries, including China, experienced an outbreak of a highly contagious form of atypical pneumonia known as severe acute respiratory syndrome, or SARS, which severely restricted the level of economic activity in affected areas, including Beijing and Guangdong Province. The SARS epidemic in China had an adverse impact on the sale of engines, particularly during the second and third quarters in 2003. Although this SARS outbreak was brought under control during 2003, there have been a number of cases reported in China and elsewhere in the Asia region since that outbreak. Most recently, an infectious strain of influenza known as the bird flu has also been reported from time to time in China, Hong Kong and other parts of Asia. Outbreaks of infectious diseases such as these could adversely affect general commercial activity, which could have a material adverse effect on our financial condition, results of operations, business or prospects.

ITEM 4. INFORMATION ON THE COMPANY.

History and Development

The Company

The Company is a Bermuda holding company established in April 1993 to own a controlling interest in Yuchai. The Company currently owns, through six wholly-owned subsidiaries, 76.4% of the outstanding common shares of Yuchai (Yuchai Shares). The Company operates under The Companies Act 1981 of Bermuda. The principal executive office of the Company is located at 16 Raffles Quay #26-00, Hong Leong Building, Singapore 048581. The Company s telephone number is (+65) 6220-8411.

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Until August 2002, the Company was controlled by Diesel Machinery (BVI) Limited (DML), a company that was 53.0% owned by Hong Leong Asia Ltd. (HLA) through its wholly-owned subsidiary, Hong Leong (China) Limited (HLC). HLC owns HL Technology Systems Pte Ltd (HLT), which held shares in the Company through DML. DML was also 47.0% owned by China Everbright Holdings Company Limited (EB Holdings) through its wholly-owned subsidiary, Coomber Investments Ltd. (Coomber). HLA, a company listed on the Singapore Exchange Securities Trading Limited (Singapore Exchange) is part of the Hong Leong Group Singapore, which was founded in 1941 by the Kwek family of Singapore and is one of the largest privately-controlled business groups in Southeast Asia. EB Holdings is a state-owned enterprise of China. In 2002, EB Holdings and Coomber gave notice to DML and its other shareholders of DML to effect a liquidation of DML. As a result of the liquidation, HLA acquired the special share of the Company through HLT which entitles HLA to elect a majority of the directors of the Company and veto any resolution of shareholders of the Company. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders . EB Holdings sold its shareholding in Coomber, which held shares in the Company, in October 2002 to Goldman Industrial Limited (Goldman), and EB Holdings is no longer a shareholder of the Company. Goldman is a subsidiary of Zhong Lin Development Company Limited (Zhong Lin), an investment vehicle of the city government of Yulin in Guangxi, China. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders .

Through the Company, HLA provides certain management, financial planning and other services to Yuchai and has designated one financial controller to work full-time at Yuchai s principal manufacturing facilities in Yulin City as part of Yuchai s day-to-day management team.

To the Company s knowledge, since January 1, 2005, there have not been any public takeover offers by third parties in respect of the Company s shares, nor has the Company made any public takeover offers in respect of the shares of other companies.

Minority Investments

The Company s main operating asset has historically been its ownership interest in Yuchai, and its primary source of cash flow has historically been its share of the dividends, if any, paid by Yuchai and investment interest thereon. However, on February 7, 2005, the board of directors of the Company announced its approval of the implementation of a business expansion and diversification plan by the Company. Pursuant to this plan, the Company has looked for new business opportunities to seek to reduce its financial dependence on Yuchai.

TCL

The first step in implementing this plan occurred in March 2005, through the acquisition by the Company s wholly-owned subsidiary, Venture Delta Limited (VDL), of an approximate 14.99% stake comprising 264.0 million newly-issued shares in TCL, for approximately S$30.9 million (approximately $18.9 million, based on an exchange rate of S$1.637 to $1.00).

On August 5, 2005, the Company through VDL agreed to acquire an additional 17.8 million shares in TCL, representing approximately 1% stake in the total number of TCL shares in issue for approximately S$1.4 million (approximately US$0.86 million based on an exchange rate of S$1.63). This acquisition was completed on September 5, 2005.

A call option granted to certain members of the Thakral family pursuant to a scheme of arrangement dated October 24, 2001 relating to TCL. The call option granted to the Thakral family expired on March 26, 2006.

On February 16, 2006, pursuant to a right issue, the Company through VDL was allotted 87,860,288 newly issued TCL Shares and 52,933,440 convertible bonds in TCL, for an aggregate cash consideration of S$49.4 million (US$30.2 million). With this acquisition, the Company has increased its beneficial shareholding in TCL from its level then of 15.99% to 19.36% of the enlarged TCL Shares in issue (assuming no conversion of bonds and exercise of share options of TCL). The Company believes that through VDL it is currently the second largest shareholder in TCL.

Since February 16, 2006, there has been some conversion of bonds by other bondholders of TCL. This resulted in a minor dilution of the Company s indirect interest in TCL from approximately 19.36% to 19.25%. As of June 30, 2006, the Company beneficially owns:

(a) an aggregate of 369,655,952 shares representing approximately 19.25% of the total number of ordinary shares in issue in the capital of TCL; and

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(b) an aggregate of 52.9 million unsecured 2% convertible bonds due 2009 in the denomination of S$0.80 each issued by TCL, which are capable of being converted into an aggregate of 529.3 million new TCL shares, representing approximately 20.2% of TCL s enlarged issued share capital.

If the Company exercises its right through VDL to convert the 52.9 million TCL bonds owned by it into new TCL shares, this will result in an increase of the Company s effective shareholding in TCL to an aggregate of 898.99 million shares, representing approximately 34.4% of the total number of TCL shares outstanding following such conversion. In such event, the Company would be required under the Singapore Code on Take-overs and Mergers to make mandatory conditional cash offers for all the TCL bonds not already owned, controlled or agreed to be acquired by the Company at the price of S$0.08 for each TCL share and S$0.80 for each TCL bond. TCL s share price on the Singapore Exchange closed at S$0.08 on June 30, 2006.

TCL s principal businesses include trading and distribution of consumer electronics products and accessories in China and Hong Kong; distribution of home entertainment products in China; and assembly of electronic products and electronic manufacturing services in China. TCL is listed on the Main Board of the Singapore Exchange. TCL has an established presence in China and the Company believes that TCL is well placed to capitalize on China s expanding economy. In addition, the Company believes that TCL could offer a platform to the Company for further expansion in the consumer electronics sector in China and other parts of Asia, given TCL s distribution and supply chain management business model in China.

TCL currently has ten directors on its board, of which three directors were nominated by the Company. The Company accounts for its investment in TCL using the equity method beginning March 23, 2005 in view that the Company has a significant board representation in TCL and hence believes that it has the ability to exercise significant influence over TCL.

LKN

In early February 2006, the Company through its following wholly-owned subsidiaries acquired debt and equity in LKN for an aggregate consideration of approximately S$131.6 million (approximately US$81.2 million, based on an exchange rate of S$1.62 to US$1.00):

Grace Star Services Ltd. (Grace Star) acquired 191,413,465 ordinary shares representing approximately 29.13% of the total number of ordinary shares in issue, and 123,010,555 redeemable convertible preference shares (the Existing LKN RCPS), in the capital of LKN; and

Venture Lewis Limited (Venture Lewis) acquired approximately S$129.4 million (approximately US$79.9 million, based on an exchange rate of S$1.62 to US$1.00) in principal amount of outstanding secured non-convertible bonds (the Existing LKN Bonds) issued by LKN.

On July 4, 2006, pursuant to a rights issue, the Company through its subsidiaries was allotted 196,201,374 non-redeemable convertible cumulative preference shares in the capital of LKN (the New LKN NCCPS) and 130,800,917 zero coupon unsecured non-convertible bonds due 2009 in LKN, for an aggregate consideration of approximately S$134.7 million (the New LKN Bonds). The consideration was satisfied by offsetting against the money from the full redemption by LKN of the Existing LKN Bonds and the balance by cash. LKN had also made partial redemption of the Existing LKN RCPS. As of to date, the Company holds (i) 191,413,465 ordinary shares representing approximately 29.13% of the total number of ordinary shares in issue; (ii) 114,366,772 Existing LKN RCPS; (iii) 196,201,374 New LKN NCCPS; and (iv) 130,800,917 New LKN Bonds in LKN.

LKN is also listed on the Main Board of the Singapore Exchange. LKN is primarily engaged in the business of investment holding, and the principal business activities of LKN s subsidiaries are those of hospitality-related businesses in Asia. LKN s share price on the Singapore Exchange closed at S$0.04 on June 30, 2006.

Assuming full conversion of (i) the Existing LKN RCPS and (ii) the New LKN NCCPS in LKN, the Company s effective interest in LKN could be expected to increase from the current 29.1% to 51.7%. The acquisition of the debt and equity in LKN by the Company is not expected to have any material impact on the earnings per share and the net tangible assets of the Company and its subsidiaries.

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In order to finance the acquisition of shares and bonds in TCL and LKN, as well as other strategic acquisitions which the Company may consider from time to time as part of its business diversification strategy, in February 2005, the Company issued $25.0 million in principal amount of convertible bonds due 2012 in a private placement. Consequent upon the conversion of the convertible bonds by the bondholders, 1,927,673 shares of common stock of US$0.10 per share of the Company were issued in June 2005. In March 2005, September 2005, January 2006 and March 2006, the Company also entered into credit facilities for $25.0 million, $50.0 million, S$60.0 million (approximately $37.04 million, based on an exchange rate of S$1.59 to US$1.00) and S$110.0 million (approximately $69.18 million, based on an exchange rate of S$1.62 to US$1.00), respectively, with banks in Singapore. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources .

Yuchai

Notwithstanding the Company s business expansion plans and minority investments described above, the Company s main operating asset continues to be its ownership interest in Yuchai. The following is primarily a discussion of the business of Yuchai.

Yuchai is one of the largest medium-duty diesel engine manufacturers in China and also produces diesel power generators and diesel engine parts. Yuchai is located in Yulin City, Guangxi Zhuang Autonomous Region in southern China, approximately 280 miles west of Hong Kong. With a population of approximately 3.0 million, greater Yulin City is believed to be the sixth largest city in Guangxi Zhuang Autonomous Region.

Yuchai was founded in 1951 and became a state-owned enterprise in 1959. Prior to 1984, Yuchai was a small producer of low-power diesel engines for agricultural machinery. In 1984, Yuchai introduced the earliest model of its 6105 medium-duty diesel engine for medium-duty trucks. In 1989, Yuchai became one of China s 500 largest industrial enterprises in terms of profitability and tax contribution. In July 1992, in order to raise funds for further expansion, Yuchai became the first state-owned enterprise in the Guangxi Zhuang Autonomous Region to be restructured into a joint stock company.

As a result of this restructuring, Yuchai was incorporated as a joint stock company in July 1992 and succeeded to the machinery business of Yulin Diesel, and all of Yulin Diesel s businesses, other than its machinery business, as well as certain social service related operations, assets, liabilities and employees (for example, cafeterias, cleaning and security services, a hotel and a department store), were transferred to the State Holding Company. The State Holding Company also became the majority shareholder of Yuchai through its ownership stake of approximately 104 million shares of Yuchai (State Shares). The State Holding Company is owned by the Guangxi local government. In connection with its incorporation, Yuchai also issued 7 million shares to various Chinese institutional investors (Legal Person Shares).

In May 1993, in order to finance further expansion, Yuchai sold shares to the Company (Foreign Shares) and became a Sino-foreign joint stock company.

The initial shareholders of the Company, consisting of HLT, Sun Yuan Overseas (BVI) Ltd. (Sun Yuan BVI), the Cathay Investment Fund, Limited (Cathay), GS Capital Partners L.P. (GSCP) and Coomber, then a wholly-owned subsidiary of EB Holdings and, thus, controlled by China Everbright International Limited (China Everbright), made their initial investments in Yuchai in May 1993, when their respective wholly-owned subsidiaries purchased for cash 200 million newly-issued shares (51.3% of the then-outstanding Yuchai Shares). These shareholders exchanged with the Company their shareholdings in their wholly-owned subsidiaries, six companies which held Foreign Shares of Yuchai, for 20 million shares of the Company s Common Stock (after giving effect to a 10-for-1 stock split in July 1994 (the Stock Split)). In connection therewith, Yuchai became a Sino-foreign joint stock company and became subject to the laws and regulations relating to joint stock limited liability companies and Sino-foreign joint venture companies in China. Foreign Shares may be held by and transferred to non-Chinese legal and natural persons, subject to approval of the Ministry of Commerce (MOC), the successor entity of the Ministry of Foreign Trade and Economic Cooperation of China (MOFTEC). Foreign Shares are entitled to the same economic rights as State Shares and Legal Person Shares. State Shares are shares purchased with state assets by government departments or organs authorized to represent state investment. Legal Person Shares are shares purchased by Chinese legal persons or institutions or social groups with legal person status and with assets authorized by the state for use in business.

In November 1994, the Company purchased from an affiliate of China Everbright 78,015,500 Foreign Shares in exchange for the issuance of 7,801,550 shares of Common Stock (after giving effect to the Stock Split) (the China Everbright Purchase). The 78,015,500 Foreign Shares of Yuchai held by Earnest Assets Ltd, a subsidiary of EB Holdings and China Everbright before its sale to the Company, had been originally issued as Legal Person Shares and State Shares and were converted to Foreign Shares, pursuant to approvals granted by MOFTEC. As a result, the Company became the owner of each of these six companies: Hong Leong Technology

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Systems (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd., Cathay Diesel Holdings Ltd., Goldman Sachs Guangxi Holdings (BVI) Ltd., Youngstar Holdings Ltd. and Earnest Assets Ltd.

In December 1994, the Company sold 7,538,450 shares of Common Stock in its initial public offering (IPO) and used substantially all of the proceeds to finance its six wholly-owned subsidiaries purchase of 83,404,650 additional Foreign Shares from Yuchai.

In connection with the Company s purchase, through its six wholly-owned subsidiaries, of additional Foreign Shares from Yuchai with proceeds of its IPO, Yuchai offered additional shares pro rata to its other existing shareholders (30 shares for each 100 shares owned) in accordance with such shareholders pre-emptive rights, and each of the Company s subsidiaries was able to acquire these additional Yuchai Foreign Shares. Such pro rata offering (including the offering to the Company) is referred to herein as the Yuchai Offering . Certain Legal Person shareholders subscribed for additional shares in the Yuchai Offering. The State Holding Company informed Yuchai at the time that it would not subscribe for any of its portion of Yuchai Shares (31,345,094 shares) in the Yuchai Offering. In order to obtain MOFTEC approval of the Yuchai Offering, the State Holding Company was given the right by Yuchai s Board of Directors to subscribe for approximately 31 million shares of Yuchai at a price of Rmb 6.29 per share at any time prior to December 1998. This was because provisional regulations of the State Administration Bureau of State Property (SABSP) and the State Committee of Economic System Reform (SCESR), published in November 1994, imposed on any holder of state-owned shares certain obligations to protect its interest in any share offering. Under such regulations, the State Holding Company could have been required to subscribe for Yuchai Shares in the Yuchai Offering. Yuchai s shareholders subsequently agreed to extend the duration of such subscription right to March 31, 2002 (the exercise of which would have reduced the Company s ownership of Yuchai from 76.4% to 71.7%). The State Holding Company informed the shareholders of Yuchai that it had determined not to subscribe for additional Yuchai Shares and this determination was minuted by the Yuchai Board of Directors on November 1, 2002. However, given the November 1994 provisional regulations of the SABSP and the SCESR, the SABSP, the SCESR and/or the MOC may take action against the State Holding Company, and there can be no assurance that any such action would not, directly or indirectly, have a material adverse effect on Yuchai or the Company.

Recent Developments

On February 7, 2005, the board of directors of the Company announced its approval of the implementation of a business expansion and diversification plan by the Company. Pursuant to this plan, the Company has looked for new business opportunities to seek to reduce its financial dependence on Yuchai, which has historically been the Company s main operating asset. The directors of the Company believe that the Company s plans for expansion can be best met through acquisition opportunities in the greater China region and elsewhere in Asia. The board believes that acquisitions particularly in the greater China region can offer synergies with the Company s existing Chinese operations. For description of the two minority investments made by the Company to date under this business expansion and diversification plan. See Minority Investments .

On April 7, 2005, the Company entered into the Reorganization Agreement with Yuchai and Coomber, which is intended to be in furtherance of the terms of the July 2003 Agreement. The terms of the Reorganization Agreement have also been acknowledged and agreed to by the State Holding Company. The Reorganization Agreement provides for the implementation of corporate governance guidelines approved by the directors and shareholders of Yuchai in November 2002 and outlines steps for the adoption of corporate governance practices at Yuchai conforming to international custom and practice. Pursuant to the Reorganization Agreement, Yuchai also acknowledged and affirmed the Company s continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai s board of directors.

The Reorganization Agreement outlines a broad framework for restructuring the Company s ownership of Yuchai. The restructuring exercise contemplates the transfer of the Company s approximate 76.4% interest in Yuchai to a new company to be organized under Bermuda law (Newco) in exchange for shares of Newco and distribution of Newco s shares to the shareholders of the Company, subject to the successful implementation of the business diversification plan by the Company. No portion of the distribution is intended to be made in respect of the special share in the Company held by HLA, and Newco s capital structure is not intended to provide for any special share comparable to the existing special share in the Company. The Company is expected to be recapitalized or restructured as may be

necessary in order to maintain its listing on the NYSE. Therefore, the Company has executed its business diversification plan to seek to acquire assets or businesses of such size and sufficient historical operating results to permit such continued listing.

The Reorganization Agreement also provides that the Company may, if necessary to maintain its listing, retain up to 10 million Newco shares or approximately 22.0% of Newco s capital. If the Company does retain such Newco shares, then, subject to any necessary approval by the shareholders of the Company (i) the Company would grant to Coomber an irrevocable proxy to vote such

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shares for the election of directors to the board of Newco for such time as the Company owns those shares, and (ii) Newco and the Company would enter into a registration rights agreement to permit the Company to sell such shares to the public at such times as the Company determines that the sale of such shares would not affect the listing of the Company s shares on the NYSE.

Subsequent to the execution of the Reorganization Agreement (see Item 19. Exhibits Exhibit 4.12), a number of steps have been taken by the parties thereto towards its implementation. For example, Yuchai s directors and shareholders have confirmed that the amendments to Yuchai s Articles of Association and corporate governance guidelines required to be adopted by Yuchai pursuant to the Reorganization Agreement have been ratified and implemented, and that steps are being taken to have such amendments and guidelines approved by the relevant Chinese authorities. Yuchai has also paid a consultancy fee of US$1.5 million to the Company. Yuchai has also declared and paid dividends to its shareholders for profits earned in the financial years ended December 31, 2003 and 2004, resulting in the Company receiving dividends of Rmb 231.3 million (US$27.9 million, based on an exchange rate of Rmb 8.29 to US$1.00), following which the Company declared dividends representing approximately 50% of the amount of dividends paid to the Company by Yuchai, as contemplated in Section 1.5(c) of the Reorganization Agreement. On June 26, 2006, Yuchai has declared dividends payable to the Company of Rmb 72.3 million (US$9.0 million) in respect of the financial year ended December 31, 2005 and this will be paid by July 31, 2006.

Pursuant to Clause 1.8 of the Reorganization Agreement, Yuchai is obligated to pay US$20.0 million within five business days of the issuance of the Company s audited consolidated financial statements for the year ended December 31, 2004. The due date for such payment under the Reorganization Agreement was June 24, 2005, which has been subsequently extended pursuant to the Reorganization Agreement Amendment (No. 1) described below.

Completion of the transactions contemplated by the Reorganization Agreement is subject to various conditions, including the receipt of all required regulatory and shareholder approvals. On December 2, 2005, the Company entered into a Reorganization Agreement Amendment (No. 1) with Yuchai and Coomber; the terms of which were acknowledged and agreed by the State Holding Company. The Reorganization Agreement, as amended, includes an extension for the term of the Reorganization Agreement from December 31, 2005 to December 31, 2006 and the date of payment by Yuchai of the abovementioned US$20.0 million to the earlier of (i) the date of the completion of certain transactions described in Clause 2.6 of the Reorganization Agreement; and (ii) December 31, 2006.

Given that the expiration date for the Reorganization Agreement has been extended through December 31, 2006, Yuchai has advised the Company that it has notified Credit Suisse that the appointment of Credit Suisse as financial advisor to Yuchai has been terminated pending Yuchai s ongoing review of the implementation of the corporate reorganization contemplated in the Reorganization Agreement.

Business Overview

Product Development

Overview

The general market demand for trucks and buses has contributed to Yuchai s significant growth since 2001, with the continued expansion of the highways and toll roads in China. The Company expects heavy-duty trucks to become an increasingly important means of freight transportation as road conditions and infrastructure in China improve. Both medium-duty and heavy-duty trucks are increasingly fitted with diesel engines because of their higher power, fuel efficiency and reliability as compared to gasoline engines. In addition, the Chinese government had announced as a policy objective in 1994 that motor vehicles weighing five tons or more should principally have diesel engines after 2000.

To take advantage of anticipated growth in demand for diesel engines in China, Yuchai substantially expanded its manufacturing facilities from their production capacity of 37,000 units of medium-duty diesel engines in 1993 to approximately 120,000 units of light-duty diesel engines, 120,000 units of medium-duty diesel engines and 50,000 units of heavy-duty diesel engines in 2005. In response to the introduction of high power medium-duty engines introduced by its competitors in 1995, Yuchai began commercial production of the 6108 medium-duty engine in the third quarter of 1997. In addition, Yuchai began trial production of its 4-Series engines (as defined in 4-Series Light-Duty Diesel Engines below) in late 1999 and commenced commercial production of these engines in 2000. Due to strong competition, quality defects and a high pricing structure, sales of the 4-Series engines were weak in 2000,

but improved in following years with the total number of units sold reaching 20,735 units, 46,022 units, 71,562 units and 103,598 units in 2002, 2003, 2004 and 2005, respectively. Yuchai also commenced trial marketing of the 6112 heavy-duty engine in early 1999 and began commercial production of these engines in the second half of 1999. The quality of the 6112 engine has improved significantly due to the improvements made in the past five years, which the Company believes has translated into higher sales. In

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addition, continued economic growth in China, together with the development of new highway infrastructure, has resulted in greater demand for long-haul, heavy-duty trucks. As a result, sales of the 6112 engine increased from 15,371 units in 2002 to 20,472 units in 2003, 24,073 units in 2004 but declined to 14,788 units in 2005 due to shrinking demand arising from the Chinese Government s macroeconomic cooling-off measures. The Company also commenced engine development work on its new heavy-duty 6L and 6M engines in 2003. In 2003, 2004 and 2005, Yuchai sold 62 units, 963 units and 782 units of the 6L engine, respectively. In addition, 818 units and 3,471 units of the 6M engine were sold in 2004 and 2005, respectively. Due mainly to the credit tightening by buyers in China, there are more customers buying the 4-Series light-duty engines because the average selling price of the light-duty diesel engine is lower than the medium and heavy-duty diesel engines.

6105 Medium-Duty Diesel Engines

The 6105 medium-duty engine was historically Yuchai s primary product and was principally installed in medium-duty trucks. However, in response to the introduction of high-power medium-duty engines by its competitors in 1995, Yuchai has been increasing its production and sales efforts on the 6108 medium-duty engine. In 2002, Yuchai produced 39,644 units of the 6105 engine representing 27.4% of Yuchai s total production volume of 144,463 units for that year. Yuchai produced 43,325 units of the 6105 engine in 2003, representing 24.0% of total production volume of 180,423 units. In 2004, Yuchai produced 55,910 units of the 6105 engine representing 24.4% of total production volume of 229,210 units. In 2005, Yuchai produced 70,052 units of the 6105 engine representing 29.2% of total production volume of 240,061 units. A significant driver of these production increases has been continuing demand for agricultural machinery equipment in China. See Products Medium-Duty Diesel Engines 6105 Engines .

6108 Medium-Duty Diesel Engines

The 6108 medium-duty engine is an overall improvement over the 6105 medium-duty engine. In particular, the Company expects the 6108 engine to enhance Yuchai s competitiveness in the medium-duty diesel engine market in China. In 2002, 2003 and 2004, unit sales of the 6108 engine exceeded unit sales of the 6105 engine. However, unit sales of the 6108 engines was less than the 6105 engines in 2005 due to poor market demand for the 6108 engines, due mainly to increased pricing arising from conversion to Euro III environmental standards. See Products Medium-Duty Diesel Engines 6108 Engines .

Yuchai produced 61,950 units of the 6108 engine in 2002, representing 42.9% of Yuchai s total production volume of 144,463 units for the year. In 2003, Yuchai produced 64,054 units of the 6108 engine, representing 35.5% of Yuchai s total production volume of 180,423 units. In 2004, Yuchai produced 62,394 units of the 6108 engine, representing 27.2% of Yuchai s total production volume of 229,210 units. In 2005, Yuchai produced 35,627 units of the 6108 engine, or 14.8% of Yuchai s total production volume of 240,061 units for the year.

6112 Heavy-Duty Diesel Engines

In 1992, Yuchai purchased from an affiliate of Ford Motor Company in Brazil the production line machinery for manufacturing 6112 heavy-duty engines and moved the production line machinery to a factory in China (the 6112 Engine Factory). The facilities were designed to have a production capacity of approximately 50,000 units of the 6112 engine per year and could support production of medium-duty engines when necessary. In addition, the facilities could also perform product testing, production equipment repair and maintenance, factory automation and other support functions.

The 6112 Engine Factory was completed in 1995 and commercial production was scheduled to commence in late 1997. However, primarily as a result of the unreliable quality of key engine components supplied by domestic component manufacturers, the 6112 engine encountered significant technical problems during initial road testing, and did not perform satisfactorily under harsh environmental conditions. Yuchai was able to resolve these technical problems and commence trial marketing of the 6112 engine in early 1999. Commercial production of these engines began in the second half of 1999. Due to the delay in commencement of commercial production, however, Yuchai was not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Consequently, the volume of sales of the 6112 engine had been lower than previously expected. However, during 2002, sales of the 6112 engine had increased steadily to over 1,000 units per month, reaching 15,371 units in 2002. This higher level of customer acceptance of the 6112 engine had led to unit sales of 20,472 engines in 2003 which was an increase of 33.2% over 2002. In 2004, Yuchai further sold 24,073 units, which represented an increase of 17.6%

over 2003. In 2005, Yuchai sold 14,788 units, which represented a decrease of 38.6% over 2004 due to shrinking demand arising from the Chinese Government s macroeconomic cooling-off measures. See Products Heavy-Duty Diesel Engines .

Yuchai produced 17,201 units of the 6112 engine in 2002, representing 11.9% of Yuchai s total production volume of 144,463 units for that year. In 2003, Yuchai produced 22,024 units of the 6112 engine, representing 12.2% of Yuchai s total production

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volume of 180,423 units. In 2004, Yuchai produced 27,410 units of the 6112 engine, representing 12.0% of Yuchai s total production volume of 229,210 units. In 2005, Yuchai produced 15,990 units of the 6112 engine, or 6.7% of total production volume of 240,061 units for the year.

6L Heavy-Duty Diesel Engines

The 6L heavy-duty engine (formerly referred to as 6113) is a six-cylinder, four-stroke, turbocharged intercooling engine, with a rated power ranging from 280 to 350 horsepower. The 6L heavy-duty engine was co-developed with FEV, an independent German-owned engine development institute for big passenger buses. Yuchai s first sales of the 6L engine occurred in November 2003. In 2003, 2004 and 2005, Yuchai sold 62 units, 963 units and 782 units of the 6L engine, respectively.

6M Heavy-Duty Diesel Engines

The 6M heavy-duty engine family for heavy-duty trucks and passenger buses were developed based on technologies from USA, Japan and Germany in accordance with FEV procedures. It has a 10 liter displacement and power ranging from 280 to 390 horsepower. Yuchai s first commercial sales of 6M occurred in January 2004 with total sales of 818 units in 2004. In 2005, Yuchai sold 3,471 units, which represented an increase of 324.3% over 2004.

4-Series Light-Duty Diesel Engines

The 4-Series light-duty engines comprise the 4F, 4108, 4110, 4110Q, 4110ZQ and 4112 engines (collectively, the 4-Series engines). See Products Light-Duty Diesel Engines .

The 4110Q and 4110ZQ engines were developed to allow Yuchai to compete in the light-duty diesel engine market. Trial production of the 4110 engines commenced in late 1999. Sales of the 4110 engines in 2000 were weak due to strong competition, minor technical problems and a high pricing structure. Significant improvements to the technical specifications of the 4-Series light-duty engines have resulted in higher customer acceptance resulting in higher unit sales in 2003, 2004 and 2005.

The 4108 engine was based on the 6105 and the 6108 engines. The 4108 engine is designed for light trucks and passenger vehicles. Trial production of the 4108 engine started in the third quarter of 2000, and commercial production of the 4108 engine began in 2001. The 4112 engine was primarily based on the 6112 engine. The 4112 engine is designed for use in light- to medium-duty cargo trucks and buses. The 4112 engine also features a low emission level that is compliant with Euro II standards. Trial production of the 4112 engine started in early 2001 and commercial production of the 4112 engine began in late 2001. Both the 4108 and 4112 engines have experienced minor technical problems which have since been resolved, and are facing strong competition.

The 4F diesel engine is a four-cylinder, four-stroke engines with a rated power ranging from 90 to 115 horsepower. The 4F diesel engines were developed based on technologies from Germany and Japan for mini buses, trucks and passenger cars. Trial production of 4F engines commenced in mid-2004. Yuchai expects growth of these new engines to strengthen over the few years and become a significant contributor to sales growth for Yuchai. Yuchai produced 7,009 units of 4F engines in 2005 and embarked upon a major capital expenditure to increase the production capacity to 50,000 units per year by 2007. The expansion is expected to enable Yuchai to enter into light duty diesel engines market for light duty trucks, trucks and passenger cars.

In 2002, Yuchai produced 23,773 units of the 4-Series engines in 2002, representing 16.5% of Yuchai s total production volume of 144,463 units for that year. In 2003, Yuchai produced 50,264 units of the 4-Series engines, representing 27.9% of Yuchai s total production volume of 180,423 units for that year. In 2004, Yuchai produced 79,498 units of the 4-Series engines, representing 34.7% of Yuchai s total production volume of 229,210 units. In 2005, Yuchai produced 110,346 units of 4-Series engines, or 46.0% of Yuchai s total production volume of 240,061 units. The increase in 4108 engines in 2005 is mainly due to increase in demand for light trucks and agricultural machineries.

Products

Yuchai primarily manufactures and sells diesel engines for medium-duty trucks in China. Yuchai s primary products are its 6105 and 6108 medium-duty engines, which are principally used in medium-duty trucks with a load capacity of five to seven tons. In addition, Yuchai also offers the 4-Series light-duty engines and the 6112 heavy-duty engines. See Product Development . The following table sets forth the technical specifications of the 4F engine, the 4110ZQ engine, the 6105 engine, the 6108 engine, the 6112 engine, the 6L engine and the 6M engine:

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e and Technical Specifications	4F Engine*	4110ZQ Engine	6105 Engine	6108 Engine	6112 Engine	6L Engine*	6M Engin
e	4-stroke, turbo-charged, inner-cooling or water-cooling, in-line vertical	4-stroke, turbo-charged, water-cooling, in-line vertical	4-stroke, turbo-charged, water-cooling, in-line vertical	4-stroke, Water-cooling, in-line vertical	4-stroke, turbo-charged, inner-cooling, water-cooling, in-line vertical	4-stroke, turbo-charged, inner-cooling or water-cooling, 4 valve per cylinder in-line vertical	4-stroke, turbo-charge inner-coolin water-coolin 4 valve per cylinder in-l vertical
d Power	115 horsepower (66 85 kw)	136 horsepower (118 kw)	230 horsepower (170 kw)	240 horsepower (206 kw)	270 horsepower (221 kw)	350 horsepower (243 kw)	390 horsepo (288 kw)
nber of Cylinders	4	4	6	6	6	6	6
nder placement	2.66L	4.257L	6.494L	7.255L	7.8L	8.424L	9.84L
d Speed	3200 r/min	2800 r/min	2500 r/min	2300 r/min	2400 r/min	2200 r/min	2100 r/min
imum Torque	300 N.m	392 N.m	810 N.m	1100 N.m	980 N.m	1400 N.m	1680 N.m
ed at Maximum que	2200 r/min	1600 r/min	1700 r/min	1600 r/min	1500 r/min	1400 r/min	1600 r/min
e x Stroke	92 x 100 mm	110 x 112 mm	105 x 125 mm	108 x 132 mm	112 x 132 mm	113 x 140 mm	120 x 145 m
imum Fuel sumption	£ 203 g/kw.h	< 200 g/kw.h	< 200 g/kw.h	< 196 g/kw.h	< 195 g/kw.h	< 198 g/kw.h	< 193 g/kw.
sumption Ratio il to Fuel	£ 0.2%	< 0.5%	< 0.1%	< 0.15%	< 0.1%	< 0.1%	< 0.1%
se	£ 96 dB(A)	< 99 dB(A)	< 99 dB(A)	< 97 dB(A)	< 97 dB(A)	< 97 dB(A)	< 96 dB(A)
ke	£ 2 Bosch	< 3.5 Bosch	< 2.5 Bosch	< 2.5 Bosch	< 2.5 Bosch	< 2 Bosch	< 2 Bosch
Machine Weight	320 kg	350 kg	650 kg	600 kg	700 kg	750 kg	880 kg
ensions gth x width x ht)	800 x 576 x 767 mm	950 x 600 x 750 mm	1226 x 803 x 1012 mm	1234 x 800 x 1100 mm	1184 x 823 x 1040 mm	1330 x 800 x 1100 mm	1343 x 651 1095 mm

* Yuchai s 6L and 6M engines have a rated power ranging from 280 to 390

horsepower.

Besides diesel engines, Yuchai also produces a limited number of diesel power generators and diesel engine parts. The following table sets forth a breakdown of Yuchai s sales by major product category for each of the three years ended December 31, 2003, 2004 and 2005, respectively:

	2003			2004			2005		
Product	**Revenues, net Rmb (in thousands)**	**% of Revenues, net**	**Units Sold**	**Revenues, net Rmb (in thousands)**	**% of Revenues, net**	**Units Sold**	**Revenues, net Rmb (in thousands)**	**% of Revenues, net**	**Units Sold**
Diesel engines									
6105	911,190	19.9%	44,131	1,143,535	20.5%	50,609	1,748,847	30.0%	69,379
6108	1,504,140	32.9%	61,361	1,372,073	24.6%	57,908	810,859	13.9%	37,560
6112	1,003,791	22.0%	20,472	1,203,558	21.6%	24,073	786,989	13.5%	14,788
6L	3,697	0.1%	62	60,056	1.1%	963	46,603	0.8%	782
6M				37,312	0.6%	818	146,677	2.5%	3,471
4-Series	769,805	16.8%	46,022	1,183,992	21.2%	71,562	1,607,096	27.6%	103,598
Diesel power generators & others[1]	377,327	8.3%	171	581,569	10.4%	695	682,360	11.7%	650
Total	4,569,950	100.0%	172,219	5,582,095	100.0%	206,628	5,829,431	100.0%	230,228

(1) Units sold relate mainly to agricultural and industrial engines.

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Medium-Duty Diesel Engines

6105 Engines

The 6105 medium-duty engine is a six-cylinder, four-stroke engine that offers up to 230 horsepower, and is principally installed in medium-duty trucks. Yuchai believes that its 6105 engine has a reputation for fuel efficiency, low noise levels, firm uphill traction and reliability. Yuchai also believes that its manufacturing quality control and the design of its engine blocks, which are thicker than those of its major domestic competitors as well as leading international manufacturers, make its engines more durable.

In response to the introduction of high-power medium-duty engines by its competitors in 1995, Yuchai began development of its 6108 medium-duty engine. Commercial production of the 6108 engine began in the third quarter of 1997. In 2002, 2003 and 2004, unit sales of the 6108 engine exceeded unit sales of the 6105 engine. However, unit sales of the 6108 engines was less than the 6105 engines in 2005 due to poor market demand for the 6108 engines. As a result of the more stringent Euro III environmental compliance standards (see Item 3. Key Information Risk Factors Risks relating to our company and our business We may be adversely affected by environmental regulations), Yuchai s 6108 diesel engines have experienced increased production costs making the sales price more expensive.

6108 Engines

The 6108 engine offers improved overall performance compared to the 6105 engine, principally because of greater horsepower, increased reliability and improved acceleration. Commencing in the third quarter of 1997, Yuchai began offering the 6108 engine to its customers as a premium model, along-side its standard 6105 engine, and plans to eventually replace the 6105 engine with the 6108 engine. Yuchai s existing and planned production facilities for medium-duty diesel engines are designed to be capable of producing 6108 engines without major modification.

Yuchai sells its 6108 engine to a similar customer base to that which previously bought its 6105 engines. Although the increased competition in the medium-duty diesel market and Yuchai s delay in commercially introducing the 6108 engine had adversely affected Yuchai s market share, through an aggressive marketing program which included brand building and enhancing corporate image, Yuchai was able to increase its unit sales of the 6108 engine by 30.2% to 31,667 units in 2001 from 2000. Unit sales of the 6108 further increased to 58,042 units in 2002, representing an increase of 83.3% over 2001. Due to the overall decline in the medium-duty truck market in China in 2003, medium-duty engines also decreased in unit quantity resulting in Yuchai achieving 61,361 units in 2003 as compared to 58,042 units in 2002, and sales of 57,908 units in 2004. In 2005, unit sales of the 6108 engine decreased by 35.1% to 37,560 units as compared to 57,908 units in 2004. There can be no assurance, however, that Yuchai will be able to maintain or improve its current market share or develop new markets for the 6108 engine.

Heavy-Duty Diesel Engines

The 6112 heavy-duty engine is a six-cylinder, four-stroke engine with a rated power ranging from 190 to 270 horsepower. Primarily as a result of unreliable key engine components supplied by domestic component manufacturers, the 6112 engine encountered significant technical problems during initial road testing and failed to perform satisfactorily under harsh environmental conditions. Although commercial production of the 6112 engine was delayed beyond the previously scheduled date, Yuchai was able to resolve these technical problems and commence trial marketing of the engine in early 1999. Commercial production of these engines began during the second half of 1999. In 2003, 2004 and 2005, Yuchai produced 22,024, 27,410 and 15,990 units of the 6112 engine, respectively. See Item 5. Operating and Financial Review and Prospects Overview . With higher levels of acceptance by customers, however, 6112 engine unit sales have decreased in 2005 as compared to 2004 due to poor market conditions generally attributable to the Chinese government s measures for the tightening of credit supply within the banking sector in China to minimize overheating of the economy.

The 6L and 6M heavy-duty diesel engine are six-cylinder, four-stroke engines with a rated power ranging from 280 to 390 horsepower. Yuchai s first sales of the 6L occurred in November 2003, and Yuchai expects growth of these two new engines to strengthen over the next few years and become a significant contributor to sales growth for Yuchai. Early in 2003, Yuchai embarked upon a major capital expenditure program to increase the production capacity of heavy-duty engines by 20,000 units per year. The expansion is expected to enable Yuchai to enter the higher margin market for engines over 300 horsepower, while eventually reducing its cost base by replacing imported engine blocks and cylinder heads with production from Yuchai s new foundry.

Light-Duty Diesel Engines

The 4-Series engines utilize much of the same technology as the 6112 heavy-duty engine, modified to produce short-range and reduced cylinder engines for lightweight cars and trucks. Despite their relatively small size (less than half the size of the 6112 engine), they have the advantages of the 6112 engine, including reliability, high performance and a long life span. Due to its versatility, the 4110Q engine is suitable for light vehicles and agricultural trucks. The 4110ZQ engine, with features such as a low emission level that is compliant with Euro II standards and low noise levels, is well-suited for light commercial vehicles and medium-size passenger vehicles. Trial production of the 4-Series engines commenced in late 1999. In 2000, due to strong competition in the light-duty diesel engine market, minor technical problems and the high pricing structure of the 4-Series engines, only 1,175 of the 2,220 units which it produced were sold. In 2002, Yuchai achieved sales of 20,735 units, which is a significant increase compared to 2001. In 2003, sales of the 4-Series engines further increased to 46,022 units, representing an increase of 122.0% over 2002. In 2004, sales of the 4-Series engines increased to 71,562 units, representing an increase of 55.0% over 2003. In 2005, sales of the 4-Series engines increased to 103,598 units, representing an increase of 44.8% over 2004. The increase in 4108 engines in 2005 is mainly due to increased in

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demand for light trucks and agricultural machineries due to their lower pricing relative to Yuchai s other models, making them more affordable to customers.

An important part of Yuchai s business strategy is to continually achieve higher standards of quality in its diesel engines. Yuchai believes that its engines have an established reputation among truck manufacturers and end-users for durability and quality. Due to poor road conditions, lack of engine maintenance by end-users and the common practice of overloading trucks in China, Yuchai believes that the reliability and durability of its engines are critical factors in maintaining competitiveness. By further improving the reliability and overall quality of its engines and controlling the costs of production, Yuchai believes it can command higher prices for its engines than its competitors and remain competitive in China.

Other Products

Diesel Power Generators

Yuchai produces diesel power generators which are primarily used in the construction and mining industries. The diesel power generators offer a rated power of 12 kilowatts to 160 kilowatts. Yuchai s diesel power generators use both the 6105 and 6108 medium-duty engines as their power source.

Diesel Engine Parts

Yuchai supplies diesel engine parts to its nationwide chain of customer service stations. Although sales of diesel engine parts do not constitute a major percentage of Yuchai s net revenues, the availability of such parts to its customers and to end-users through its nationwide chain of customer service stations is an important part of Yuchai s customer service program.

Sales, Marketing and Services

Sales and Marketing

Yuchai distributes most of its engines directly to auto plants and retailers from its primary manufacturing facilities in Yulin City. In addition, Yuchai operates 31 regional sales offices in major geographic regions in China. With a sales force of approximately 609 persons nationwide, Yuchai provides a comprehensive range of services to its customers, including dispatching engineers to provide on-site assistance to major customers in the resolution of technical problems.

Yuchai promotes its products primarily through television commercials, advertisements in newspapers and industry journals. Since 1993, Yuchai has been sponsoring an annual program, User Service Week , during which Yuchai provides its customer service stations with information brochures, customer suggestion cards for the improvement of Yuchai s service and small gifts for end-users. In connection with this promotion, Yuchai s customer service stations also perform minor repairs on end-users diesel engines free of charge. Yuchai believes that its promotional efforts are unusual for an automotive component company in China and lead to greater brand name recognition among end-users.

Advertising expenses decreased by 7.0% to Rmb 45.3 million in 2005 from Rmb 48.7 million in 2004 due to lower spending on television and road signboard advertising in 2005. Sales commissions increased to Rmb 39.4 million in 2005 compared to Rmb 11.6 million in 2004 due to higher commission given to promote the sales of new products such as 6L and 6M heavy duty diesel engines.

Yuchai believes that proximity to its factories in Yulin City is an important factor in the geographical make-up of its customers. Due in part to transportation and shipping costs, a substantial majority of Yuchai s engines are sold to customers in southern and central eastern China. In addition, a very small percentage of Yuchai s products are exported outside China, as the following table indicates:

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	2003			2004			2005		
	Sales Revenue Rmb (000)	% of Sales Revenue	Unit Sales	Sales Revenue Rmb (000)	% of Sales Revenue	Unit Sales	Sales Revenue Rmb (000)	% of Sales Revenue	Unit Sales
Total Domestic Sales	4,546,383	99.48%	171,769	5,518,582	98.86%	204,812	5,715,804	98.05%	226,073
Total Export Sales	23,567	0.52%	450	63,513	1.14%	1,816	113,627	1.95%	4,155
	4,569,950	100.0%	172,219	5,582,095	100.0%	206,628	5,829,431	100.0%	230,228

Vietnam, Saudi Arabia, Taiwan, Cuba and Kazakhstan (in descending order) represented Yuchai s top five export markets in 2005 in terms of number of units. In particular, Yuchai exported 130, 510 and 339 diesel engine units to Cuba in 2003, 2004 and 2005, respectively. In April 2006, Yuchai signed a memorandum of understanding with the Cuban government for the export by Yuchai of approximately 20,000 diesel engines over the next four years. Yuchai does not expect that sales pursuant to this memorandum of understanding will have a material impact on its unit production or sales revenue.

Yuchai s sales are concentrated among the Dongfeng Group, one of the largest state-owned automobile companies in China, and other major diesel truck manufacturers controlled by or affiliated with the Dongfeng Group. Sales to the Dongfeng Group accounted for approximately 31.3%, 28.8% and 19.8% of Yuchai s total net revenues in 2003, 2004 and 2005, respectively. The Dongfeng Group is also a major competitor of Yuchai. See Competition .

Yuchai has been continuing its sales efforts to retailers and end-users of diesel engines. Yuchai seeks to encourage end-users of gas engine trucks to replace their gas engines with Yuchai diesel engines by advertising the advantages of diesel engines. Such sales of replacement engines are generally made through customer service centers at a retail price, which is higher than the sales price to truck manufacturers.

Customers orders with Yuchai can be cancelled either by Yuchai or its customers prior to delivery in accordance with the sales contracts. As part of Yuchai s credit procedures to control and manage its trade accounts receivables, Yuchai would hold shipments for delivery if customers credit position is not satisfactory or if customers have not made payments for earlier deliveries. There can be no assurance that such cost-controlling measures will successfully control Yuchai s trade receivable balance, or that they will not adversely affect the future purchase decisions of Yuchai s customers. Yuchai had net trade accounts receivable of Rmb 875.6 million as of December 31, 2004, representing 25.2% of the Company s total current assets at the same date. As of December 31, 2005, Yuchai had net trade accounts receivable of Rmb 1,146.2 million, representing 27.5% of the Company s total current assets as of the same date.

Customer Service

Yuchai believes that customer service is an important part of maintaining its market competitiveness. In addition to various services provided initially at its sales offices, Yuchai has a nationwide network of over 1,150 authorized service stations that provide repair and maintenance services, spare parts, retrofitting services and training to Yuchai s customers. To ensure a consistently high level of service, Yuchai trains the technicians at each of these service stations. In addition, Yuchai also owns and operates over 20 repair training centers. Any warranty-related services or repairs will be borne by Yuchai. Other than above, all non-warranty activities will be charged to customers.

Yuchai s customer service program emphasizes a fast turnaround time on repair requests. As part of this policy, Yuchai supplies authorized service stations with spare parts for repairs and requires these service stations to provide on-site assistance at the customer s place of business within 12 to 24 hours, depending on the customer s location.

Yuchai provides a repair and replacement warranty for all of its engines. Prior to 1993, Yuchai s warranty was for 12 months or 30,000 kilometers. In September 1993, Yuchai extended its warranty to 18 months or 50,000 kilometers and, in September 1994, Yuchai further extended its warranty from a period of 12 months or 120,000 kilometers to a period of 18 months or 180,000 kilometers, whichever is lower. For the years ended 2003, 2004 and 2005, warranty costs represented approximately 3.6%, 3.4% and 3.1% of net revenues, respectively.

In March 2004, at the State Holding Company s initiative, Yuchai established a new company, Yuchai Express Guarantee Company Limited (YEGCL), which provides credit guarantee, appraisal and consulting services to Yuchai s customers to purchase

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trucks that are mounted with Yuchai s diesel engines. Yuchai has contributed Rmb 100.0 million for the establishment of this company, in return for 76.9% of its share capital. YEGCL commenced operations in June 2004.

Also in March 2004, Coomber and the State Holding Company established a related company, YMLC, to offer a complementary range of services with YEGCL. YMLC and YEGCL provide a range of complementary services, such as insurance, financing, warranty servicing, administrative and marketing services to independent Chinese truck operators. This was intended to facilitate sales and servicing of Yuchai products. Yuchai loaned approximately Rmb 205.0 million to YMLC in May 2004 (see also Note 5 to the Company s Consolidated Financial Statements appearing elsewhere herein).

Manufacturing

Yuchai s primary manufacturing facilities are located in Yulin City in the Guangxi Zhuang Autonomous Region. The principal production land area currently occupies approximately 960,900 square meters, including the existing production factory for the 6105 medium-duty engines, the existing production factory for the 6108 medium-duty engine (the 6108 Engine Factory), the 6112 Engine Factory and various testing and supporting facilities. In 2004, the annual production capacity of Yuchai s manufacturing facilities was approximately 80,000 units of light-duty diesel engines, 120,000 units of medium-duty diesel engines and 50,000 units of heavy diesel engines. In 2004, with the completion of the new second foundry and 6L and 6M heavy-duty diesel engines lines, Yuchai s total production capacity has increased to approximately 250,000 units at end 2004. Yuchai operated at less than full capacity in 2004. Yuchai s total production capacity increased to approximately 290,000 units at end 2005, or 16% over 2004. The current production capacity is adequate to meet expected higher demand and unit sales from customers in the near future arising from the continued government spending on new highways and other infrastructure development projects in China.

Yuchai s production process involves the manufacture of key components and the assembly of the diesel engines from components and parts internally manufactured or purchased from third parties. Yuchai manufactures a substantial portion of the key components of its diesel engines, including the engine block, cylinder heads, crankshaft and camshaft. Yuchai cast and molded approximately 250,000 engine blocks in 2005, satisfying almost all of its engine block needs in 2005. When necessary, Yuchai is able to purchase additional engine blocks from a domestic foundry under an existing requirement contract. Yuchai/ASIMCO Components Company Limited (Yuchai/ASIMCO) is one of Yuchai s principal suppliers of fuel injection pumps through two of its related companies. Yuchai purchases the remaining parts and components for its 6105 engines as well as raw materials, principally steel and cast iron, from domestic suppliers. Yuchai does not believe that it is dependent on any one supplier as it generally purchases supplies from at least two sources (except with respect to engine blocks where Yuchai currently has a purchase arrangement only with the domestic foundry referred to above). Yuchai manufactures internally the same key components for its 6108 engine as it does for the 6105 engine and purchases the remaining parts and components for its 6108 engine from domestic suppliers. The main parts for the 6112 heavy-duty engine, which are the engine blocks, cylinder heads, crankshaft and fuel pumps, are imported from foreign suppliers and the other parts are purchased from domestic suppliers. Yuchai expects to further reduce its reliance on imported parts and components in 2006.

To ensure that its standards and specifications are met, Yuchai conducts routine checks at each stage of the production process, tests each diesel engine prior to delivery to the customer, and inspects all raw materials, parts and components purchased from suppliers to ensure that they meet Yuchai s requirements. To promote the safety of its workers, Yuchai has established a safety department to supervise the proper use of equipment, prevent fire and explosions and promote safe practices and procedures in the workplace.

Yuchai/ASIMCO is a joint venture between Yuchai and a subsidiary of Asian Strategic Investments Corporation (ASIMCO) that invests in factories in China that produce parts and components for diesel engines. ASIMCO is a joint venture among The Pacific Alliance Group Limited, Dean Witter Capital Corporation and TCW Capital Investment Corporation. As of December 31, 2005, Yuchai had contributed Rmb 5.7 million to Yuchai/ASIMCO and owned a 4.73% interest in the common stock of Yuchai/ASIMCO.

During 2000, at the State Holding Company s initiative, Yuchai established two new companies involved in the manufacture and sale of spare parts and components for diesel engines in China. Yuchai contributed a total of Rmb 105.0 million in assets to the companies and received equity interests of 71.8% and 97.0%, respectively, in the two

companies. During 2002, Yuchai increased its equity interest in Guangxi Yulin Yuchai Machinery Spare Parts Manufacturing Company Limited, the subsidiary involved in the manufacture of spare parts, from 97.0% to 97.1% by an additional contribution of Rmb 4.3 million. The State Holding Company owns the remaining equity interests in these companies. Yuchai established these new companies to ensure access to a consistent and quality supply of spare parts and components for its diesel engines and to improve the quality of its customer service by maintaining a regular

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supply of these spare parts. The establishment of these companies by Yuchai was initially not made with the requisite corporate approvals, but was subsequently ratified by the Board of Directors of Yuchai in October 2001.

Capital Expenditures

Capital expenditures for routine upgrades to, and replacement of, equipment, plant and property were Rmb 372.8 million, Rmb 552.9 million and Rmb 515.4 million (US$63.9 million) in 2003, 2004 and 2005, respectively. The Company funded its capital expenditures primarily from funds generated from operations and, when necessary, from bank loans obtained by Yuchai. The Company incurred capital expenditures in 2003 relating to the completion of the second foundry as well as for the production line of the 6L and 6M heavy-duty diesel engine. The Company s capital expenditures for 2004 of Rmb 552.9 million were primarily used for the completion of the new production line for 6L and 6M heavy-duty engines, the second foundry described above, production capacity upgrading and the second stage of construction of Yuchai heavy-duty engine project. The Company s capital expenditures for 2005 of Rmb 515.4 million (US$63.9 million) were primarily used for production capacity upgrading, second stage construction of Yuchai heavy-duty engine project and the new 4F engine project. The Company expects that it will be able to continue to fund its capital expenditures in 2006 in the same manner as in prior years, as described above and under Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources .

Seasonality

Yuchai s business generally is not seasonal. However, Yuchai s results of operations in the first and second quarters of recent calendar years have been marginally higher than in the third and fourth quarters of the corresponding year, due to slightly better production and sales performance in the first half compared to the second half of such calendar years. As a result, cash generated from operations may also be subject to some seasonal variation (See also Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources).

Trademarks

Yuchai owns and maintains Chinese trademark registrations of its principal trademarks. Yuchai believes that its logo is well recognized as a quality brand in China. As Yuchai currently sells most of its products in the domestic market, registration of its principal trademarks is not maintained in countries outside China. Yuchai has not been involved in any material claim or dispute in relation to trademarks or other intellectual property rights and, to the best of Yuchai s knowledge, no such claim or dispute is pending or threatened.

Competition

The diesel engine industry in China is highly competitive. Yuchai believes, based on internal studies, that competition is based primarily on performance, quality, price and after-sales service, and secondarily on noise, size and weight. Yuchai believes that its engines have a strong reputation among truck manufacturers and consumers for leading performance and reliability. In addition, Yuchai believes that its after-sales service to end-users of Yuchai engines, conducted through a nationwide network of over 1,150 authorized service stations and 20 Yuchai-owned repair training centers, gives Yuchai a competitive advantage over other diesel engine producers.

Most of Yuchai s major domestic competitors are state-owned enterprises. The Dongfeng Group, which is a major competitor of Yuchai and which controls two of Yuchai s largest competitors, is also one of Yuchai s major customers and controls Yuchai s other major customers, accounting in the aggregate for approximately 19.8% of Yuchai s total net revenues in 2005. Some of Yuchai s competitors have formed joint ventures with, or have technology assistance arrangements with, foreign diesel engine manufacturers or engine design consulting firms, and use foreign technology that is more advanced than Yuchai s technology. The current production capacity is adequate to meet expected higher demand and unit sales from customers in the near future arising from the continued government spending on new highways and other infrastructure development projects in China. Yuchai expects competition to intensify as a result of, among other things, improvements in competitors products, increased production capacity of competitors, increased utilization of unused capacity by competitors and price competition.

In the medium-duty diesel engine market, Yuchai s 6105 and 6108 engines compete primarily against the 6110 engines produced by a number of Yuchai s competitors. Initially, the introduction of the 6110 engine in 1995 had put considerable pressure on Yuchai s competitiveness in the medium-duty diesel engine market because it offered greater horsepower than Yuchai s 6105 engine. However, the commercial introduction of the 6108 engine in 1997 by Yuchai, which offers substantially the same horsepower as the 6110 engine, has allowed Yuchai to compete more effectively

in the medium-duty diesel engine market. In competing with the 6110 engine, Yuchai focuses on the quality and price of, and the after-sales service on, the 6108 engine. In 2002, 2003 and 2004, unit sales of the

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6108 engine exceeded unit sales of the 6105 engine. However, unit sales of the 6108 engines was less than 6105 engines in 2005 due to poor market demand for the more expensive 6108 engines. There can be no assurance, however, that Yuchai will be able to maintain or improve its current market share or develop new markets for its medium-duty diesel engines.

In addition, Yuchai commenced trial marketing of its 6112 heavy-duty engine in early 1999, and began commercial production of these engines in the second half of 1999. Due to the delay in commercial production of the 6112 engine until 1999, however, Yuchai was not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is relatively price sensitive. Yuchai will continue to manufacture its 6112 heavy-duty diesel engines although there has been a decline in unit sales in 2005 mainly due to changes in customers demand to light-duty diesel engines. In 2005, the sales volume of the 6112 engine was 14,788 units, which was lower than 24,073 units in 2004, due to shrinking demand arising from the Chinese government s measures to tighten the credit supply within the banking sector in China so as to minimize overheating of the economy. This situation has led to more customers demand for the cheaper light-duty diesel engines as compared to the more expensive heavy-duty diesel engines. There can be no assurance that Yuchai will be able to compete successfully in the heavy-duty diesel engine market in China with the existing producers (such as Weichei Power Co., Ltd.) or any new entrants.

Yuchai also faces intense competition in the light-duty diesel engine market. In this market, Yuchai competes primarily against Wuxi Diesel Engine Factory First Auto Group and Dalian Diesel Engine Factory First Auto Group (collectively, the First Auto Group). As Yuchai is a late entrant into the light-duty diesel engine market relative to the First Auto Group, Yuchai believes that it could be difficult for Yuchai to become a major market leader in the short-term.

As the Chinese automotive industry develops, Yuchai will have to continuously improve its existing engine products and develop new diesel engine products in order to remain competitive. Consequently, Yuchai s long-term business prospects will largely depend upon its ability to develop and introduce new or improved products at competitive prices. Future products may utilize different technologies and may require knowledge of markets that Yuchai does not currently possess. Currently, Yuchai is heavily dependent on foreign engine design consulting firms and foreign engine manufacturers for technological assistance in improving its products and developing new products, and expects such dependency to continue. The introduction of new diesel engine products will also require significant capital expenditures, such as purchases of foreign manufacturing equipment and technologies. In addition, Yuchai s competitors in the diesel engine markets may be able to introduce new or improved models that are more favorably received by customers than Yuchai s products. Competition in the end-use markets, mainly the truck market, may also lead to technological improvement and advances that render Yuchai s current products obsolete at an earlier than expected date, in which case Yuchai may have to depreciate or impair its production equipment more rapidly than planned. Failure to introduce, or delays in the introduction of, new or improved products at competitive prices could have a material adverse effect on the financial condition, results of operations, business or prospects of Yuchai.

The admission of China into the WTO which regulates trading among its member states could lead to increased foreign competition for Yuchai. As a result of China becoming a member of the WTO, import restrictions on both motor vehicle components, including diesel engines, and motor vehicles are expected to be reduced. China is also required to lower its import tariffs as a condition for membership in the WTO. Reduced import restrictions and/or lower tariffs may lead to increased imports of foreign diesel engines and, therefore, to increased competition in the domestic diesel engine markets. Similarly, reduced import restrictions and/or lower tariffs on automobiles may affect the competition in the end-use markets of Yuchai s customers and indirectly affect Yuchai s sales to such customers. Currently, China is encouraging foreign investments into the motor vehicle engine manufacturing industry. Yuchai has from time to time been in discussions with potential foreign diesel engine manufacturers on a possible strategic joint venture to develop and manufacture new diesel engines.

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Organizational Structure

The following chart illustrates the organizational structure of the Company and Yuchai as of June 30, 2006, and is based on information generally known to Company or otherwise disclosed in filings made with the SEC (see also Item 7. Major Shareholders and Related Parties Major Shareholders).

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Regulatory and Related Matters

Governance, Operation and Dissolution of Yuchai

Governance, operation and dissolution of Yuchai are governed by laws and regulations of China relating to Sino-foreign joint stock companies, as well as by Yuchai s Articles of Association.

Yuchai is subject to the Sino-Foreign Equity Joint Venture Enterprise Labor Management Regulations. Under these regulations, management may hire and discharge employees and make other determinations with respect to wages, welfare, insurance and employee discipline.

Chinese laws and regulations applicable to a Sino-foreign joint stock company require that, before Yuchai distributes profits, it must: (i) satisfy all tax liabilities; (ii) recover losses in previous years; and (iii) make contributions to certain statutory reserve fund in an amount equal to at least 10% of net income for the year determined in accordance with generally accepted accounting principles in China (PRC GAAP). However, the allocation of statutory reserve fund will not be further required once the accumulated amount of such fund reaches fifty per cent of the registered capital of Yuchai.

Pursuant to Chinese law and Yuchai s Articles of Association, Yuchai may be dissolved upon the occurrence of certain events, including force majeure, severe losses, lack of supply of necessary materials or other events that render Yuchai unable to continue its operations. Upon dissolution, Yuchai will form a liquidation committee. Final dissolution is subject to government review and approval.

During 2003, the Company believes affiliates of the State Holding Company caused various Chinese government agencies to raise allegations of irregularities regarding the status of the Company s ownership of and rights of control over Yuchai, which the Company believes was intended to try to limit the Company s rights to exercise control over Yuchai. The Company further believes that such allegations were based on an inaccurate understanding of the structure of the Company s ownership of and rights of control over Yuchai. The Company also believes that Yuchai s ownership structure has been validly approved by the relevant Chinese authorities, and that the shares of Yuchai held by the Company s six wholly-owned subsidiaries are legally and validly held under Chinese law. The Company has obtained legal opinions from two Chinese law firms confirming these matters (see the Form 6-K filed by the Company with the SEC in April 1, 2005). The Company has also taken steps to communicate to the relevant Chinese government agencies the reasons for its position with respect to these matters. The Company believes the July 2003 Agreement and the Reorganization Agreement, as amended, when fully implemented will resolve the issues raised by the various Chinese governmental agencies relating to its share ownership in Yuchai and the continued corporate governance and other difficulties which the Company has had from time to time with respect to Yuchai. Based upon the above-mentioned legal opinions, the Company believes that in the event of a future dispute with the Chinese stakeholders at Yuchai, the Company expects to pursue as appropriate legal remedies in appropriate jurisdictions to seek to enforce its legal rights as the majority shareholder with a controlling financial interest in Yuchai to protect its investment for the benefit of the Company and its shareholders. See also Item 3. Key Information Risk Factors .

Property, Plants and Equipment

Yuchai s headquarters is located in Yulin City in the Guangxi Zhuang Autonomous Region. Yuchai has the right to use approximately 1.5 million square meters of land, which is currently used primarily for the production of diesel engines and employee housing. The principal production land area for the manufacture of diesel engines currently occupies approximately 960,900 square meters, including a building for the current 6105 manufacturing facilities and recently completed facilities occupying approximately 620,000 square meters that comprise the 6108 Engine Factory, the 6112 Engine Factory, administrative offices and technical operations space. In addition, Yuchai leases 31 regional sales offices in PRC. During 2005, Yuchai increased production capacity to approximately 290,000 units after the completion of the second foundry and new 6L and 6M heavy-duty engines lines.

Environmental Matters

China adopted its Environmental Protection Law in 1989, and the State Council and the State Environmental Protection Agency promulgate regulations as required from time to time. The Environmental Protection Law addresses issues relating to environmental quality, waste disposal and emissions, including air, water and noise emissions. Environmental regulations have not had a material impact on Yuchai s results of operations. Yuchai delivers, on a regular basis, burned sand and certain other waste products to a waste disposal site approved by the

local government and makes payments in respect thereof. Yuchai expects that environmental standards and their enforcement in China will, as in many other countries, become more stringent over time, especially as technical advances make achievement of higher standards more feasible. Yuchai has built an air filter system to reduce the level of dust and fumes

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resulting from its production of diesel engines. The PRC emission standard equivalent to Euro III will take effect from January 1, 2007. Yuchai believes the Company will be able to comply with the new standard.

ITEM 4A. UNRESOLVED STAFF COMMENTS.

As of the date of filing of this Annual Report, the Company has one unresolved written comment letter from the SEC staff regarding the Company s periodic reports under the Securities Exchange Act. The letter, dated June 14, 2006, requests information pertaining to exports (i) by the Company to Cuba and (ii) by an affiliated entity (another Chinese subsidiary of HLA, the Company s controlling shareholder) to North Korea. The Company intends to respond to this comment letter by providing historical export data and confirming that the amounts exported are de mininis in nature and are therefore immaterial. Such information has also been added to Item 4. Information on the Company Business Overview Sales, Marketing and Services .

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS.

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto contained in this Annual Report. The consolidated financial statements of the Company are prepared in conformity with US GAAP.

During the fiscal years ended December 31, 2003, 2004 and 2005, the Company s main asset has been its 76.4% ownership interest in Yuchai. As a result, the Company s financial condition and results of operations have depended primarily upon Yuchai s financial condition and results of operations. The Company acquired its initial 51.3% interest in Yuchai effective April 1, 1993, increased its interest to 71.4% in November 1994 through the China Everbright Purchase and then to 76.4% in December 1994 by purchasing additional Yuchai Shares with the net proceeds of its initial public offering. The Company s historical results of operations differ from those of Yuchai, primarily as a result of amortization of goodwill prior to 2002 which arose in connection with the three investments in Yuchai s equity, additional operating expenses and the minority interest of other Yuchai shareholders in Yuchai s income. In future financial periods, the Company s financial condition, results of operations, business and prospects may differ significantly from Yuchai, depending upon, among other things, the implementation of the Company s new business expansion and diversification plan and the consummation of the spin-off contemplated in the Reorganization Agreement (see Item 4. Information on the Company Recent Developments). For example, in March 2005, the Company through its wholly-owned subsidiary, VDL, acquired an approximate 14.99% interest in TCL, VDL further acquired another 1.00% interest of the total number of TCL Shares in issue. As a result, the Company held a 15.99% stake in TCL as of December 31, 2005. The Company accounts for its investment in TCL using the equity method and the Company has reflected its proportionate share of TCL s losses in its consolidated statement of income since March 2005.

Overview

The various austerity measures taken by the Chinese government over the last decade to regulate economic growth and control inflation have at times dampened demand for trucks in China. In particular, austerity measures that restricted access to credit and slowed the rate of fixed investment (including infrastructure development) adversely affected demand for, and production of, trucks and other commercial vehicles. Such market conditions, together with increased competition in the diesel engine market, resulted in various degrees of financial and marketing difficulties for diesel engine producers, including the Company. However, the Chinese government announced in 1998 a major initiative to boost consumer demand through investments in infrastructure projects, including the construction of highways and tollways, and also through increased availability of bank credit. As a result, demand for trucks and other commercial vehicles, and thus demand for diesel engines has been increasing annually since 1999 to 2004.

Although demand for commercial vehicles in China declined by approximately 1.0% in 2005, the Company s net revenues in 2005 increased by 4.4% to Rmb 5,829.4 million compared to Rmb 5,582.1 million in 2004. This increase was primarily a result of higher unit sales of the 4-Series light-duty diesel and industrial engines. The Company had income before minority interests of Rmb 96.4 million in 2005 compared to income before minority interests of Rmb 648.7 million in 2004. The decrease in income before minority interests was primarily due to reduced gross margins, higher selling, general and administrative expenses, and compounded by the specific provision made of Rmb 205 million for loans (non-trade) to a related company (see also Note 5 to the Company s Consolidated Financial Statements appearing elsewhere herein). Sales of the 6108 medium-duty and 6112

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heavy-duty engines accounted for 13.9% and 13.5%, respectively, of the Company s net revenues in 2005. Sales of the 6L and 6M heavy-duty diesel engines accounted for 0.8% and 2.5%, respectively, of the Company s net revenues in 2005. Due mainly to the credit tightening by banks in China, there are more customers buying the light-duty diesel engines and industrial engines because the coverage selling price of these light-duty diesel and industrial engines are lower than the medium and heavy-duty engines.

In 2005, the Company continued its efforts to control production costs and operating expenses. However, a large portion of the Company s costs and expenses relate to fixed costs incurred in connection with the production of its diesel engines, which limits the Company s ability to significantly reduce its costs and expenses. The Company s cost of goods sold mainly includes cost of materials consumed, factory overhead, direct labor and depreciation. The Company analyzes its cost of goods sold based on its cost of manufacturing for each period. Cost of manufacturing for each period equals cost of goods sold for the period plus or minus the change in period end finished goods inventory. In 2005, cost of materials consumed accounted for approximately 80.9% of the cost of manufacturing. The Company s selling, general and administrative (SG&A) expenses include advertising expenses, provision for doubtful accounts, salaries and wages, freight charges, sales commission expenses and a large number of smaller expenses.

The Company had effective income tax rates of 16.2%, 14.0% and 17.8% in 2003, 2004 and 2005, respectively. Yuchai was subject to PRC income tax at a rate of 24.0% of its income determined in accordance with PRC GAAP in 1993 prior to the restructuring. After becoming a Sino-foreign joint stock company, it was exempt from PRC income tax in 1994 and 1995. Under current laws, Yuchai is subject to PRC income tax at a rate of 7.5% for each of the three years from 1996 to 1998 and a rate of 10.0% for each of the three years from 1999 to 2001. Since January 1, 2002, Yuchai is subject to tax at a rate of 15.0% so long as it continues to qualify as a foreign-invested enterprise eligible for tax reductions under PRC income tax law. In addition to the PRC income tax, Yuchai has been subject to value-added taxes on its sales since January 1, 1994. Dividends received by the Company from Yuchai can be remitted from China without any PRC taxation under current Chinese law. See Item 10. Additional Information Taxation People s Republic of China Taxation .

The Company commenced trial marketing of its 6112 heavy-duty engine in early 1999, and began commercial production of these engines during the second half of 1999. Due to the delay in commercial production of the 6112 engine until 1999, however, the Company was not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is relatively price sensitive. With increasing customer acceptance of the 6112 engine in late 2001 through 2003, the sales volume of the 6112 engine improved significantly. Yuchai intends to continue to manufacture its 6112 heavy-duty diesel engines although there has been a decline in unit sales in 2005 mainly due to changes in customers demand to light-duty diesel engines. In 2005, the sales volume of the 6112 engine was 14,788 units, which was lower than 24,073 units in 2004, due to shrinking demand arising from the Chinese government s measures to tighten the credit supply within the banking sector in China as part of its efforts to minimize overheating of the economy. This situation has led to Yuchai s customers buying more of the cheaper light-duty diesel engines as compared to the more expensive heavy-duty diesel engines. There can be no assurance that Yuchai will be able to compete successfully in the heavy-duty diesel engine market in China with the existing producers (such as Weichei Power Co., Ltd.) or any new entrants.

The Company s future financial condition and results of operations could be adversely affected as a result of China s admission into the WTO. See Item 3. Key Information Risk Factors Risks relating to Mainland China The admission of China into the WTO could lead to increased foreign competition . Currently, China is encouraging foreign investments into the motor vehicle engine manufacturing industry. However, the Company believes that the possible adverse impact of foreign competition as a result of China becoming a member of the WTO would likely be mitigated by a number of factors, including, (i) foreign diesel engines are not generally price competitive in the domestic China market, (ii) foreign producers do not have the sales and distribution network or service and parts center infrastructure of Chinese producers and (iii) while China s import tariffs on motor vehicle components may be lowered, China has indicated that it does not intend to eliminate such tariffs.

The Company s future financial condition and results of operations could also be adversely affected as a result of China macroeconomic policy changes recently announced by the Chinese government. The Chinese government has

announced that it is considering additional measures in certain sectors to avoid overheating of the economy, including tightening bank lending policies and increases in bank interest rates. The market demand for diesel engines in China may be adversely affected by these measures, particularly if diesel engines are included in any specific economic sectoral caps or attempts to slow down sectoral lending. See Item 3. Key Information Risk Factors Risks relating to Mainland China Adverse changes in the economic policies of the Chinese government could have a material adverse effect on the overall economic growth of Mainland China, which could reduce the demand for our products and adversely affect our competitive position and Item 3. Key Information Risk Factors Risks relating to our company and our business The diesel engine business in China is dependent in large part on the performance of the Chinese economy, as well as Chinese government policy. As a result, our financial condition, results of operations, business and

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prospects could be adversely affected by slowdowns in the Chinese economy, as well as Chinese government policies that de-emphasize the use of diesel engines .

Critical Accounting Policies

The preparation of financial statements in accordance with US GAAP require the Company s management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of the Company s assets and liabilities, disclosures of contingent liabilities and the reported amounts of revenues and expenses. These judgments, assumptions and estimates are reflected in the Company s accounting policies, which are more fully described in Note 3 to the Company s Consolidated Financial Statements appearing elsewhere herein.

Certain of the Company s accounting policies are particularly important to the portrayal of the Company s financial position and results of operations and require the application of significant assumptions and estimates by the Company s management. The Company refers to these accounting policies as its critical accounting policies . The Company s management uses its historical experience and analyses, the terms of existing contracts, historical cost convention, industry trends, information provided by its agents and information available from other outside sources, as appropriate, when forming its assumptions and estimates. However, this task is inexact because the Company s management is making assumptions and providing estimates on matters that are inherently uncertain. On an ongoing basis, management evaluates its estimates. Actual results may differ from those estimates under different assumptions and conditions.

While the Company believes that all aspects of its financial statements should be studied and understood in assessing its current expected financial condition and results, the Company believes that the following critical accounting policies involve a higher degree of judgment and estimation and therefore warrant additional attention:

Allowances for doubtful accounts;

Realization of the carrying value of inventories;

Product warranty obligations;

Realization of deferred tax assets;

Impairment of long-lived assets other than goodwill;

Provision for loss contingency for guarantee granted by YEGCL; and

Recoverability of carrying value of investment in TCL.

Allowances for doubtful accounts

Allowance for doubtful accounts is management s best estimate of the amount of probable credit losses in the Company s existing accounts receivable. The Company determines the allowance based on historical write-off experience by industry and national economic data. The Company reviews its allowance for doubtful accounts monthly. In 2005, the Company has examined the debtors ageing report and noted that there was a significant change in the amounts owing by one of its major customers, Dongfeng Group. For the year ended December 31, 2004, the Dongfeng Group accounted for about 28% of the trade debtors outstanding as compared to approximately 12% of the amount owing as of December 31, 2005. Likewise, the top 20 non-Dongfeng Group customers had increased its significance in our sales and accounted for about 44% of the gross debts outstanding at the end of 2005 from 38% at the end of 2004. The Company has noted the customer s trends, repayment patterns and ageing analysis in 2005 which confirmed that the provision policy for doubtful accounts for the year ended December 31, 2004 is no longer appropriate. Therefore, the Company has changed its accounting estimates on allowances for doubtful accounts, taking into account the changes in customers mix. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by aging of such balances. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

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Changes in the allowances for doubtful accounts for each of the years in the three-year period ended December 31, 2005 are summarized as follows:

	December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$
	(in thousands)			
Balance at beginning of year	158,075	94,423	107,457	13,315
Add: Charged to consolidated statements of income		13,034	25,587	3,171
Less: Written back to consolidated statements of income	(493)			
Doubtful debts written off	(63,159)		(63,997)	(7,930)
Balance at end of year	94,423	107,457	69,047	8,556

The Company believes that the present level of its allowance for doubtful debts adequately reflects probable losses related to impaired accounts receivable. However, changes in the assumptions used to assess the frequency and severity of doubtful accounts would have an impact on the Company s allowance for doubtful debts. If economic or specific industry trends change, the Company would adjust its allowances for doubtful accounts by recording additional expense or benefit. Management studies show that a decrease or increase of 5% in historical write-off experience would increase or decrease the provision for doubtful accounts by approximately Rmb 13.9 million (US$1.7 million).

Realization of the carrying value of inventories

The Company s inventories are valued at the lower of cost or net realizable value at the balance sheet date. Net realizable value represents the estimated selling price less costs to be incurred in selling the inventories. Net realizable value is estimated based on the age and market condition of inventories.

If market conditions or future product enhancements and developments change, the Company would adjust its provision for inventories by recording additional expense or benefit. In the preceding three years, there were no significant differences or adjustments between the book cost and the net realizable or market value. Management studies show that a decrease or increase of 5.0% in historical charge experience would increase or decrease the provision for inventories by approximately Rmb 5.9 million (US$0.7 million).

Product warranty obligations

The Company accrues a liability for estimated future costs to be incurred under a warranty period or warranty mileage on various engine models, for which it provides free repair and replacement. Warranties generally extend for a duration (12 months to 18 months) or mileage (80,000 kilometers to 180,000 kilometers), whichever is the lower. Provisions for warranty are primarily determined based on historical warranty cost per unit of engines sold adjusted for specific conditions that may arise and the number of engines under warranty at each financial year-end.

Changes in the accrued product warranty liability for each of the years in the three-year period ended December 31, 2005 are summarized as follows:

	December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$
	(in thousands)			
Balance at beginning of year	66,864	101,215	126,114	15,627
Add: Provision charged to consolidated statements of income	162,369	190,205	179,184	22,203
Less: Amounts utilized	(128,018)	(165,306)	(163,172)	(20,219)

Balance at end of year	101,215	126,114	142,126	17,611

The Company s estimate of its warranty obligations is evaluated on an annual basis. In previous years, warranty claims have typically not been higher than the relevant provisions made in the Company s balance sheet. If the nature, frequency and average cost of warranty claims change, the Company would adjust its allowances for product warranty by recording additional expense or benefit so as to seek to ensure that accruals will be adequate to meet expected future obligations. Management studies show that a decrease or

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increase of 5.0% in historical utilization experience would increase or decrease the provision for product warranty by approximately Rmb 8.2 million (US$1.0 million).

Realization of deferred tax assets

Deferred tax assets are reduced by a valuation allowance to the extent the Company concludes it is more likely than not that the assets will not be realized. This valuation allowance is an estimate of the difference between the actual existing and future realizable deferred tax assets. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible, tax credits and tax losses carried forward utilized. Management considers the scheduled reversal of deferred tax assets, projected future taxable income, and tax planning strategies in making this assessment. Forecasted taxable income may significantly differ from actual taxable income in future years, which may result in material revisions to the valuation allowance of deferred tax assets. Differences in actual results from available evidence used in determining the valuation allowances could result in future adjustments to the allowance. The realization of the deferred tax assets is subject to specific PRC tax regulations and not solely dependent on generating future taxable income. For example, tax credits relating to the purchase of domestic equipment may not be fully utilized as the amount entitled for deduction each year is limited to the incremental current income tax expense of the subsidiary compared to the income tax of the subsidiary for the year before the domestic equipment was purchased. Tax credit may also have a validity period. It is therefore possible that a subsidiary has a taxable income but unable to utilize the deferred tax benefit brought forward, if any. Tax losses incurred by certain subsidiaries are not likely to be realized in the future in connection with the assessment for valuation allowance. Based on management s forecast of future taxable income, the Company views the recoverability of the deferred tax assets, net of existing valuation allowances, as more likely than not to be realizable. In addition, based upon the results of prior years taxable income and projections for future taxable income over the next five years in which the deferred tax assets are deductible and tax losses carried forward, management believes the Company will realize the benefits of these deductible differences and tax losses carried forward as of December 31, 2005. Deferred tax assets which were not probable to be realized had been subjected to valuation allowance. For the years ended December 31, 2003 and 2004, no deferred tax asset valuation allowance was provided. For the year ended December 31, 2005, management concluded that a deferred tax asset valuation allowance of Rmb 45.2 million (US$5.6 million) was necessary. This valuation allowance is primarily for tax credits that management believes will expire unused.

Forecasted taxable income may significantly differ from actual taxable income in future years, which may result in material adjustment to the valuation allowance for deferred tax assets.

Impairment of long-lived assets, other than goodwill

Long-lived assets, such as property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The Company has conducted a review on the conditions of the property, plant and equipment. In 2003, management identified that certain property, plant and equipment would no longer be used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed. The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to estimated fair value. Since there was no active second hand resale market for these items relating to property, plant and equipment, management has adopted the discounted cash flow model to determine their fair value. Impairment loss of Rmb 12.4 million (US$1.5 million) has been charged to income statements in 2003 under selling, general and administrative expense. In 2004 and 2005, the Company has not identified circumstances which indicate that the carrying value of the property, plant and equipment may not be recoverable, hence no impairment loss was recognized.

If the estimates of cash flows and fair value of these long-lived assets change, management studies show that a 5.0% variance in historical charge experience would not have any significant impact to the Company s financial

statements.

Provision for loss contingency for guarantee granted by YEGCL

YEGCL guaranteed borrowings of Rmb 7.6 million and Rmb 178.5 million (US$22.1 million) granted by commercial banks to unrelated parties in 2004 and 2005, respectively. The borrowings are due in equal monthly or quarterly instalments through one to two years. The guarantees were made to individual persons who applied for mortgage loans from commercial banks to purchase automobiles equipped with diesel engines produced by Yuchai. The guarantees are for the entire amount and term of the borrowings. In return, YEGCL receives a premium fee amounted to 2% to 8% of the amount of borrowings. All guarantees are secured by automobiles at a net book value totaling Rmb 11.7 million and Rmb 242.2 million (US$30.0 million) as of December 31, 2004 and 2005, respectively. If the individual defaults on payment, YEGCL would have to perform under the guarantees. It is reasonably possible that YEGCL would be required to make payment under its guarantees. As of December 31, 2004 and 2005, the maximum amount of undiscounted payments that YEGCL would have to make in the event of default is Rmb 7.4 million and Rmb 134.2 million

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(US$16.6 million). Pursuant to the requirements of FIN 45, the Company accrued Rmb 0.2 million and Rmb 16.8 million (US$2.1 million) related to its stand ready obligation under the guarantee arrangement in 2004 and 2005, respectively. In assessing the contingent liability, management considered the probable recoverable amount of the secured automobiles and the customers deposits against its obligations to the banks for the defaulted payments from the customers. The Company has assessed that there is a risk exposure relating to default by customers on the expected future payments and therefore such a provision for loss contingency is required. The amount recognized during the year ended December 31, 2004 and 2005 includes premium received or receivable, which is amortized on a straight line basis over the terms of the guarantees, of Rmb 220.0 million and Rmb 4.5 million (US$0.6 million), respectively. The amount of premium being amortized, which were recorded as revenue, for the year ended December 31, 2004 and 2005 were amounted to Rmb 0.01 million and Rmb 1.2 million (US$0.1 million), respectively. The remaining balance of Rmb 12.3 million (US$1.5 million) as of December 31, 2005 represents the provision for loss contingency related to the guarantees where payment by the Company was probable.

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Recoverability of carrying amount of investment in TCL

The Company acquired a 15.99% equity ownership interest in TCL in 2005 as part of its diversification plan to include new businesses, other than Yuchai. The total purchase consideration was S$32.3 million, which approximates S$0.12 per share. The market price of TCL shares traded on the Singapore Exchange has fallen to S$0.08 on December 31, 2005 and was S$0.085 per share on July 31, 2006. Management of the Company has assessed and deemed the impairment to be temporary in nature and the Company has the ability and intent to hold its investment in TCL for a period that should allow it to recover its carrying value. Accordingly, no provision for impairment is required.

Using the quoted market price at December 31, 2005, the TCL investment was valued at S$22.5 million (Rmb 109.0 million based on an exchange rate of S$1.00 to Rmb 4.83), compared to our carrying value of S$38.3 million (Rmb 185.0 million based on an exchange rate of S$1.00 to Rmb 4.83). If the Company s management considered such impairment to be other than temporary, an impairment provision would have been recognized and income before income taxes and minority interest would have been reduced by Rmb 76.0 million (US$9.4 million based on an exchange rate of Rmb 8.0957 to US$1.00) for the year ended December 31, 2005.

Results of Operations

The following table sets forth the percentages of net revenues of certain income and expense items of the Company for the last three fiscal years ended December 31, 2003, 2004 and 2005, respectively:

	Percentage of Net Revenues Year Ended December 31,		
	2003	**2004**	**2005**
Revenues, net	100.0%	100.0%	100.0%
Cost of goods sold	69.9%	71.8%	77.7%
Gross profit	30.1%	28.2%	22.3%
Research and development costs	2.1%	2.5%	2.1%
Selling, general and administrative expenses	12.3%	11.8%	13.8%
Provision for uncollectible loans to a related party			3.5%
Operating income	15.8%	14.0%	2.9%
Interest expense	0.5%	0.6%	1.2%
Other (expenses)/income, net	0.0%	0.1%	0.4%
Income before income taxes and minority interests	15.2%	13.5%	2.0%
Income taxes	2.5%	1.9%	0.4%
Income before minority interests	12.8%	11.6%	1.7%
Minority interests in income of consolidated subsidiaries	3.2%	2.8%	0.5%
Net income	9.6%	8.8%	1.2%

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2005 Compared to 2004

Net revenue increased by 4.4% to Rmb 5,829.4 million (US$722.3 million) in 2005 compared to Rmb 5,582.1 million in 2004. The increase in net revenue was primarily due to higher sales volume arising from more aggressive marketing programs. Unit sales of diesel engines increased by 11.4% to 230,228 units in 2005 from 206,628 units in 2004 and this unit sales increase came mainly from higher sales of the 4-Series light-duty diesel engines and 6105 medium-duty diesel engines. In 2005, net revenues of the 4-Series light-duty diesel engines increased by approximately 35.7% and net revenues of the 6105 medium-duty engines increased by approximately 52.9% as compared to 2004.

Cost of goods sold increased by 13.0% to Rmb 4,527.0 million (US$561.0 million) in 2005 from Rmb 4,006.9 million in 2004, and increased as a percentage of net revenues to 77.7% in 2005 from 71.8% in 2004. Cost of manufacturing increased by 14.5% to Rmb 4,371.1 million (US$541.6 million) in 2005 from Rmb 3,816.7 million in 2004, and increased as a percentage of net revenue to 75.0% from 68.4% in 2004. Cost of materials consumed in costs of manufacturing increased by 15.9% to Rmb 3,660.9 million (US$453.6 million) in 2005 from Rmb 3,159.9 million in 2004 (due to higher production throughout during 2005, while cost of materials consumed as a percentage of net revenue increased to 62.8% in 2005 from 56.6% in 2004. Factory overhead (which does not include depreciation and salaries) included in cost of manufacturing decreased by 2.4% to Rmb 409.0 million (US$50.7 million) in 2005 from Rmb 419.2 million in 2004, due to lower variable factory expenses. Factory overhead as a percentage of net revenue decreased to 7.0% for 2005 and 7.5% for 2004. Depreciation included in cost of manufacturing increased to Rmb 115.5 million (US$14.3 million) from Rmb 84.9 million in 2004. Depreciation as a percentage of net revenue increased to 2.0% in 2005 from 1.5% in 2004.

Gross profit decreased by 17.3% to Rmb 1,302.4 million (US$161.4 million) in 2005 from Rmb 1,575.2 million in 2004. Gross profit margin (gross profit divided by net revenue) decreased to 22.3% in 2005 compared to 28.2% in 2004, reflecting a shift in the sales mix whereby the gross margin for the 4-Series and industrial engines were lower than margins historically achieved for both medium and heavy-duty engines.

SG&A expenses (excluding research and development) increased by 22.6% to Rmb 807.4 million (US$100.0 million) in 2005 from Rmb 658.3 million in 2004 and increased as a percentage of net revenue from 11.8% in 2004 to 13.8% in 2005. This increase in SG&A was primarily due to the increase in sales, legal and professional costs and allowance for doubtful accounts on trade accounts receivable. Research and development expenses decreased to Rmb 123.9 million (US$15.4 million) in 2005 from Rmb 137.0 million in 2004. Advertising expenses included in SG&A decreased by 7.0% to Rmb 45.3 million (US$5.6 million) in 2005 from Rmb 48.7 million in 2004. Advertising expenses as a percentage of net revenue decreased to 0.8% in 2005 from 0.9% in 2004. Sales commission expenses included in SG&A expenses increased by 239.7% to Rmb 39.4 million (US$4.9 million) in 2005 from Rmb 11.6 million in 2004. Sales commission expenses as a percentage of net revenues increased to 0.7% in 2005 from 0.2% in 2004. The decrease in advertising is mainly due to lower spending on television and road signboard advertising. The increase in sales commissions is mainly due to higher commission given to promote the sales of new products such as 6L and 6M heavy duty diesel engines.

Included in the 2005 income statement, is a provision for uncollectible loans to related party of Rmb 205,000 (US$25,402). See Note 5 to the Company s Consolidated Financial Statements appearing elsewhere herein. Salaries and wages as a percentage of net revenues was 8.3% in 2005 and 7.4% in 2004. As a result of the foregoing, profits from operations decreased to Rmb 168.7 million (US$20.9 million) in 2005 compared to Rmb 779.9 million in 2004.

Interest expenses increased by 122.1% to Rmb 70.5 million (US$8.7 million) in 2005 from Rmb 31.8 million in 2004, primarily due to increase in bank borrowings.

Profit before income taxes and minority interests in 2005 was Rmb 117.2 million (US$14.5 million), as compared to a profit of Rmb 753.9 million in 2004. Income tax expenses in 2005 was Rmb 20.9 million (US$2.6 million) compared to income tax expenses of Rmb 105.2 million in 2004. Yuchai was subject to PRC income tax at a rate of 15.0% in both 2004 and 2005. The effective tax rates of Yuchai were 14.0% and 17.8% for 2004 and 2005 respectively. Effective tax rate for 2005 was primarily due to additional non-deductible expenses for tax purposes.

As a result of the foregoing factors, the Company had profit before minority interests of Rmb 96.4 million (US$11.9 million) in 2005 compared to Rmb 648.7 million in 2004, and net income of Rmb 68.5 million

(US$8.5 million) in 2005 compared to a net income of Rmb 491.4 million in 2004.

2004 Compared to 2003

Net revenue increased by 22.1% to Rmb 5,582.1 million (US$674.5 million) in 2004 compared to Rmb 4,570.0 million in 2003. The increase in net revenue was primarily due to higher sales volume arising from more aggressive marketing programs. Unit sales of diesel engines increased by 20.0% to 206,628 units in 2004 from 172,219 units in 2003 and this unit sales increase came mainly from higher sales of the 4-Series light-duty diesel engines and 6112 heavy-duty diesel engines. In 2004, net revenues of the 4-Series light-duty diesel engines increased by approximately 54% and net revenues of the 6112 heavy-duty engines increased by approximately 20% as compared to 2003.

Cost of goods sold increased by 25.5% to Rmb 4,006.9 million (US$484.1 million) in 2004 from Rmb 3,192.8 million in 2003, and increased as a percentage of net revenues to 71.8% in 2004 from 69.9% in 2003. Cost of manufacturing increased by 27.5% to Rmb 3,816.7 million (US$461.1 million) in 2004 from Rmb 2,993.7 million in 2003, and increased as a percentage of net revenue to 68.4% from 65.5% in 2003. Cost of materials consumed in costs of manufacturing increased by 27.4% to Rmb 3,159.9 million (US$381.8 million) in 2004 from Rmb 2,479.9 million in 2003 (due to higher production throughput during 2004), while cost of materials consumed as a percentage of net revenue increased to 56.6% in 2004 from 54.3% in 2003. Factory overhead (which does not include depreciation and salaries) included in cost of manufacturing increased by 118.4% to Rmb 419.2 million (US$50.6 million) in 2004 from Rmb 191.9 million in 2003, due to higher variable factory expenses (such as utilities) arising from higher diesel engine production in 2004. Factory overhead as a percentage of net revenue similarly increased to 7.5% for 2004 and 4.2% for 2003. Depreciation included in cost of manufacturing decreased to Rmb 84.9 million (US$10.3 million) from Rmb 88.7 million in 2003. Depreciation as a percentage of net revenue decreased to 1.5% in 2004 from 1.9% in 2003.

Gross profit increased by 14.4% to Rmb 1,575.2 million (US$190.3 million) in 2004 from Rmb 1,377.2 million in 2003. Gross profit margin (gross profit divided by net revenue) decreased to 28.2% in 2004 compared to 30.1% in 2003, reflecting a shift in the sales mix whereby the gross margin for the 4-Series and industrial engines were lower than margins historically achieved for both medium and heavy-duty engines.

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SG&A expenses (excluding research and development) increased by 17.3% to Rmb 658.3 million (US$79.5 million) in 2004 from Rmb 561.2 million in 2003 and decreased as a percentage of net revenue from 12.3% in 2003 to 11.8% in 2004. This increase in SG&A was primarily due to the increase in sales. Research and development expenses increased to Rmb 137.0 million (US$16.5 million) in 2004 from Rmb 94.6 million in 2003. Such increased expenses were primarily due to the development of the 6L engines and Euro II compliance. Advertising expenses included in SG&A increased by 18.8% to Rmb 48.7 million (US$5.9 million) in 2004 from Rmb 41.0 million in 2003. Advertising expenses as a percentage of net revenue decreased to 0.9% in 2004 from 0.90% in 2003. Sales commission expenses included in SG&A expenses decreased by 30.5% to Rmb 11.6 million (US$1.4 million) in 2004 from Rmb 16.7 million in 2003. Sales commission expenses as a percentage of net revenues decreased to 0.2% in 2004 from 0.4% in 2003. The increase in advertising and decrease in sales commission expenses reflected primarily higher costs incurred for the promotion of the 6L and 6M engines in 2004 and the change in Yuchai s promotion strategies by offering lower selling prices to customers rather than through sales commission paid to its sales agents. Salaries and wages as a percentage of net revenues was 7.4% in 2004 and 7.5% in 2003. In 2003, management identified that certain property, plant and equipment were no longer used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed in accordance with SFAS No. 144. The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to estimated fair value. Impairment loss of Rmb 12.4 million (US$1.5 million) has been charged to income statements in 2003. In 2004, the Company has not identified circumstances which indicate that the carrying value of the property, plant and equipment may not be recoverable, hence no impairment loss was recognized. As a result of the foregoing, profits from operations increased to Rmb 779.9 million (US$94.2 million) in 2004 compared to Rmb 721.4 million in 2003.

Interest expenses increased by 34.7% to Rmb 31.8 million (US$3.8 million) in 2004 from Rmb 23.6 million in 2003, primarily due to increase in bank borrowings.

Income before income taxes and minority interests in 2004 was Rmb 753.9 million (US$91.1 million), as compared to Rmb 696.9 million in 2003. Income tax expenses in 2004 was Rmb 105.2 million (US$12.7 million) compared to income tax expenses of Rmb 112.9 million in 2003. Yuchai was subject to PRC income tax at a rate of 10.0% in 2000 and 2001, and 15.0% in 2002, 2003 and 2004.

As a result of the foregoing factors, the Company had income before minority interests of Rmb 648.7 million (US$78.4 million) in 2004 compared to Rmb 584.0 million in 2003, and net income of Rmb 491.4 million (US$59.4 million) in 2004 compared to Rmb 438.2 million in 2003.

Inflation

The general annual inflation rate in China was approximately 1.2%, 3.9% and 1.8% in 2003, 2004 and 2005, respectively. The Company s results of operations may be affected by inflation, particularly rising prices for parts and components, labor costs and other operating costs.

Liquidity and Capital Resources

The Company s primary sources of cash are funds from operations generated by Yuchai, as well as debt financing incurred by the Company. The Company s operations provided cash in 2003, 2004 and 2005. The acquisitions of TCL in 2005 and LKN in 2006 were funded from internal cash and external bank borrowings. In 2005, the Company s primary cash requirements were for working capital and capital expenditures to complete the expansion of production capacity. The Company believes that its sources of liquidity are sufficient for its requirements over the next year. Factors which may affect the Company s ability to generate funds from operations include increased competition (including as a result of China s admission to the WTO), fluctuations in customer demand for the Company s products, the Company s ability to collect and control its level of accounts receivable, the status of the Company s investment in Yuchai under Chinese law and the implementation of the Reorganization Agreement (see Item 4. Information on the Company Recent Developments).

As of December 31, 2005, the Company had approximately Rmb 736.2 million (US$91.2 million) in cash on a consolidated basis which the Company considers would be sufficient to meet the Company s operational requirements at least for the next year. However, the Company believes that if the Company is considered on a stand alone basis

without its investment in Yuchai, the Company would find it difficult to raise new capital (either debt or equity) on its own.

The following table summarizes the key elements of the Company s cash flows for the last three years:

	December 31,			
	2003	**2004**	**2005**	**2005**
	Rmb	**Rmb**	**Rmb**	**US$**
	(in thousands)			
Net cash provided by operating activities	1,075,274	589,608	242,674	30,070
Net cash used in investing activities	(372,373)	(753,367)	(677,215)	(83,915)
Net cash (used in)/provided by financing activities	(714,163)	254,493	452,777	56,105
Currency translation adjustment			(4,713)	(584)
Net (decrease)/increase in cash and cash equivalents	(11,262)	90,734	13,523	1,676

Net cash flow provided by operating activities decreased by Rmb 346.9 millions. The decrease was principally caused by an increase in inventories, net of Rmb 289.7 million, due to stocking up at the end 2005 to meet expected higher sales in 2006. In addition,

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the decrease in net cash from operating activities was also partly attributed to increase in trade accounts receivables, net of Rmb 270.7 million and increased in amount due from related companies of Rmb 115.1 million. In addition, there was an increased in trade accounts payable in 2005 of Rmb 553.3 million arising from increased business activities from higher production. Net cash used in investing activities decreased by Rmb 76.2 million in 2005, principally due to repayment of Rmb 205.0 million of loans from a related company and increased in purchased of investments of Rmb 161.4 million. The Rmb 205.0 million loan repaid by the related company (YMLC) was subsequently re-loaned to the same company (see also Note 5 to the Company s Consolidated Financial Statements appearing elsewhere herein. Net cash provided by financing activities increased by Rmb 198.3 million in 2005, mainly due to net increase in net proceeds from bank terms loans of Rmb 432.8 million, proceeds from 2% convertible bonds of Rmb 206.9 million and offset by the dividend payment of Rmb 120.3 million made in 2005.

Cash provided by continuing operations is a major source of the Company s liquidity. Other than with respect to the application of cash generated from operations for capital expenditures and dividend payments (see Item 8. Financial Information Policy on Dividend Distributions), the Company does not have a formal cash management policy.

The Company expects that cash generated from operations and credit collection arrangements should provide the Company with sufficient financial flexibility to satisfy future bank obligations, capital expenditures and projected working capital requirements. However, at certain times cash generated from operations is subject to seasonal fluctuations. As a result, the Company may use periodic borrowings to supplement its working capital requirements. Yuchai has established banking relationships with a number of domestic Chinese banks, each of which will review Yuchai s loan applications on a case by case basis with reference to the loan limit approved by Yuchai s Board of Directors. Yuchai had outstanding borrowings of Rmb 962.8 million as of December 31, 2005. The interest rate applicable to the amounts borrowed ranges from 4.94% and 5.85% per annum. During its April 2006 board meeting, the Yuchai board of directors approved an increase in this borrowing limit to Rmb 2,000 million. As of June 30, 2006, Yuchai had outstanding borrowings of Rmb 920 million. The Company believes that should there be a need for further loans from banks, Yuchai could seek to drawdown additional amounts up to such limit from the Chinese domestic banks; however, no assurance can be given that such additional borrowings would be approved by such banks.

The Company s working capital as of December 31, 2005 was Rmb 959.4 million compared to Rmb 1,402.2 million as of December 31, 2004. The decrease in working capital was primarily due to the increase of accounts payable by 50.8% to Rmb 1,643.0 million, with higher volume of raw materials and components purchased to meet expected higher sales in 2006. In addition, the increase in total current liabilities was also partly due to increase in borrowings of Rmb 432.8 million. As of December 31, 2005, the Company had long-term debt, including current installments, totaling Rmb 150.0 million, of which Rmb 100.0 million will mature in 2006. The Company had current debt totaling Rmb 812.8 million as of December 31, 2005.

The Company s capital expenditures were Rmb 515.4 million in 2005, Rmb 552.9 million in 2004 and Rmb 372.8 million in 2003. As of December 31, 2005, the Company had authorized and contracted for capital expenditures for improvement to existing production facilities in the amount of Rmb 214.1 million. As the Company s business continues to grow, it will also require additional funds for increased working capital requirements, including to finance increased accounts receivable. The Company expects to fund its capital expenditures and working capital requirements primarily from funds from operations generated by Yuchai and, to the extent that is insufficient, from bank loans incurred by Yuchai and the Company. Yuchai s ability to obtain financing is limited by government regulation and a general shortage of debt and equity financing in China. Any additional capital contribution by the Company to Yuchai would require, among other things, the approval of the MOC, which has broad discretion with respect to such approval.

In February 2005, the Company issued $25.0 million in principal amount of convertible bonds due 2012 in a private placement. The convertible bonds carried interest at 2.0% per annum and matured in 2012, unless redeemed earlier in accordance with their terms. The bonds were convertible by their holders into newly issued ordinary shares of the Company at a conversion price of $12.969 per share, subject to customary adjustments. The bonds were fully converted by their holders in June 2005. Upon conversion, the Company issued 1,927,673 ordinary shares, representing approximately 5.45% and 5.17% of the then existing and enlarged issued share capital of the Company, respectively. The Company received approximately $24.9 million in proceeds from the convertible bond placement

after deducting costs and expenses. The proceeds of the offering had been fully utilized to finance the TCL share acquisitions described above.

As an additional source of funding for the Company s business expansion and diversification related activities, the Company had in March 2005, September 2005, January 2006 and March 2006 entered into credit facilities for $25.0 million, $50.0 million, S$60.0 million (approximately US$37.0 million, based on an exchange rate of S$1.62 to US$1.00) and S$110.0 million (approximately US$69.2 million, based on an exchange rate of S$1.59 to US$1.00), respectively, with various banks in Singapore. The Company has drawn down the first three facilities as of June 30, 2006 in connection with its acquisition of shares and bonds in TCL and LKN described above. The purpose of the fourth credit facility is to enable the Company to make further new acquisitions

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as part of its diversification plans. These facilities aggregate approximately $181.2 million of which $112 million had been drawn down as of June 30, 2006. The terms of these facilities require, among other things, that HLA retains ownership of CYI s Special Share and that CYI remains a consolidated subsidiary of HLA. The terms of these facilities also include certain financial covenants with respect to CYI s tangible net worth and net gearing ratio throughout the tenor of the facility, as well as negative pledge provisions and customary drawdown requirements and events of default.

As part of its business strategy, Yuchai seeks from time to time opportunities to invest in domestic manufacturers of diesel engine parts and components, as well as in other related automotive businesses, including truck manufacturers, and insurance, warranty servicing and credit support for diesel engine customers. Yuchai may make such investments and acquisitions with funds provided by operations, future debt or equity financings or a combination thereof. Subsequent to December 31, 2005, Yuchai has lodged an application to the People s Bank of China for short-term bonds issuing limit amounting to Rmb 1,000 million (US$124.5 million). The application was approved on May 30, 2006 and is valid until the end of June 2007. Yuchai can issue the bonds in multiple tranches at various dates during the validity period of the approval. Yuchai intends to use these short-term bonds principally to refinance existing indebtedness relating to its working capital requirements.

Yuchai issued the first tranche of Rmb 500 million short-term bonds on June 13, 2006 with a maturity date on March 9, 2007.

The following table sets forth information on the Company s material contractual obligation payments for the periods indicated as of December 31, 2005:

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**More than 5 Years**
			(in Rmb millions)		
Short-term debt	913	913			
Long-term debt	50		50		
Purchase Obligations regarding capital expenditure	214	214			
Lease Commitments	6	3	3		
Total	1,183	1,130	53		

Subsequent to December 31, 2005, the Company entered into a number of contractual arrangement that result in additional cash obligations or contingent cash obligations (see Note 34 to the Consolidated Financial Statements).

Off-Balance Sheet Arrangements

The Company currently does not engage in any off-balance sheet arrangements.

Guarantee by YEGCL

YEGCL guaranteed borrowings of Rmb 7.6 million and Rmb 178.5 million (US$22.1 million) granted by commercial banks to unrelated parties in 2004 and 2005, respectively. The borrowings are due in equal monthly or quarterly instalments through one to two years. The guarantees were made to individual persons who applied for mortgage loans from commercial banks to purchase automobiles equipped with diesel engines produced by Yuchai. The guarantees are for the entire amount and term of the borrowings. In return, YEGCL receives a premium fee amounted to 2% to 8% of the amount of borrowings. All guarantees are secured by automobiles at a net book value totaling Rmb 11.7 million and Rmb 242.2 million (US$30.0 million) at December 31, 2004 and 2005, respectively. If the individual defaults on payment, YEGCL would have to perform under the guarantees. It is reasonably possible that YEGCL would be required to make payment under its guarantees. As of December 31, 2004 and 2005, the maximum

amount of undiscounted payments that YEGCL would have to make in the event of default is Rmb 7.4 million and Rmb 134.2 million (US$16.6 million). Pursuant to the requirements of FIN 45, the Company accrued Rmb 0.2 million and Rmb 16.8 million (US$2.1 million) related to its stand ready obligation under the guarantee arrangement in 2004 and 2005, respectively. The amount recognized during the year ended December 31, 2004 and 2005 includes premium received or receivable, which is amortized on a straight line basis over the terms of the guarantees, of Rmb 0.2 million and Rmb 4.5 million (US$0.6 million), respectively. The amount of premium being amortized, which were recorded as revenue, for the year ended December 31, 2004 and 2005 were amounted to Rmb 0.01 million and Rmb 1.2 million (US$0.1 million), respectively. The remaining balance of Rmb 12.3 million (US$1.5 million) as of December 31, 2005 represents the provision for loss contingency related to the guarantees where payment by the Company was probable.

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Outstanding bills discounted

As of December 31, 2004 and 2005, outstanding bills discounted with banks for which the Company has retained a recourse obligation totaled Rmb 1,117.8 million and Rmb 1,373.7 million (US$170.2 million), respectively.

Outstanding letter of credits

As of December 31, 2004 and 2005, the Company had issued irrevocable letter of credits of Rmb 165.9 million and Rmb 110.3 million (US$13.7 million), respectively.

Except for the above off-balance sheet arrangements, the Company has no other outstanding derivative financial instruments, off-balance sheet arrangements or guarantees.

Recently Issued Accounting Standards

Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 47

In March 2005, the FASB issued FIN No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. The types of asset retirement obligations that are covered by this interpretation are those for which an entity has a legal obligation to perform an asset retirement activity, however the timing and (or) method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ended after December 15, 2005. The initial adoption of FIN 47 did not have an impact on the Company s financial condition and consolidated statements of income.

FIN No. 48

In June 2005, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are effective for the fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of the provisions of FIN 48 to the Company s consolidated financial statements.

Emerging Issues Task Force (EITF) 04-13

In September 2005, the EITF issued EITF 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty . EITF 04-13 provides guidance as to when purchases and sales of inventory with the same counterparty should be accounted for as a single exchange transaction. EITF 04-13 also provides guidance as to when a nonmonetary exchange of inventory should be accounted for at fair value. EITF 04-13 will be applied to new arrangements entered into, and modifications or renewals of existing arrangements beginning in the first interim or annual reporting beginning after March 15, 2006. The application of EITF 04-13 is not expected to have a significant impact on the Company s consolidated financial statements.

SFAS No. 151

In December 2004, the FASB issued SFAS No. 151, Inventory Costs , which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Under this statement, such items will be recognized as current-period charges. In addition, the statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement will be effective for the Company for inventory costs incurred on or after January 1, 2006. The initial adoption of this statement will not have a significant effect on the Company s 2006 consolidated financial statements.

SFAS No. 153

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets , which eliminates an exception in Accounting Principles Board (APB) Opinion No. 29, Accounting for Nonmonetary Transactions , for recognizing nonmonetary exchanges of similar productive assets at fair value and replaces it with an exception for recognizing exchanges of nonmonetary assets at fair value that do not have commercial substance. This statement will be effective for the Company for nonmonetary asset exchanges occurring on or after January 1, 2006. The adoption of this statement will not have a significant effect on the Company s 2006 consolidated financial statements.

SFAS No. 155

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 . This statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . This statement resolves issues addressed in SFAS No 133 Implementation and Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets . This statement will be effective for the fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact of the statement to the Company s consolidated financial statements.

SFAS No. 156

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 . This statement amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities , with respect to the accounting for separately recognized servicing assets and servicing liabilities. The statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations and requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The statement also provides guidelines to classification, disclosure and subsequent measurement of servicing assets and servicing liabilities. This statement will be effective for the fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact of the statement to the Company s consolidated financial statements.

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SFAS No. 123 (revised 2004)

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment , which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. This statement is a revision to SFAS No. 123 and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees , and its related implementation guidance. This statement will require measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock options. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized. The Company will adopt this statement on January 1, 2006 under the modified prospective method of application. Under that method, the Company will recognize compensation costs for new grants of share-based awards, awards modified after the effect date, and the remaining portion of the fair value of the unvested awards at the adoption date. The initial adoption of this statement will not have any effect on the Company s 2006 consolidated financial statements.

Research and Development

The Company has committed substantial resources to continually improve the technology of its products. The Company s internal development effort focuses primarily on improving manufacturing processes and adapting foreign technology to the Chinese market. In addition, the Company plans to continue to acquire advanced technology from Chinese research institutes, foreign engine design consulting firms and foreign diesel engine and engine parts manufacturers. As of December 31, 2005, the Company employed over 1,445 engineers, approximately 267 of whom were devoted to research and development, product enhancement and new designs. In 2003, 2004 and 2005, the Company spent approximately Rmb 94.6 million, Rmb 137.0 million and Rmb 123.9 million (US$15.4 million), respectively, on research and development. The Company believes that it has been able to control to some extent the increase of research and development expenses due to the relatively low salary levels of engineers in China.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.

Directors and Senior Management of the Company

The Board of Directors of the Company shall consist of up to eleven members. Currently, there are nine members elected to and serving on the Company s Board of Directors, with two vacancies. Pursuant to the rights afforded to the holder of the Company s Special Share, HLA has designated Messrs. Teo Tong Kooi, Gan Khai Choon, Gao Jia Lin, Kwek Leng Peck, Wong Hong Ren and Philip Ting Sii Tien as its directors.

The directors and executive officers of the Company as of June 30, 2006 are identified below.

Name	Position	Year First Elected or Appointed Director or Officer
TEO Tong Kooi[1]	President and Director	2004
GAO Jia Lin[1]	Vice President and Director	1995
GAN Khai Choon	Director	1995
Raymond C. K. HO[1][2][3][4][6]	Director	2004
KWEK Leng Peck[1][3]	Director	1994
NEO Poh Kiat[2][3]	Director	2005[5]
TAN Aik-Leang[1][2][4]	Director	2005[5]
Philip TING Sii Tien[1]	Director and Chief Financial Officer	1994
WONG Hong Ren[1][4]	Director	1994
Sheila MURUGASU	General Counsel	2003
Ira Stuart OUTERBRIDGE III	Secretary	2001

(1) Also a director of Yuchai.

(2) Member of the Audit Committee.

(3) Member of the Compensation Committee.

(4) Member of the Special Committee.

(5) Appointed as director in 2005.

(6) Mr. Ho has notified the Company that he will not be seeking re-election at the Company s forthcoming annual general meeting of shareholders.

Mr. Teo Tong Kooi is the President of the Company and a Director of Yuchai. He is also a Director and Chief Executive Officer of HLA as well as a Director of TCL, Henan Xinfei Electric Group and various building materials companies within the Hong Leong Group Singapore. He is also an Executive Director of Malaysia listed Tasek Corporation Berhad, which previously he held the position of the Managing Director. Mr. Teo holds a Bachelor of Science degree in Marketing Management and a Master of Business Administration (both from Golden Gate University, San Francisco, California, USA). He has also completed the Executive Management Programme at the Stanford University Graduate School of Business and has 19 years of corporate and commercial banking experience with 13 years in senior management positions.

Mr. Gao Jia Lin is the Vice-President and a Director of the Company and Deputy Chairman and a Director of Yuchai. He has a mechanical engineering degree from Qinghua University, and joined Hong Leong (China) Limited in 1992. He is currently the Senior Vice President of HLA, China Operation.

Mr. Gan Khai Choon is a Director of the Company. He is currently the joint managing director of Hong Leong International (Hong Kong) Limited. He holds a bachelor s degree (economics honors) from the University of Malaya.

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Mr. Raymond C. K. Ho is a partner of Fred Kan & Co., a Hong Kong based law firm. He has been in private practice as a solicitor since 1983 in Hong Kong, Mainland China and Canada. He has held various public service positions with the Law Society of Hong Kong, Hong Kong Trade Development Council and Hong Kong International Arbitration Centre. He is also currently the Chairman of the Mainland Legal Affairs Committee of the Law Society of Hong Kong. During 2004, Fred Kan & Co. rendered legal advice to the Company in connection with the implementation of the July 2003 Agreement, for which CYI paid approximately US$30,000. The Company s Board of Directors has determined that Mr. Ho is independent within the meaning of NYSE s recently adopted corporate governance standards, on the basis that the amount paid for the legal services provided by Fred Kan & Co is not material to either the Company or Fred Kan & Co and that the Company has no other relationship, direct or indirect, which is material with Mr. Ho. Mr. Ho has notified the Company that he will not be seeking re-election at the forthcoming annual general meeting of the Company. Upon conclusion of that meeting, Mr. Ho will cease to be a director of the Company and Yuchai, and will cease to serve on the Company s Audit Committee, Compensation Committee and Special Committee.

Mr. Kwek Leng Peck is a Director of the Company. Mr. Kwek is a member of the Kwek family, which controls the Hong Leong Group Singapore. Mr. Kwek serves as Executive Director of HLA, and has over 25 years of experience in trading, manufacturing, property investment and development, hotel operations, corporate finance and management. Mr. Kwek holds directorships on the boards of several Hong Leong Group Singapore companies, including HLA, City Developments Limited, HLC, Hong Leong Finance Limited, City e-Solutions Limited and Millennium & Copthorne Hotels plc.

Mr. Neo Poh Kiat is a Director of the Company. He is a Managing Director of Octagon Advisors Pte Ltd, a financial advisory firm in Singapore. Between 1976 to January 2005, he has held senior managerial positions with companies in the Development Bank of Singapore group and United Overseas Bank Ltd, including as Country Officer (China), Head Corporate Banking (Greater China) at United Overseas Bank Ltd. Mr. Neo is currently a director of Octagon Advisors (Shanghai) Co. Ltd., Singapore International School Foundation Ltd (Hong Kong), and Asia Airfreight Terminal Co Ltd. He holds a Bachelor of Commerce degree from Nanyang University, Singapore. The Company s Board of Directors has determined that Mr. Neo is independent within the meaning of NYSE s recently adopted corporate governance standards, on the basis that the Company has no material relationship with him.

Mr. Tan Aik-Leang is a Director of the Company. He is currently an independent Risk Management Consultant to banks and other financial services institutions and is based in Hong Kong. Between 1973 and 2001, he has held various senior executive and managerial positions at the Dao Heng Bank Group in Hong Kong, the National Australia Bank Group in Australia and Hong Kong and The Bank of Nova Scotia in Canada. Mr. Tan is currently a Director of the Board of The Risk Management Association, Hong Kong Chapter (headquartered in U.S.A.) and a Fellow member of the Hong Kong Institute of Certified Public Accountants, CPA Australia, the Australasian Institute of Banking and Finance and the Institute of Canadian Bankers. The Company s Board of Directors has determined that Mr. Tan is independent within the meaning of NYSE s recently adopted corporate governance standards, on the basis that the Company has no material relationship with him.

Mr. Philip Ting Sii Tien has been the Chief Financial Officer of the Company since 1994 and became a Director in February 2004. He is also an alternate director to Mr. Teo Tong Kooi on the Board of TCL. He was appointed Chief Financial Officer of HLC in 1994. In 2001, he became the Group Chief Financial Officer for the HLA group of companies. Prior to joining the Hong Leong Group Singapore, from 1993 to 1994, Mr. Ting served as Regional Controller of Quantum Asia Pacific, Singapore, a leading disk drive manufacturer. Mr. Ting served as Regional Controller of Black & Decker Asia Pacific Pte. Ltd. (Singapore) from 1990 to 1993 and as Controller of Deutsche Bank (Singapore) from 1987 to 1989. Mr. Ting is an Associate Member of the Institute of Chartered Accountants in England and Wales.

Mr. Wong Hong Ren has been a Director of the Company since 1994. He has also been a Director of Yuchai since 1993. He is also the Chairman of LKN and a Director of TCL. Since 1988, he has served as Group Investment Manager of Hong Leong Management Services Pte. Ltd. in Singapore. Prior to his joining the Hong Leong Group in January 1988, Mr. Wong was Director and General Manager (Investment and Property) of Haw Par Brothers International Ltd. and Director of Investment with Royal Trust Asset Management Pte. Ltd. and First Capital

Corporation Ltd., where he was actively involved in management of the companies funds in international equities.

Ms. Sheila Murugasu is the Group Counsel of the Company. Ms. Murugasu has been the Group Legal Counsel for the HLA group of companies since 1996. Ms. Murugasu is a qualified Singapore lawyer, and prior to joining HLA, was in private legal practice in Singapore.

Mr. Ira Stuart Outerbridge III is the Secretary of the Company. Mr. Outerbridge is a graduate of the University of North Carolina at Chapel Hill and is a Fellow of the Institute of Chartered Secretaries and Administrators. He joined Codan Services Limited as a Corporate Manager in February 1996.

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Audit Committee

The members of the Audit Committee are Messrs. Tan Aik-Leang (Chairman), Raymond C. K. Ho and Neo Poh Kiat. The Audit Committee oversees the actions of the Company s independent public accountants and reviews the Company s internal accounting procedures. The Board has designated Mr. Tan Aik-Leang as the Company s Audit Committee Financial Expert. However, Mr. Ho has notified the Company that he will not be seeking re-election at the forthcoming annual general meeting of the Company. The Company is currently searching for a replacement independent director, and until such person is appointed, the Company s Audit Committee will consist of only two independent members.

Compensation Committee

The members of the Compensation Committee are Messrs. Kwek Leng Peck (Chairman), Raymond C.K. Ho and Neo Poh Kiat. The Compensation Committee reviews and approves executive appointments and remuneration, and administers the Company s employee benefit plans, including the Company s stock option plans, if any. See also Share Ownership Stock Option Plan .

Special Committee

The members of the Special Committee are Messrs. Wong Hong Ren (Chairman), Raymond C. K. Ho and Tan Aik-Leang. The Special Committee was established in 2003 in response to the difficulties which the Company faced with respect to its investment in Yuchai, and is not a permanent committee of the Company s Board of Directors. Steps taken by the Special Committee included instituting legal and arbitration proceedings against the Chinese shareholders of Yuchai in May 2003, and subsequently discontinuing these proceedings following the execution of the July 2003 Agreement. The Special Committee s mandate has subsequently been further expanded to address issues relating to the implementation of the July 2003 Agreement and the Reorganization Agreement, including the business expansion and diversification plans, as well as to review and resolve any difficulties which CYI may experience in obtaining the cooperation of the Chinese shareholders of Yuchai in the management and operation of Yuchai, including if necessary the commencement of litigation and/or arbitration. See also Item 8. Financial Information Legal Proceedings .

Directors and Executive Officers of Yuchai

The Board of Directors of Yuchai consists of thirteen members. Currently, there are thirteen members elected to and serving on Yuchai s Board of Directors. Yuchai s Articles of Association entitle the Company (as the indirect holder of the Foreign Shares) to designate nine directors and entitle the Chinese shareholders to designate four directors. These nomination rights were acknowledged and confirmed by Yuchai as part of the terms of the Reorganization Agreement. Pursuant to and subject to the conditions in the Shareholders Agreement described under Item 7. Major Shareholders and Related Party Transactions , and by virtue of the Special Share, HLA is entitled to designate six of the nine Yuchai directors designated by the Company. The Company has designated Messrs. Gao Jia Lin, Teo Tong Kooi, Raymond C. K. Ho, Kwek Leng Peck, Tan Aik-Leang, Philip Ting Sii Tien, Wong Hong Ren, Qin Xiao Cong and Yuan Xu Cheng as Yuchai s directors. Pursuant to the Shareholders Agreement and the Bye-laws of the Company, the Yuchai directors designated by the Company will vote as a block in accordance with the vote of the majority of such directors. As part of the terms of the Reorganization Agreement, Yuchai affirmed the continued rights of the Company, as Yuchai s majority shareholder, to direct the management and policies of Yuchai through Yuchai s board of directors.

The directors and executive officers of Yuchai as of June 30, 2006 are identified below.

Name	Position	Year First Elected or Appointed Director Position or Officer
YAN Ping	Chairman of the Board of Directors	2005
GAO Jia Lin[1]	Deputy Chairman of the Board of Directors	1995
Raymond C.K. HO[1][2]	Director	2004
LI Tiansheng	General Manager and Director	2001
KWEK Leng Peck[1]	Director	2005
TAN Aik-Leang[1]	Director	2005

TEO Tong Kooi[1]	Director	2004
TING Sii Tien, Philip[1]	Director	2004
QIN Xiao Cong	Director	2003
SHAO Qihui	Director	2003

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Name	Position	Year First Elected or Appointed Director Position or Officer
WONG Hong Ren(1)	Director	1993
YUAN Xu Cheng	Director	2003
GU Tangsheng	Assistant to Chairman and Director	2005
GONG Hai	Deputy General Manager	2006
LIM Poh Lea	Financial Controller	2004
SHEN Jie	Chief Engineer	2002
WU Qiwei	Deputy General Manager	2006
YANG Weizhong	Chief Accountant	1992

(1) Also a Director of the Company.

(2) Mr. Ho has advised Yuchai that he will resign as a director of Yuchai concurrent with his resignation as a director of the Company.

For information about Messrs. Gao Jia Lin, Teo Tong Kooi, Raymond C.K. Ho, Wong Hong Ren, Philip Ting Sii Tien, Kwek Leng Peck and Tan Aik-Leang, see Directors and Senior Management of the Company . For additional information regarding Mr. Wang Jianming s employment status with Yuchai, see Compensation Yuchai and Item 8. Financial Information Legal Proceedings .

Mr. Yan Ping is the Chairman of the Board of Directors of Yuchai. Mr. Yan Ping has been the Chairman of the State Holding Company since May 2005. The State Holding Company owns 22.1% of the shares of Yuchai, and is owned by the Yulin City Government. Prior to becoming Chairman of the State Holding Company, Mr. Yan Ping held various government related position, including most recently as Deputy Secretary-General, Yulin Municipal Government and as Director, Yulin Municipal Development and Reform Commission. Mr. Yan Ping holds a Bachelor of Engineering degree from Dalian Railway College and a Master of Economics degree from the East-North Financial University.

Mr. Li Tiansheng is a Director and Deputy General Manager of Yuchai. He previously served as the principal coordinator for liaison with Chinese government agencies, banks and tax department.

Mr. Qin Xiao Cong is a director of Yuchai and Coomber Investments Limited. He also serves as a director and General Manager of Zhonglin Development Company Limited.

Mr. Shao Qihui is an independent director of Yuchai. He previously served as the Minister of Machinery Industry Ministry. He is the Honorary President of China Machinery Association.

Mr. Yuan Xu Cheng is a director of Yuchai. He previously served as the director and Assistant General Manager of Guijiang Enterprise Co.

Mr. Gu Tangsheng is a Director of Yuchai and Assistant to the Chairman of the State Holding Company. He holds a PhD in physics from Zhongshan University.

Mr. Gong Hai serves as Deputy General Manager in charge of parts and supplies. Mr. Gong is a graduate from Sichuan Science and Technology University majoring in foundry science and completed his MBA program from

Huazhong University of Science and Technology.

Mr. Lim Poh Lea is the Financial Controller assigned by the Company to assist in the financial administration, budgeting and planning of Yuchai s financial matters. Mr. Lim is a financial controller employed by the Company. Mr. Lim is a Fellow of the Association of Chartered Certified Accountants, United Kingdom and a Certified Public Accountant of Singapore.

Mr. Shen Jie is the Chief Engineer and is responsible for all matters relating to engine design, testing and quality control. He joined Yuchai over 20 years ago as an engineer.

Mr. Wu Quwei is the Deputy General Manager and is in charge of sales and marketing. Mr. Wu graduated from Hunan University majoring in internal-combustion engine, vehicle and mechanical engineering. Mr. Wu had also completed his MBA program from the Huazhong University of Science and Technology.

Mr. Yang Weizhong joined Yuchai in 1969. He has been the Chief Accountant since 1993. Prior thereto, he served as Assistant Chief of Yuchai s Finance Division.

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Pursuant to Yuchai s Articles of Association, Yuchai s shareholders have authority over all matters of importance relating to Yuchai, including: (i) the review and approval of reports submitted by the Board of Directors of Yuchai; (ii) the approval of Yuchai s plans for distribution of profits and recovery of losses; (iii) the approval of Yuchai s annual capital and operating budget and year-end financial statements; (iv) the issuance of new common shares or other securities, the increase in the scope of any subscription of shares and the transfer procedures for Yuchai s share certificates; (v) the nomination, election, dismissal and compensation of members of the Board of Directors; and (vi) significant sales or purchases of assets, or any division, merger, acquisition, termination, liquidation or other major corporate action of Yuchai. Yuchai shareholders are entitled to preemptive rights to subscribe pro rata in accordance with their ownership percentage for any new Yuchai shares or other equity interests offered by Yuchai at a price and on terms at least equivalent to those offered to new subscribers.

Yuchai s Board of Directors reports directly to the shareholders of Yuchai and is the principal executive authority responsible for major decisions relating to Yuchai, including: (i) the execution of resolutions adopted by the shareholders; (ii) the formulation and review of Yuchai s development plans; (iii) the review of Yuchai s annual business plans; (iv) the review of Yuchai s financial budget, final accounts, dividend distribution plan, plans for issuances of Yuchai Shares and plans for merger, division and transfer of assets; (v) the election and dismissal of the Chief Executive Officer; (vi) the adoption of various corporate policies and rules; (vii) the appointment and dismissal of senior executive officers as recommended by the Chief Executive Officer; (viii) major external matters; (ix) sales, purchases, transfers and leases of material assets with a value in excess of US$3 million and which are not contemplated in Yuchai s approved budgets; and (x) any other matters that may be determined by the Board of Directors in accordance with Yuchai s Articles of Association.

In order to further strengthen its level of corporate governance, the Company has continued to seek to cause Yuchai to adopt comprehensive corporate governance guidelines, which seek to put procedures in place to improve the management and corporate governance of Yuchai. Pursuant to the Reorganization Agreement, as amended, Yuchai has agreed to implement the corporate governance guidelines which had been approved by Yuchai s Board of Directors in November 2002 but which had subsequently not been submitted to the relevant Chinese governmental authorities for approval. Yuchai has advised the Company that such submission has now been made, and that other steps are currently being taken by Yuchai to put in place an appropriate corporate governance structure conforming to international custom and practice at Yuchai.

The Company is also required to comply with the requirements of the Sarbanes-Oxley Act of 2002. Section 404 of that Act requires the Company s management to file an internal control report which states that it is management s responsibility to establish and maintain an adequate internal control structure and procedures and financial reporting. Management also needs to assess the effectiveness of the internal control structure and procedures for financial reporting. External auditors will be engaged to attest to management s assertion on the internal control report for the financial year ending December 31, 2006. In November 2005, the Company employed an internal control specialist to head the Company s Section 404 implementation project. The Company has also engaged PricewaterhouseCoopers Singapore as the technical consultants for the project. Section 404 attestation work by external auditors is expected to commence in August 2006.

Pursuant to Yuchai s Articles of Association, the Board of Directors of Yuchai consists of 13 directors appointed for three-year terms. So long as the present ratio of Foreign Shares to the total number of State Shares and Legal Person Shares of Yuchai remains unchanged, a total of nine directors shall be elected from nominees of holders of Foreign Shares and a total of four directors shall be elected from nominees of holders of State Shares and Legal Person Shares. Actions generally may be taken by a majority vote of the directors present at a meeting at which a quorum is present. Attendance of at least seven directors (at least four representing holders of Foreign Shares and at least three representing holders of State Shares or Legal Person Shares) constitutes a quorum.

The Company is entitled under Yuchai s Articles of Association to elect nine of Yuchai s 13 directors, thereby entitling it to effect all major decisions relating to Yuchai. As part of the terms of the Reorganization Agreement, Yuchai affirmed the continued rights of the Company, as Yuchai s majority shareholder, to direct the management and policies of Yuchai through Yuchai s board of directors. A two-thirds vote of the outstanding shares at a shareholders meeting at which a quorum is present is required for major corporate actions, such as an amendment to Yuchai s

Articles of Association, significant sales or purchases of assets or a division, merger, acquisition or liquidation of Yuchai, or issuances of new common shares or other securities of Yuchai. Attendance of shareholders representing at least two-thirds of the outstanding Yuchai shares constitutes a quorum for shareholder meetings considering such major corporate actions.

However, although the Company s nominees constitute a majority of the Board of Directors of Yuchai, there have on various occasions in the past been periods of time when no board meetings have been held, despite Yuchai s Articles of Association requiring the Board of Directors to meet at least once every six months as well as repeated requests by the Company. Prior to execution of the Reorganization Agreement, Yuchai s Articles of Association contained stringent quorum provisions, which required that, three of the

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four directors elected by holders of State Shares or Legal Person Shares had to attend, in order for quorum to be achieved, and as a result Board of Directors meetings to be held. However, subsequent to execution of the Reorganization Agreement, these quorum requirements have been amended to permit a meeting to occur in circumstances in which a quorum for a Board of Directors meeting is not met on two occasions prior thereto.

Yuchai s management consists of a Chairman, a General Manager and several Deputy General Managers, other senior officers designated by the board of directors and one senior manager designated by the Company. Yuchai s management handles daily operations and implements the corporate policies under the direction and guidance of the Board of Directors of the Company. In November 2003, Mr. Wang Jianming entered into a new contract of employment with Yuchai, pursuant to which he was appointed as Chief Executive Officer of Yuchai. Mr. Wang Jianming ceased to serve as the chairman, legal representative and chief executive officer of Yuchai, as well as the chairman and legal representative of the State Holding Company, the principal Chinese shareholder of Yuchai with effect from October 28, 2005. The new chairman and legal representative of these companies is Mr. Yan Ping whose appointment was confirmed on December 2, 2005.

Yuchai s Board of Directors has established an Investment Review Committee, which is responsible for reviewing the necessity and feasibility of investment projects and making recommendations to the Board of Directors. Although significant investment decisions should be made by a majority vote of the Board of Directors, not all investments undertaken by Yuchai have in the past been submitted to this Committee for approval or have received this or other required corporate approvals. For example, Yuchai s loan of Rmb 205.0 million to YMLC, Yuchai s appointment of a consultant to advise on the formation of and Yuchai s investment in a new logistics business, the consultancy contract of Rmb 60.0 million, and the disbursement of funds to acquire headquarters in Guilin for this new logistics company, each only received the requisite corporate approvals subsequent to their occurrence. See also the formation of YEGCL, described under Item 4. Information on the Company Business Overview Manufacturing , and the recent loans made by Yuchai, described under Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Other Transactions .

As a general matter, the Company requires access to certain financial books and records of Yuchai so as to be able to monitor its investment in Yuchai and to prepare the Company s consolidated financial statements. In early 2004, Yuchai management temporarily denied the Company such access. In response, the Company initiated dialogue with representatives of Yuchai and shortly thereafter agreed with Yuchai management to re-allow the Company full access to the financial books and records of Yuchai. Moreover, and as disclosed elsewhere in this Annual Report, the Company requires the cooperation of Yuchai and its Chinese shareholders and from time to time experiences certain problems in obtaining such cooperation. In response to such problems, the Company entered into dialogue with representatives of Yuchai and its Chinese shareholders and thereafter executed the Reorganization Agreement, which the Company believes addresses these problems. As part of the terms of the Reorganization Agreement, Yuchai agreed that it would seek the requisite shareholder approval prior to entering into any material transactions (including any agreements or arrangements with parties related to Yuchai or any of its shareholders) and that it would comply with its governance requirements. However, no assurances can be given regarding implementation of the terms of the Reorganization Agreement (see also Item 3. Key Information Risk Factors Risks relating to our company and our business Our financial condition, results of operations, business and prospects may be adversely affected if we are unable to implement the Reorganization Agreement).

Compensation

Company

For 2005, HLA charged Yuchai a management fee of US$500,000 for management services, including the services of the Company s President, Vice President and Chief Financial Officer, each of whom are employees of HLA. In December 2005, HLA has seconded two senior managers to Yuchai for support services in respect of internal audit and Sarbanes-Oxley Act implementation.

The Company paid an annual service fee for services rendered in 2005 of US$50,000 and US$30,000 to each of the Company s independent and non-independent directors, respectively, and US$20,000 to the Company s Group Counsel. The Company also paid an annual service fee of US$50,000 and US$30,000 to the Chairman and each of the members of the Special Committee, respectively. See Item 7. Major Shareholders and Related Party Transactions .

Yuchai

The aggregate amount of compensation paid by Yuchai to all directors and executive officers of Yuchai during 2005 was approximately Rmb 10.9 million (US$1.4 million). Yuchai has a management bonus plan for its executive, mid-level and junior officers under which annual incentive bonuses in an aggregate amount equal to 5.5% (3.5% for executive officers (allocated as 2.5%

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for the Chairman and 1.0% for other executive officers) and 2.0% for mid-level and junior officers and employees) of Yuchai s after-tax profit must be paid if Yuchai achieves the after-tax profit approved in the annual budget by Yuchai s board of directors or, in the case of certain bonuses, if Yuchai achieves 80.0% of such budgeted after-tax profit. In addition, Yuchai s officers participate in an incentive pay program which is available to all employees and is based on performance and productivity.

There are no benefits provided to the directors of the Company or Yuchai upon their termination of employment.

Employees

As of December 31, 2005, Yuchai employed approximately 8,827 people nationwide, inclusive of a sales force of 609 employees. Yuchai provides its employees with a fixed base salary and a bonus that is determined by the employees performance and productivity. Yuchai also provides its employees with housing and meal subsidies and medical insurance. In the year ended December 31, 2005, the average annual base salary and bonus of an employee was approximately Rmb 54,677 (US$6,775), a decrease of approximately 6.0% from the previous year. Yuchai has not experienced any strikes or similar significant work stoppages. Yuchai believes that its employee relations are good.

Share Ownership

Stock Option Plan

The Company had previously adopted a Stock Option Plan (the Plan) to award stock options to key employees and outside directors. The Plan was administered by the Compensation Committee. The maximum number of shares of the Company s Common Stock that could have been purchased pursuant to stock options granted under the Plan was 750,000 shares. The Plan expired in 2004, without any options being granted under the Plan. The Company has no outstanding stock options to purchase any shares of the Company.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS.

Major Shareholders

The following table sets forth certain information regarding beneficial ownership of the Company s shares of Common Stock as of June 30, 2006 by all persons who are known to the Company to own five percent (5%) or more of the outstanding shares of Common Stock.

Beneficial ownership is determined in accordance with rules of the SEC, which generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities and includes equity shares issuable pursuant to the exercise of stock options or warrants that are immediately exercisable or exercisable within 60 days of June 30, 2006. These shares are deemed to be outstanding and to be beneficially owned by the person holding those options or warrants for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated, all information with respect to the beneficial ownership of any principal shareholder has been furnished by such shareholder and, unless otherwise indicated, we believe that persons named in the table have sole voting and sole investment power with respect to all the equity shares shown as beneficially owned. The share numbers and percentages listed below are based on 37,267,673 common shares outstanding as of June 30, 2006.

Identity of Person or Group	Number	Percentage (%)
Hong Leong Asia Ltd.[1]	7,913,769	21.2%
The Yulin City Government[2]	8,601,550	23.1%
Tai Tak Industries Pte Ltd[3]	1,927,673	5.2%

(1) Information based upon a report on Schedule 13D jointly filed by

HLA and its wholly-owned subsidiaries, HLC, HLT, Flite Technology Industries Pte Ltd and Lydale Pte Ltd, with the SEC on July 19, 2002, as amended on September 10, 2003, October 7, 2003, October 15, 2003 and December 1, 2003, and other information provided by HLA to the Company.

(2) Information based on a report on Schedule 13D filed by Coomber, Goldman, Zhong Lin and the State Holding Company, with the SEC on December 16, 2002, as amended on June 23, 2003, July 9, 2003, December 23, 2003, March 15, 2004, February 15, 2005 and April 18, 2005. Based on Amendment No. 4 to the

Schedule 13D filed by Coomber and others with the SEC on December 23, 2003, Coomber is a wholly-owned subsidiary of Goldman, which is indirectly owned and controlled by Yulin City Municipal Government, or Yulin City Government, in Guangxi Zhuang Autonomous Region, PRC. Accordingly, the Yulin City Government is the ultimate beneficial owner of the 8,601,550 shares of the Company s Common Stock held of record by Coomber. Coomber has advised the Company of the following information. Coomber has entered into forward sale agreements with a financial institution as a counterparty, with respect to a total of

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1,900,000 shares of the Company s Common Stock. On the respective settlement dates of these forward sales agreements, Coomber will have the option to settle the forward sales by delivery of cash or the Company s Common Stock. The counterparty may borrow the pledged shares from Coomber in connection with that party s hedging of its exposure under the forward sale arrangements. Coomber will temporarily cease to have voting rights with respect to any common stock borrowed by the counterparty but will reacquire such voting rights when the counterparty returns the borrowed shares to Coomber. In the event Coomber elects to settle the forward sale

agreement or agreements entirely by delivering shares of the Company s Common Stock, its beneficial ownership of the Company s Common Stock could, depending on the number of shares of the Company s Common Stock delivered, decrease to 6,701,550 shares, or approximately 18.0% of the Company s Common Stock, or to 4,601,550 shares, or approximately 12.3% of the Company s Common Stock, if it sells 2,100,000 shares pursuant to the Company s prospectus dated March 24, 2004.

(3) Information based on a report on Schedule 13G jointly filed by Tai Tak Industries Pte Ltd and its affiliate, Tai Tak Securities Pte Ltd, with the SEC on

March 7, 2005
and as amended
on June 20,
2005.

HLA exercises control over and is the beneficial owner of 7,913,769 or approximately 21.2% of shares of the Company s Common Stock through its wholly-owned subsidiaries, HLT and Well Summit Investments Limited. See Related Party Transactions Shareholders Agreement . Other than as described under Item 3. Key Information Risk Factors Risks relating to our company and our business We may experience a change of control as a result of offerings of shares by our controlling shareholders and The Special Share below, the Company is not aware of any arrangement which may, at a subsequent date, result in a change of control of the Company.

On June 23, 2003, Coomber, Goldman, Zhong Lin, the State Holding Company and certain individuals filed an amended Schedule 13D reporting beneficial ownership of 8,601,550 shares, or 24.3%, of the Company. This Schedule 13D amended and restated in its entirety the Schedule 13D dated November 13, 2002 and filed December 16, 2002, which reported beneficial ownership by Coomber and Goldman of 8,601,550 shares of the Company (the Coomber Shares). This Schedule 13D reports beneficial ownership of the Coomber Shares by (i) Coomber, a wholly-owned subsidiary of Goldman, and the record holder of such 8,601,550 shares of the Company; (ii) Goldman, a company owned by Qin Xiao Cong, Zhu Guoxin and Yuan Xu Cheng, each of whom holds their respective shares in Goldman on trust for the benefit Zhong Lin; (iii) Zhong Lin, a company owned by Qin Xiao Cong and Zhu Guoxin, each of whom holds their respective shares in Zhong Lin on trust for the benefit of the Yulin City Government; and (iv) the State Holding Company, which, acting under the direction of the Yulin City Government, financed Goldman s purchase of the Coomber Shares from China Everbright in October 2002. Qin Xiao Cong, Zhu Guoxin and Yuan Xu Cheng reported but disclaimed beneficial ownership. This Schedule 13D also reports that the ultimate beneficial owner of the Coomber Shares is the Yulin City Government, and discloses certain financing and control arrangements with respect to the Coomber Shares acquisition, as well as the Yulin City Government s intentions with respect to the Company. This Schedule 13D was most recently amended on April 18, 2005.

As of the record date on June 30, 2006, there were 22,089,296 shares of Common Stock, or 59.3% shares of Common Stock, held of record by 42 persons with registered addresses in the United States.

The Special Share

The Special Share entitles the holder thereof to elect a majority of the directors of the Company. In addition, no shareholders resolution may be passed without the affirmative vote of the Special Share, including any resolution to amend the Memorandum of Association or Bye-laws of the Company. The Special Share is not transferable except to HLA, HLC or any of its affiliates. In 1994, the Company issued the Special Share to DML, a holding company of the Company then controlled by Hong Leong (China) Limited, or HLC. During 2002, following the decision of the shareholders of DML to dissolve DML, DML redeemed all of the redeemable stock issued by it to its shareholders. Per the DML Shareholders Agreement (defined below), DML transferred all its shares of the Company to its shareholders, which included HLC and their wholly-owned subsidiaries. Because Coomber, an affiliate of China Everbright, was the shareholder of DML which gave notice of the dissolution of DML, the Special Share was transferred from DML to HLT, an affiliate of HLA, pursuant to the terms of the DML Shareholders Agreement, as amended on January 21, 2002 and on May 17, 2002.

The Company s Bye-Laws provide that the Special Share shall cease to carry any rights in the event that, if HLA and its affiliates own the Special Share, HLA and its affiliates cease to own, directly or indirectly, at least 7,290,000 shares of Common Stock (or such equivalent number upon a consolidation or subdivision of shares of Common Stock), or if China Everbright and its affiliates own the Special Share, China Everbright and its affiliates cease to own, directly or indirectly, at least 6,570,000 shares of Common Stock (or such equivalent number upon a consolidation or subdivision of shares of Common Stock). The Bye-Laws also provide for circumstances in which DML holds the Special Share; however, DML was dissolved in 2002. HLT, an affiliate of HLA, holds the Special Share in addition to 7,831,169 shares of Common Stock, which is greater than the number stipulated in the provisions of the Company s Bye-Laws set forth above.

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Related Party Transactions

Shareholders Agreement

HLC, China Everbright, Cathay, GSCP, the Sun Yuan Shareholders (14 shareholders who initially invested in the Company through Sun Yuan BVI) and the Company entered into an amended and restated Shareholders Agreement (the Shareholders Agreement) in 1994, which provides for certain matters relating to the management of the Company and Yuchai and the ownership of the Company s Common Stock. The Shareholders Agreement provides that the Board of Directors of the Company will consist of eleven directors, the Controlling Shareholder (as described below) will be entitled to designate six directors, the Major Shareholder (as described below) will be entitled to designate two directors, and each of Cathay and GSCP will be entitled to designate one director and the Chief Executive Officer of Yuchai will initially be the other director. The Shareholders Agreement also provides that the Controlling Shareholder will be entitled to designate five of the nine Yuchai directors designated by the Company, the Major Shareholder will be entitled to designate two such directors and each of Cathay and GSCP will be entitled to designate one such director. Under the Shareholders Agreement, the nine Yuchai directors designated by the Company will vote as a block in accordance with the vote of the majority of such nine directors. The Shareholders Agreement provides that the Controlling Shareholder will be the person holding the Special Share, provided that at all times the Controlling Shareholder will be either HLA or China Everbright, and the other will be the Major Shareholder. Since the Company s initial public offering in 1994, HLA has been the Controlling Shareholder and China Everbright has been the Major Shareholder. However, in October 2002, China Everbright sold all of its shares in the Company to Goldman in October 2002 and is no longer the Major Shareholder of the Company. The Shareholder Agreement provides that if any shareholder (other than the Controlling Shareholder) ceases to own at least 4% of the Company s Common Stock, such shareholder shall no longer be entitled to designate any directors. Accordingly, China Everbright no longer has director designation rights. The Shareholders Agreement also provides that, so long as HLA is the Controlling Shareholder, Yuchai or the Company will pay HLA an annual management fee of not less than US$500,000 for management services provided by HLA, including the services of the Company s President and Chief Financial Officer. The Shareholders Agreement will terminate upon the occurrence of an event resulting in the Special Share ceasing to carry any rights.

In addition to the Shareholders Agreement, HLA, China Everbright and DML had entered into a Subscription and Shareholders Agreement (the DML Shareholders Agreement), which provided for certain matters relating to the management of DML, the Company and Yuchai and the ownership of DML stock. The DML Shareholders Agreement provided that HLA would control DML, provided, however, that if HLA and its affiliates ceased to own directly or through DML at least 7,290,000 shares of Common Stock when China Everbright and its affiliates own directly or through DML at least 6,570,000 shares of Common Stock, China Everbright would control DML. The DML Shareholders Agreement provided that all rights of the Special Share held by DML would be exercised as directed by the shareholder that controls DML. With the dissolution of DML and the sale by China Everbright of all of its shares in the Company to Goldman in October 2002, the DML Shareholders Agreement no longer directly affects the Company.

Registration Rights Agreement

Pursuant to a Registration Rights Agreement (the Registration Rights Agreement), the Company has granted two demand registration rights to each of HLC, China Everbright, Cathay, GSCP and the Sun Yuan Shareholders (the Selling Stockholders) requiring the Company, subject to certain conditions, to use its best efforts to prepare and file a registration statement on behalf of such shareholder under the Securities Act and to use its best efforts to qualify the shares for offer and sale under any applicable U.S. state securities laws. Expenses incurred in connection with one demand registration for each such shareholder will be borne by the Company, and the Company and Yuchai will be required to indemnify the underwriters in connection with any demand registration. The Registration Rights Agreement also grants each such shareholder certain piggyback registration rights entitling each shareholder to sell Common Stock in any registered offerings of equity securities of the Company, for the account of the Company or on behalf of its security holders. China Everbright, Cathay, GSCP and the Sun Yuan shareholders are no longer shareholders of the Company.

Pursuant to the demand registration rights, the Company filed a Registration Statement (Registration No. 333-111106) on Form F-3 (the Registration Statement) with the SEC in December 2003, registering an aggregate of 9,931,169 shares of the Company s Common Stock for sale by the Selling Stockholders from time to time, depending on market conditions and other factors, in one or more transactions on the NYSE, in the over-the-counter market or otherwise, at market prices prevailing at the time of sale, at negotiated prices or at fixed prices.

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Reorganization Agreement

On April 7, 2005, the Company entered into the Reorganization Agreement with Yuchai and Coomber, which is intended to be in furtherance of the terms of the July 2003 Agreement. On December 2, 2005, certain provisions of the Reorganization Agreement were amended, including to extend the implementation deadline to December 31, 2006. See Item 4. Information on the Company Recent Developments .

Other Transactions

During each of 2003, 2004 and 2005, HLA charged Yuchai a management fee of US$500,000 per annum for management, financial planning and control and other services, including the services of the Company s President, Vice President and Chief Financial Officer, each of whom are employees of HLA. Such charges represent HLA s estimated direct costs of providing these services. In December 2005, HLA has seconded two senior managers to Yuchai for support services in respect of internal audit and Sarbanes-Oxley Act implementation.

During each of 2003, 2004 and 2005, the State Holding Company charged Yuchai Rmb 30.6 million, Rmb 21.2 million and Rmb 25.9 million (US$3.2 million), respectively, for certain general and administrative expenses on an actually incurred basis. The Company believes that the expenses charged to Yuchai by the State Holding Company would not have been materially different on a stand-alone basis because Yuchai could provide these services for itself at approximately the same cost.

During 2004, Yuchai granted a loan of Rmb 205.0 million to YMLC, a subsidiary of Coomber, with an interest rate of 5.58% for one year. The loans granted in 2004 matured in 2005, and subsequently extended to YMLC with a maturity date of December 29, 2006 (see also Note 5 to the Company s Consolidated Financial Statements appearing elsewhere herein.)

In January 2006, the Board of Directors authorized the Company to pay fees amounting to approximately S$6.1 million (approximately $3.8 million) to Hong Leong Management Services Pte. Ltd. (an affiliate of the Company which provides management and other services to the members of the Hong Leong Group Singapore) for work done on behalf of the Company. These fees have been reported under SG&A expenses in the Company s financial statements. The work entails assisting the Company to (a) secure credit facilities from various banks; (b) enter into the Reorganization Agreement dated April 7, 2005 with Yuchai and Coomber; (c) implement CYI s business expansion and diversification plans including the acquisition of debt and equity in TCL and LKN; and (d) issue the US$25.0 million in principal amount of convertible bonds due 2012 in a private placement.

The Company has undertaken other significant business transactions with related parties during the three years ended December 31, 2005, as set forth under Note 28 to the Company s Consolidated Financial Statements.

ITEM 8. FINANCIAL INFORMATION.

Consolidated Financial Statements

See Item 18. Financial Statements .

Legal Proceedings

Other than as set forth below, neither the Company nor any of its consolidated subsidiaries is currently involved in any material legal proceedings that the Company believes would, individually or taken as whole, adversely affect the financial condition or results of operations of the Company.

Proceedings with Yuchai

The Company has from time to time encountered difficulties in obtaining the cooperation of the State Holding Company and Mr. Wang Jianming in the daily management and operation of Yuchai. The State Holding Company is a minority shareholder of Yuchai and is wholly-owned by the municipal government of Yulin City in the Guangxi Zhuang Autonomous Region. Until December 3, 2005, Mr. Wang was previously the Chairman, legal representative and Chief Executive Officer of Yuchai, as well as the Vice-Chairman and legal representative of the State Holding Company.

In response to earlier difficulties with respect to corporate governance measures and certain dividends declared by Yuchai, the Company initiated legal and arbitration proceedings in New York, London and Singapore against Yuchai, Mr. Wang and other related

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parties in May 2003. The Company subsequently discontinued these proceedings as a result of the execution of the July 2003 Agreement. Among other things, the July 2003 Agreement led to the resolution at that time of previous disagreements with respect to the payment of dividends by Yuchai to the Company and the re-appointment of Mr. Wang Jianming as Chief Executive Officer and Chairman of the Board of Directors of Yuchai in September 2003. The Company and Yuchai also agreed to work together to implement corporate governance procedures and to promote plans to enhance shareholder value. However, from time to time, the Company has continued to face difficulties in obtaining the cooperation of the Chinese shareholders of Yuchai in the daily management and operation of Yuchai to fully exercise its controlling interest in Yuchai. Following the execution of the July 2003 Agreement, disagreements among the parties continued to recur. For example, representatives of the Chinese shareholders of Yuchai alleged that resolutions passed by the Company s six wholly-owned subsidiaries at Yuchai shareholders meeting in December 2004 were invalid; allegations with which the Company disagreed (see the Company s Form 6-K filed with the SEC on April 1, 2005).

In April 2005, the Company, Yuchai and Coomber agreed steps relating to the adoption of corporate governance practices at Yuchai and a broad framework for the restructuring of the Company s ownership of Yuchai, and entered into the Reorganization Agreement. The Reorganization Agreement is intended to be in furtherance of the July 2003 Agreement. See Item 4. Information on the Company Recent Developments and Note 25 to the Company s Consolidated Financial Statements for a detailed summary. In December 2005, the parties amended certain provisions of the Reorganization Agreement, including to extend the implementation deadline to December 31, 2006. Although the parties to the Reorganization Agreement expect to work towards its implementation as expeditiously as possible, no assurance can be given as to when the transactions contemplated therein will be fully consummated, or that implementation of the Reorganization Agreement will effectively resolve all of the difficulties faced by the Company with respect to its investment in Yuchai. In addition, Mr. Yan Ping has replaced Mr. Wang as Chairman of the Board of Directors of Yuchai, effective December 2, 2005. Yuchai does not currently have a chief executive officer.

Other Legal Proceedings

In 2003, the Yulin Branch of Bank of China (BOC) initiated legal proceedings to recover Rmb 6.6 million (US$0.8 million) from Yuchai based on an irrevocable letter of guarantee issued by Yuchai to BOC in 1993 to secure a loan of US$0.6 million to Great Wall Machinery Plant (Great Wall). At trial, a Yulin court ruled that if Great Wall could not repay the loan Yuchai would be liable to the BOC. Yuchai subsequently appealed, but lost the appeal. In January 2004, the State Holding Company issued a letter of commitment confirming that it would reimburse Yuchai in the event that Yuchai was required to pay on this guarantee. Based on the advice of its Chinese legal counsel, the Company has recorded a loss contingency equal to the amount of the claim, which has been offset by amounts to be reimbursed by the State Holding Company. The amount due to BOC and the amount due from State Holding Company have been recorded in Accrued expenses and other liabilities and Amounts due from related companies , respectively, as of December 31, 2003 and 2004. In 2005, there were no new developments in this case.

See also Note 25(c) to the Company s Consolidated Financial Statements included elsewhere herein for a description of other legal claims which Yuchai is involved in.

Policy on Dividend Distributions

The Company s principal source of cash flow has historically been its share of the dividends, if any, paid by Yuchai to the Company, as described under Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources .

Chinese laws and regulations applicable to a Sino-foreign joint stock company require that before Yuchai distributes profits, it must: (i) satisfy all tax liabilities; (ii) recover losses in previous years; and (iii) make contributions to certain statutory reserves in an amount not exceeding 15% of net income for the year determined in accordance with PRC GAAP due to its maximum ceiling limit.

Any determination by Yuchai to declare a dividend will be at the discretion of Yuchai s shareholders and will be dependent upon Yuchai s financial condition, results of operations and other relevant factors. Yuchai s Articles of Association provide that dividends may be paid once a year. To the extent Yuchai has foreign currency available, dividends declared by shareholders at a shareholders meeting to be paid to holders of Foreign Shares (currently only the Company) will be payable in foreign currency, and such shareholders will have priority thereto. If the foreign

currency available is insufficient to pay such dividends, such dividends may be payable partly in Renminbi and partly in foreign currency. Dividends allocated to holders of Foreign Shares may be remitted in accordance with the relevant Chinese laws and regulations. In the event that the dividends are distributed in Renminbi, such dividends may be converted into foreign currency and remitted in accordance with the relevant Chinese laws, regulations and policies.

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ITEM 9. THE OFFER AND LISTING.

Since December 16, 1994, the Common Stock has been listed and traded on the NYSE under the symbol CYD . The Common Stock is not listed on any other exchanges within or outside the United States.

The high and low sales prices for shares of the Common Stock on the NYSE for the periods indicated were as follows:

Period	US$ High	US$ Low
2001	1.15	0.30
2002	5.95	0.95
2003	37.24	4.45
2004	34.00	9.85
2005	14.47	7.02
2006 (through July 31, 2006)	10.00	4.64

Period	US$ High	US$ Low
2003 First Quarter	7.10	4.45
2003 Second Quarter	9.20	5.60
2003 Third Quarter	19.30	6.59
2003 Fourth Quarter	37.24	17.00
2004 First Quarter	32.22	18.53
2004 Second Quarter	22.79	15.80
2004 Third Quarter	18.75	9.85
2004 Fourth Quarter	18.46	12.65
2005 First Quarter	13.55	8.13
2005 Second Quarter	13.89	7.02
2005 Third Quarter	14.47	9.23
2005 Fourth Quarter	10.40	7.26
2006 First Quarter	9.81	6.81
2006 Second Quarter	10.00	6.26

Period	US$ High	US$ Low
December 2005	8.94	7.26
January 2006	8.36	7.55
February 2006	9.81	7.00
March 2006	7.88	6.81
April 2006	10.00	7.65
May 2006	9.00	7.07
June 2006	7.75	6.26
July 2006	7.42	4.64

ITEM 10. ADDITIONAL INFORMATION.

The Company s objects are to perform all the functions of a holding company and to coordinate the policy and administration of any subsidiary company. See paragraphs 6 and 7 of the Company s Memorandum of Association for further information on the objects and powers of the Company.

Memorandum of Association and Bye-Laws

Corporate Governance

The Company is an exempted company incorporated in Bermuda and is subject to the laws of that jurisdiction. The legal framework in Bermuda which applies to exempted companies is flexible and allows an exempted company to comply with the corporate governance regime of the relevant jurisdiction in which the company operates or applicable listing standards. Under Bermuda law, members of a board of directors owe a fiduciary duty to the company to act in good faith in their dealings with or on

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behalf of the company and to exercise their powers and fulfill the duties of their office honestly. In addition, the Bermuda company legislation imposes a duty on directors and officers of an exempted company to act honestly and in good faith with a view to the best interests of the company and requires them to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Bermuda legislation also imposes certain specific duties and obligations on companies and directors, both directly and indirectly, including duties and obligations with respect to matters such as (a) loans to directors and related persons and (b) limits on indemnities for directors and officers. Bermuda law does not impose specific obligations in respect of corporate governance, such as those prescribed by NYSE listing standards, requiring a company to (i) appoint independent directors to their boards, (ii) hold regular meetings of non-management directors; (iii) establish audit, nominating and governance or compensation committees; (iv) have shareholders approve equity compensation plans; (v) adopt corporate governance guidelines; or (vi) adopt a code of business conduct and ethics.

The Company is also subject to the NYSE listing standards, although, because it is a foreign private issuer, those standards are considerably different from those applied to U.S. companies. Under the NYSE rules, the Company need only (i) establish an independent audit committee that has specified responsibilities as described in the following table; (ii) provide prompt certification by its chief executive officer of any material non-compliance with any corporate governance rules; (iii) provide periodic written affirmations to the NYSE with respect to its corporate governance practices and (iv) provide a brief description of significant differences between its corporate governance practices and those followed by U.S. companies.

The following table compares the Company s principal corporate governance practices to those required of U.S. companies.

Standard for U.S. Domestic Listed Companies	China Yuchai International Limited s Practice
Director Independence	
A majority of the board must consist of independent directors.	Three of the Company s nine directors, Messrs. Raymond C.K. Ho, Neo Poh Kiat, Tan Aik-Leang, are independent within the meaning of the NYSE standards. Mr. Ho has notified the Company that he will not be seeking re-election at the forthcoming annual general meeting of the Company. The Company is currently searching for a replacement independent director and, until such person is appointed, the Company will have only two independent directors within the meaning of the NYSE standards.
Independence is defined by various criteria including the absence of a material relationship between director and the listed company. Directors who are employees, are immediate family of the chief executive officer or receive over $100,000 per year in direct compensation from the listed company are not independent. Directors who are employees of or otherwise affiliated through immediate family with the listed company s independent auditor are also not independent.	
The non-management directors of each company must meet at regularly scheduled executive sessions without management.	The Company s non-management directors do not meet periodically without management directors.

Audit Committee

Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Securities Exchange Act. The rule requires that the audit committee (i) be comprised entirely of independent directors; (ii) be directly responsible for the appointment, compensation and oversight of the independent auditor; (iii) adopt procedures for the receipt and treatment of complaints with respect to accounting and auditing issues; (iv) be authorized to engage independent counsel and	The Company s audit committee meets the requirements of Rule 10A-3 under the Securities Exchange Act.

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Standard for U.S. Domestic Listed Companies	China Yuchai International Limited s Practice
other advisors it deems necessary in performing its duties; and (v) be given sufficient funding by the board of directors to compensate the independent auditors and other advisors as well as for the payment of ordinary administrative expenses incurred by the committee.	
The audit committee must consist of at least three members, and each member must be independent within the meaning established by the NYSE.	The Company s audit committee currently consists of three members, each of whom is independent within the meaning established by the NYSE. However, Mr. Ho has notified the Company that he will not be seeking re-election at the forthcoming annual general meeting of the Company. The Company is currently searching for a replacement independent director and, until such person is appointed, the Company s Audit Committee will consist of only two independent members.
The Company s audit committee must have a written charter that addresses the committee s purpose and responsibilities.	The audit committee has a charter outlining the committee s purpose and responsibilities, which are similar in scope to those required of U.S. companies.
At a minimum, the committee s purpose must be to assist the board in the oversight of the integrity of the company s financial statements, the company s compliance with legal and regulatory requirements, the independent auditor s qualifications and independence and the performance of the company s internal audit function and independent auditors.	
The audit committee is also required to review the independent auditing firm s annual report, describing the firm s internal quality control procedures, any material issues raised by the most recent internal quality control review or peer review of the firm and any steps taken to address such issues. The audit committee is also to assess the auditor s independence by reviewing all relationships between the company and its auditor. It must establish the company s hiring guidelines for employees and former employees of the independent auditor.	
The committee must also discuss the company s annual audited financial statements and quarterly financial statements with management and the independent auditors, the company s earnings press releases, as well as financial information and earnings	

guidance provided to analysts and rating agencies, and policies with respect to risk assessment and risk management. It must also meet periodically with the internal auditors and the board of directors.	
Each listed company must have disclosed whether their board of directors has identified an Audit Committee Financial Expert, and if not the reasons why the board has not done so.	The Board of Directors has identified Mr. Tan Aik-Leang as the Company s Audit Committee Financial Expert.
Each listed company must have an internal audit function.	The Company s internal audit function is provided by HLA.

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Standard for U.S. Domestic Listed Companies	China Yuchai International Limited s Practice
Compensation Committee	
Listed companies must have a compensation committee composed entirely of independent board members as defined by the NYSE listing standards.	The Company s compensation committee currently has three members, two of whom are independent within the meaning of the NYSE standards. Upon the resignation of Mr. Ho, the Company s Compensation Committee will only have one independent member.
The committee must have a written charter that addresses its purpose and responsibilities.	
These responsibilities include (i) reviewing and approving corporate goals and objectives relevant to CEO compensation; (ii) evaluating CEO performance and compensation in light of such goals and objectives for the CEO; (iii) based on such evaluation, reviewing and approving CEO compensation levels; (iv) recommending to the board non-CEO compensation, incentive compensation plans and equity-based plans; and (v) producing a report on executive compensation as required by the SEC to be included in the company s annual proxy statement or annual report. The committee must also conduct an annual performance self-evaluation.	The Company s compensation committee reviews among other things the Company s general compensation structure, and reviews, recommends or approves executive appointments, compensation and benefits of directors and executive officers, subject to ratification by the Board of Directors, and supervises the administration of the Company s employee benefit plans, if any.
Nominating/Corporate Governance Committee	
Listed companies must have a nominating/corporate governance committee composed entirely of independent board members.	The Company does not have a nominating/corporate governance committee. However, certain responsibilities of this committee are undertaken by the Compensation Committee of the Company, such as the review and approval of executive appointments.
The committee must have a written charter that addresses its purpose and responsibilities, which include (i) identifying qualified individuals to become board member; (ii) selecting, or recommending that the board select, the director nominees for the next annual meeting of shareholders; (iii) developing and recommending to the board a set of corporate governance principles applicable to the company; (iv) overseeing the evaluation of the board and management; and (v) conducting an annual performance evaluation of the committee.	
Equity-Compensation Plans	

Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions.	The Company intends to have its shareholders approve equity-compensation plans.

Corporate Governance Guidelines

Listed companies must adopt and disclose corporate governance guidelines.	The Company has formally adopted various corporate governance guidelines, including Code of Business Conduct and Ethics (described below); Audit Committee Charter; Whistle-blowing Policy; Insider Trading Policy; and Disclosure Controls and Procedures.

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Standard for U.S. Domestic Listed Companies	China Yuchai International Limited s Practice
Code of Business Conduct and Ethics	
All listed companies, U.S. and foreign, must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.	The Company has adopted a Code of Business Conduct and Ethics Policy, a copy of which is available upon request from the Company.

Directors

Director Interests and Voting

A Director of the Company cannot vote or be counted in the quorum with regard to any contract or arrangement or any other proposal in which he has any interest or in respect of which he has any duty which conflicts with his duty to the Company. The restriction from voting and being counted in the quorum does not apply if the only interest the Director has is included in the following list:

(a) a resolution regarding granting any security or indemnity for any money lent or obligation incurred by such Director at the request, or for the benefit, of the Company or any of its subsidiaries (or a company of which the Company is a beneficially wholly-owned subsidiary);

(b) a resolution regarding granting any security or indemnity to any third party for a debt or obligation which is owed by the Company or any of its subsidiaries (or a company of which the Company is a beneficially wholly-owned subsidiary) to the third party, for which such Director has assumed responsibility in whole or in part under a guarantee or indemnity;

(c) a resolution about an offer of shares, debentures or other securities of the Company or any of its subsidiaries (or a company of which the Company is a beneficially wholly-owned subsidiary) for subscription or purchase in which such Director is to be a participant in the underwriting or sub-underwriting of the offer;

(d) a resolution about any proposal involving any other company in which such Director is interested, whether directly or indirectly and whether as an officer or shareholder or otherwise, provided that such Director is not the holder of, or directly or indirectly beneficially interested in, 5% or more of (i) any class of the equity share capital of such company or in any third company through which such Director s interest is derived or (ii) the voting rights in that company;

(e) any contract arrangement or proposal for the benefit of employees of the Company under which such Director benefits in a similar manner as the employees and does not receive any privileges or advantages not provided to the employees; or

(f) any proposal in which such Director is interested in the same manner as other holders of shares or debentures or other securities of the Company or any of its subsidiaries by virtue only of such Director s interest in shares or debentures or other securities of the Company or any of its subsidiaries.

If the Board of Directors of the Company is considering proposals about appointing two or more Directors to positions with the Company or any company in which the Company is interested, each such Director (if not disqualified from voting under proviso to item (d) above) can vote and be included in the quorum for each resolution, except the one concerning such Director.

Remuneration and Pensions

The total fees paid to the Directors (other than Directors appointed to an executive office) for performing their services as Directors must not exceed US$250,000 each year or such lesser amount as the Board of Directors of the Company may determine. The Directors may decide the way in which the total sum shall be divided among them,

except that any Director holding office for less than the whole of the relevant period for which the fees are paid will only receive part of the amount in proportion to the amount of time he has been a Director. The shareholders of the Company may by ordinary resolution increase the amount of the fees payable to the Directors. The shareholders of the Company had at the annual general meeting of the Company held on July 22, 2005 approved the increase of the total Directors fees from US$250,000 to US$500,000 for the financial year 2005.

The Board of Directors of the Company may grant special remuneration to any Director who shall render any special or extra services to or at the request of the Company. Such special remuneration may be paid to such Director in addition to or in substitution

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for his ordinary remuneration as a Director and may be payable by way of a lump sum, participation in profits or as otherwise determined by the Board of Directors of the Company.

The Board of Directors of the Company may provide pensions or other benefits to any Director or former Director, or any of their family members or dependants.

Borrowing Powers

The Board of Directors of the Company may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital or any part thereof and to issue debentures and other securities.

Qualification of Directors

No person is required to vacate office or is ineligible for re-election or re-appointment as a Director, and no person is ineligible for appointment as a Director, by reason only of his having attained any particular age. No Director is required to hold any shares of the Company.

Rights of Holders of shares of Common Stock

The holders of shares of Common Stock shall:

be entitled, on a show of hands, to one vote and, on a poll, to one vote per share;

be entitled to such dividends as the Board of Directors of the Company may from time to time declare;

in the event of a winding-up or dissolution of the Company, whether voluntary or involuntary or for the purpose of the reorganization or otherwise or upon any distribution of capital, be entitled to a return of the amount paid up on the Common Stock and thereafter to the surplus assets of the Company; and

generally, be entitled to enjoy all the rights attaching to shares.

All unclaimed dividends or distributions out of contributed surplus account may be invested or otherwise made use of by the Board of Directors of the Company for the benefit of the Company until claimed. No dividend or distribution shall bear interest against the Company. Any dividend or distribution which has remained unclaimed for a period of 12 years from the due date for payment thereof shall at the expiration of that period be forfeited and shall belong to the Company absolutely.

Rights of Holder of the Special Share

The holder of the Special Share shall be entitled to the following rights:

to elect six Directors of the Company and to remove Directors so appointed; and

no shareholder resolution may be passed without the affirmative vote of the holder of the Special Share, including any resolution to amend the Memorandum of Association or Bye-Laws of the Company.

The holder of the Special Share shall not be entitled to any dividends and in the event of a winding up or dissolution of the Company, the holder of the Special Share shall be entitled only to a return of the amount paid up on the Special Share.

The Special Share is not transferable except to HLA and its affiliates or to China Everbright and its affiliates. The Special Share shall cease to carry any rights in the event that, if HLA and its affiliates own the Special Share, HLA and its affiliates cease to own, directly or indirectly, at least 7,290,000 shares of Common Stock (or such equivalent number upon a consolidation or subdivision of shares of Common Stock), or if China Everbright and its affiliates own the Special Share, China Everbright and its affiliates cease to own, directly or indirectly, at least 6,570,000 shares of Common Stock (or such equivalent number upon a consolidation or subdivision of shares of Common Stock).

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Modification of Shareholders Rights

The rights attached to any class of shares (unless otherwise provided by the terms of issue of the shares of that class) may be varied, modified or abrogated with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of an ordinary resolution passed at a separate general meeting of the holders of the shares of the class. The rights conferred upon the holders of the shares of any class issued with preferred or other rights shall not, unless otherwise expressly provided by the terms of issue of the shares of that class, be deemed to be varied by the creation or issue of further shares ranking *pari passu* therewith.

Annual General and Special General Meetings

The Company must hold an annual general meeting each year. The Directors of the Company decide where and when it will be held. Not more than fifteen months may elapse between the date of one annual general meeting and the next. At least 14 clear days written notice must be given for every annual general meeting and for every special general meeting. The notice for any annual general meeting must state the date, place and time at which the meeting is to be held, and the business to be conducted at the meeting, including, if applicable, any election of Directors. The notice for any special general meeting must state the time, place and the general nature of the business to be considered at the meeting and shall state that a shareholder entitled to attend and vote is entitled to appoint one or more proxies to attend and vote instead of him. In the case of a meeting convened for passing a special resolution, the notice shall specify the intention to propose the resolution as a special resolution.

Shareholders holding not less than one-tenth in value of the paid up share capital of the Company and having the right to attend and vote at general meetings of the Company shall have the right, by written request to the Chairman or President (as applicable), Deputy Chairman or Vice President (as applicable) or Secretary of the Company, to require that a special general meeting be convened by the Directors for the transaction of any business specified in the request. Such meeting shall be held within two months after the request has been made. If within 21 days of such deposit of the request, the Board fails to convene the meeting, the petitioners may convene the meeting themselves in accordance with Section 74(3) of the Companies Act of Bermuda.

Limitations on Rights to Own Securities

There are no limitations under Bermuda law or the Company s Memorandum of Association and Bye-Laws on the rights of non-Bermuda owners of shares of the Company to hold or vote their shares.

The Company is exempt from the laws of Bermuda which restrict the percentage of share capital that may be held by non-Bermudians, but as an exempted company the Company may not participate in certain business transactions, including: (i) the acquisition or holding of land in Bermuda (except that required for its business held by way of lease or tenancy for a term not exceeding 50 years or, with the consent of the Minister of Finance of Bermuda, land by way of lease or tenancy for a term not exceeding 21 years in order to provide accommodation or recreational facilities for its employees); (ii) the taking of mortgages on land in Bermuda to secure an amount in excess of 50,000 Bermuda dollars without the prior consent of the Minister of Finance of Bermuda; (iii) the acquisition of any bonds or debentures secured by any land in Bermuda other than those issued by the Government of Bermuda or a public authority; or (iv) the carrying on of business of any kind or type whatsoever in Bermuda either along or in partnership or otherwise except, inter alia, carrying on business with persons outside Bermuda, in furtherance of the business of the Company carried on outside Bermuda or under a license granted by the Minister of Finance of Bermuda.

In accordance with the Company s Bye-Laws, share certificates are only issued to members of the Company (i.e., persons registered in the register of members as holders of shares in the Company). The Company is not bound to investigate or incur any responsibility in respect of the proper administration or execution of any trust to which any of the Company s shares are subject. The Company will take no notice of any trust applicable to any of its shares whether or not it had notice of such trust.

Exchange Controls

Bermuda Exchange Controls

The Company has been designated as a non-resident for exchange control purposes by the Bermuda Monetary Authority.

The Company has received the permission of the Bermuda Monetary Authority under the Exchange Control Act of 1972 and regulations thereunder for the transfer of shares of Common Stock to and between persons regarded as

resident outside Bermuda for exchange control purposes and the issue of shares within the existing authorized capital of the Company to such persons for so long as

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such shares are listed on the NYSE. The Bermuda Monetary Authority has also granted to all Bermuda companies with voting shares listed on an appointed stock exchange (as defined in the Companies Act 1981 of Bermuda), a general permission for the issue and subsequent transfer of any securities of such companies from and to a non-resident of Bermuda. The NYSE is an appointed stock exchange under the Companies Act 1981 of Bermuda. Issues and transfers of shares involving any person regarded as resident in Bermuda for exchange control purposes require specific prior approval under the Exchange Control Act of 1972.

Because the Company has been designated as a non-resident for Bermuda exchange control purposes, there are no restrictions on its ability to transfer funds in and out of Bermuda or to pay dividends to United States residents who are holders of the shares of Common Stock, other than in respect of local Bermuda currency.

China Exchange Controls

The Renminbi currently is not a freely convertible currency. The State Administration for Foreign Exchange (the SAFE), under the authority of the People s Bank of China (the PBOC), controls the conversion of Renminbi into foreign currency. Prior to January 1, 1994, Renminbi could be converted to foreign currency through the Bank of China or other authorized institutions at official rates fixed daily by the SAFE. Renminbi could also be converted at swap centers (Swap Centers) open to Chinese enterprises and foreign invested enterprises (FIEs), subject to SAFE approval of each foreign currency trade, at exchange rates negotiated by the parties for each transaction. In the year ended December 31, 1993, as much as 80% by value of all foreign exchange transactions in China took place through the Swap Centers. The exchange rate quoted by the Bank of China differed substantially from that available in the Swap Centers. Effective January 1, 1994, a unitary exchange rate system was introduced in China, replacing the dual-rate system previously in effect. In connection with the creation of a unitary exchange system, the China Foreign Exchange Trading System (CFETS) inter-bank foreign exchange market was established. Under the unitary foreign exchange system, PBOC sets daily exchange rates (the PBOC Rates) for conversion of Renminbi into U.S. dollars and other currencies based on the CFETS interbank market rates, and the Bank of China and other authorized banks may engage in foreign exchange transactions at rates that vary within a prescribed range above or below PBOC Rates.

Yuchai, as a FIE, is permitted to retain its foreign currency earnings and maintain foreign currency accounts at designated foreign exchange banks. However, there can be no assurance that the current authorizations for FIEs to retain their foreign exchange to satisfy foreign exchange liabilities in the future will not be limited or eliminated or that Yuchai will be able to obtain sufficient foreign exchange to satisfy their foreign exchange requirements. Foreign exchange transactions under the capital account continue to be subject to limitations and require approvals of the SAFE, which could affect the ability of the Yuchai to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from the Company.

In the event of shortages of foreign currencies, Yuchai may be unable to convert sufficient Renminbi into foreign currency to meet its foreign currency obligations or to pay dividends in foreign currency. Yuchai requires foreign currency to purchase a substantial portion of the manufacturing equipment required for the planned expansion of its manufacturing facilities and to meet foreign currency-denominated debt payment obligations. Yuchai will also require foreign currency for payment of its imported engine components.

The value of the Renminbi is subject to changes in Chinese government policies and to international economic and political developments. During the few years prior to 1994, the Renminbi experienced a devaluation against most major currencies, and a devaluation of approximately 50% of the Renminbi against the U.S. dollar occurred on January 3, 1994 in connection with the adoption of the new unitary exchange rate system. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. From that day to December 31, 2005, this change in policy has resulted in an approximately 2.5% appreciation of the Renminbi against the U.S. dollar. While the international reaction to the Renminbi revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the U.S. dollar. Any future devaluation of the Renminbi would increase the effective cost to Yuchai of foreign manufactured equipment or components, and of satisfying any other foreign currency denominated liabilities. In addition, any such devaluation would reduce the U.S. dollar value of any dividends declared in Renminbi.

In addition, State Administration of Foreign Exchange issued a public notice (October Notice) effective from November 1, 2005, which requires registration with SAFE by the PRC resident shareholders of any foreign holding company of a PRC entity. Without registration, the PRC entity cannot remit any of its profits out of the PRC as dividends or otherwise; however, it is uncertain how the October Notice will be interpreted or implemented regarding specific documentation requirements for a foreign holding company formed prior to the effective date of the October Notice, such as in our case. In addition,

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the October Notice requires that any monies remitted to PRC residents outside of the PRC be returned within 180 days; however, there is no indication of what the penalty will be for failure to comply or if shareholder non-compliance will be considered to be a violation of the October Notice by us or otherwise affect us.

Taxation

Bermuda Taxation

There is no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by shareholders of the Company other than by shareholders ordinarily resident in Bermuda. Neither the Company nor its shareholders (other than shareholders ordinarily resident in Bermuda) are subject to stamp or other similar duty on the issue, transfer or redemption of Common Stock. The Company has received from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act of 1966, as amended, an assurance that, in the event that Bermuda enacts any legislation imposing any tax computed on profits or income, or computed on any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, the imposition of such tax shall not be applicable to the Company or to any of its operations, shares, debentures or other obligations of the Company, until March 28, 2016. This assurance does not, however, prevent the imposition of any such tax or duty on such persons as are ordinarily resident in Bermuda and holding such shares, debentures or obligations of the Company or on land in Bermuda leased or let to the Company.

As an exempted company, the Company is required to pay a registration fee in Bermuda based upon its authorized share capital and the premium on the issue of its shares, at rates calculated on a sliding scale not exceeding US$27,825 per annum.

People s Republic of China Taxation

The following discussion summarizes the taxes applicable to the Company s investment in Yuchai and applicable to Yuchai under Chinese law.

Taxation of Dividends from Yuchai

Dividends distributed by Yuchai to the Company can be remitted from China without any Chinese taxation. Although the Income Tax Law on Foreign Investment Enterprises and Foreign Enterprises (the Foreign Investment Enterprise Tax Law) provides that certain remittances of foreign exchange earnings from China are subject to Chinese withholding tax, dividends received by foreign investors from a foreign investment enterprise are exempt from withholding tax. Yuchai is qualified as a foreign investment enterprise and, as a result, withholding tax is not applicable to dividends received by the Company from Yuchai.

Taxation of Disposition of Yuchai Shares

In the event the Company transfers any of its current holding of the Yuchai Shares, the amount received in excess of its original capital contribution would be subject to Chinese withholding tax at a rate of 10%.

In the event that Yuchai is liquidated, the portion of the balance of its net assets or remaining property, after deducting undistributed profits, various funds and liquidation expenses, that exceeds Yuchai s paid-in capital would be subject to withholding tax at a rate of 10%.

Income Tax

Yuchai is subject to the Foreign Investment Enterprise Tax Law. Pursuant to this law, Sino-foreign joint stock companies generally are subject to an income tax at a rate of 33%, including a national tax of 30% and a local tax of 3%. If an enterprise is located in specially designated regions, more favorable effective rates apply. The Foreign Investment Enterprise Tax Law generally exempts Sino-foreign joint stock companies engaged in manufacturing with an operation term of more than ten years from national and local income taxes for two years starting from the first profitable year of operations, followed by a 50% exemption for the next three years. The Detailed Rules for Performance of the Foreign Investment Enterprise Tax Law (the Detailed Rules) and the Guangxi Zhuang Autonomous Region Foreign Joint Venture Tax Incentives Regulation (the Guangxi Tax Regulation) generally provide a three-year extension of the 50% tax exemption if a company meets the standards of an advanced technology enterprise as defined under the regulation and will be or has been operating for at least ten years. The Foreign Investment Enterprise Tax Law and the Detailed Rules and the Guangxi Tax Regulation also generally provide for a tax reduction to a 15% tax rate for certain foreign-invested enterprises meeting the following criteria: (i) the enterprise is in an industry involving energy, transportation, port or special knowledge or

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technology, (ii) the enterprise is located in a coastal special economic zone or (iii) the enterprise has foreign investment exceeding US$30 million.

Under the tax law and regulations described above, Yuchai is qualified for the reduced tax rate of 15%. As a Sino-foreign joint stock company, Yuchai was also exempt from Chinese income tax for the years 1994 and 1995 and was entitled to a 50% tax exemption for each of the years 1996 to 1998. In addition, Yuchai has obtained approval to extend the 50% tax exemption for three additional years from 1999 to 2001 based on its qualification as an advanced technology enterprise as defined under the relevant local tax law and regulations. However, based on current interpretations of the PRC income tax law, Yuchai will be subject to a minimum tax rate of 10% during this three-year extension. As a result, under current laws, Yuchai was subject to tax at a rate of 7.5% during the three years from 1996 through 1998 and a rate of 10% during the three years from 1999 through 2001. Since January 1, 2002, Yuchai is subject to tax at a rate of 15% so long as it continues to qualify as a foreign-invested enterprise eligible for such reduction.

Value-Added Tax

In addition to Chinese income tax, Yuchai is subject to tax on its sales. Effective January 1, 1994, the Value-Added Tax Provisional Regulations subject all goods produced or processed in China, other than real property and goods produced or processed for export, to a value-added tax (VAT) at each stage or sale in the process of manufacture, processing, distribution and sale to the ultimate consumer. The basic VAT rate is 17% of the sale price of the item, although certain goods are assessed at a preferential 13% VAT rate. The seller of the goods adds 17% to the sale price of the item, which is separately invoiced (except in the case of retail sales), and collects the applicable amount of VAT through the sale of the item. The amount of the seller s VAT liability to the Taxation Bureau is calculated as the amount of sales multiplied by the applicable VAT rate. The amount of the seller s VAT liability may be reduced by deducting the VAT included in the materials, parts and other items purchased by the seller and used in producing the goods.

The Value-Added Tax Provisional Regulations do not permit the seller to deduct from its VAT liability the amount of VAT included in the purchase price of fixed assets purchased by the seller. Thus, although the book value of fixed assets, including plant and equipment, purchased by Yuchai will be the depreciated cost (ordinarily the purchase price plus VAT in the case of non-real property) of the fixed assets, Yuchai cannot deduct the amount of VAT paid at the time of such purchase from its VAT liability in respect of products sold.

According to the Decision on the Use of Interim Regulations Concerning Value-Added Taxes, Consumption Taxes and Business Taxes on Foreign-Funded Enterprises and Foreign Enterprises adopted at the Fifth Meeting of the Eighth Standing Committee of the National People s Congress on December 29, 1993, the increased tax payment from the tax obligations arising from the levy of the VAT, consumption taxes and business taxes will be refunded to foreign-funded enterprises established prior to December 31, 1993 upon their application and the relevant tax office s approval, for a period of no more than five years. In August 1994, the Ministry of Finance and State Tax Bureau announced that the goods produced and directly exported by foreign-funded enterprises are exempt from VAT and consumption tax, but the following goods are excepted: (i) crude oil, (ii) goods prohibited from being exported by the state include natural bezoar, musk, bronze and acid bronze alloy, platinum and (iii) sugar.

United States Federal Income Taxation

This section describes the material United States Federal income tax consequences of owning shares of Common Stock. It applies to a U.S. Holder (as defined below) that holds the shares as capital assets for tax purposes. This section does not apply to a U.S. Holder that is a member of a special class of holders subject to special rules, including:

a financial institution,

a dealer in securities,

a trader in securities that elects to use a mark-to-market method of accounting for its securities holdings,

a tax-exempt organization,

an insurance company,

a person liable for alternative minimum tax,

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a person that actually or constructively owns 10% or more of the voting stock of the Company,

a person that owns shares through a partnership or other pass-through entity,

a person that holds shares as part of a straddle or a hedging or conversion transaction, or

a person whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. There is currently no comprehensive income tax treaty between the United States and Bermuda.

For purposes of this discussion, a U.S. Holder is a beneficial owner of shares that is:

a citizen or resident of the United States,

a domestic corporation,

an estate the income of which is subject to United States federal income tax regardless of its source, or

a trust, if a United States court can exercise primary supervision over the trust s administration and one or more United States persons are authorized to control all substantial decisions of the trust.

U.S. Holders should consult their own tax advisor regarding the United States federal, state and local and other tax consequences of owning and disposing of shares in their particular circumstances.

Taxation of Dividends

Under the United States federal income tax laws, and subject to the passive foreign investment company (PFIC) rules discussed below, U.S. Holders will include in gross income the gross amount of any dividend paid by the Company out of its current or accumulated earnings and profits (as determined for United States federal income tax purposes). The dividend is ordinary income that the U.S. Holder must include in income when the dividend is actually or constructively received. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution includible in the income of a U.S. Holder will be the U.S. dollar value of the Bermuda dollar payments made, determined at the spot Bermuda dollar/U.S. dollar rate on the date the dividend distribution is includible in the income of the U.S. Holder, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend payment is includible in income to the date such payment is converted into U.S. dollars will be treated as ordinary income or loss. Such gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of the U.S. Holder s basis in the shares and thereafter as capital gain.

With respect to noncorporate taxpayers for taxable years beginning before January 1, 2011, dividends may be taxed at the lower applicable capital gains rate provided that (1) the Common Stock is readily tradable on an established securities market in the United States, (2) the Company is not a passive foreign investment company (as discussed below) for either the Company s taxable year in which the dividend was paid or the preceding taxable year, and (3) certain holding period requirements are met. Common stock is considered for purposes of clause (1) above to be readily tradable on an established securities market if it is listed on the New York Stock Exchange. U.S. Holders should consult their tax advisors regarding the availably of the lower rate for dividends paid with respect to the Company s Common Stock.

For foreign tax credit limitation purposes, the dividend will be income from sources outside the United States, but generally will be treated separately, together with other items of passive income or financial services income . For

taxable years beginning after December 31, 2006, the dividend would generally constitute passive category income but could, in the case of certain U.S. Holders, constitute general category income.

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Taxation of Capital Gains

Subject to the PFIC rules discussed below, upon the sale or other disposition of shares, a U.S. Holder will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. Holder s amount realized and the U.S. Holder s tax basis in such shares. If a U.S. Holder receives consideration for shares paid in a currency other than U.S. dollars, the U.S. Holder s amount realized will be the U.S. dollar value of the payment received. In general, the U.S. dollar value of such a payment will be determined on the date of sale or disposition. On the settlement date, a U.S. Holder may recognize U.S. source foreign currency gain or loss (taxable as ordinary income or loss) equal to the difference (if any) between the U.S. dollar value of the amount received based on the exchange rates in effect on the date of sale or other disposition and the settlement date. However, if the shares are treated as traded on an established securities market and the U.S. Holder is a cash basis taxpayer or an accrual basis taxpayer who has made a special election, the U.S. dollar value of the amount realized in a foreign currency is determined by translating the amount received at the spot rate of exchange on the settlement date of the sale, and no exchange gain or loss would be recognized at that time. Capital gain of a non-corporate U.S. Holder is generally taxed at a reduced rate where the property is held more than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

PFIC Rules

The Company believes that its shares should not be treated as stock of a PFIC for United States federal income tax purposes for the taxable year that ended on December 31, 2005. The Company may become a PFIC in 2006 or in future years, however, as a result of the implementation of the Reorganization Agreement as amended in December 2005. **U.S. Holders are strongly advised to consult their own tax advisors regarding the possibility of the Company becoming a PFIC as a result of the implementation of the Reorganization Agreement and the potential United States tax consequences to them.** If the Company were to be treated as a PFIC for any year during the U.S. Holder s holding period, unless a U.S. Holder elects to be taxed annually on a mark-to-market basis with respect to the shares (which election may be made only if the Company s shares are marketable stock), a U.S. Holder will be subject to special tax rules with respect to any excess distribution received and any gain realized from a sale or other disposition (including a pledge) of that holder s shares. Distributions a U.S. Holder receives in a taxable year that are greater than 125% of the average annual distributions received during the shorter of the three preceding taxable years or the holder s holding period for the shares will be treated as excess distributions. Under these special tax rules:

the excess distribution or gain will be allocated ratably over the U.S. Holder s holding period for the shares;

the amount allocated to the current taxable year, and any taxable year prior to the first taxable year in which the Company is treated as a PFIC, will be treated as ordinary income; and

the amount allocated to each other year will be subject to tax at the highest tax rate in effect for that year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

The tax liability for amounts allocated to years prior to the year of disposition or excess distribution cannot be offset by any net operating losses for such years, and gains (but not losses) realized on the sale of the shares cannot be treated as capital, even the shares are held as capital assets. If the Company were to be treated as a PFIC for any year during which a U.S. Holder holds the shares, the Company generally would continue to be treated as a PFIC with respect to that U.S. Holder for all succeeding years during which it owns the shares. If the Company were to cease to be treated as a PFIC however, a U.S. Holder may avoid some of the adverse effects of the PFIC regime by making a deemed sale election with respect to the shares.

If a U.S. Holder holds shares in any year in which the Company is a PFIC, that holder will be required to file Internal Revenue Service Form 8621.

Documents on Display

It is possible to read and copy documents referred to in this annual report on Form 20-F that have been filed with the SEC at the SEC s public reference room located at 100 F Street, Room 1580, Washington D.C., 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. Additional

information may also be obtained over the Internet at the SEC s website at http://www.sec.gov.

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ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

The Company is subject to market rate risks due to fluctuations in interest rates. The majority of the Company s debt is variable rate short-term and long-term Renminbi denominated loans obtained by Yuchai from banks in China. The interest rates of such loans are generally established in accordance with directives announced from time to time by the PBOC, which are in turn affected by various factors such as the general economic conditions in China and the monetary polices of the Chinese government. There is no ready market in China for the Company to enter into interest rate swaps or other instruments designed to mitigate its exposure to interest rate risks. In addition, the Company also various bank facilities from banks in Singapore to fund the Company s business expansion plan. Subsequent to December 31, 2005, the Company has drawn down various bank facilities relating to its investments in TCL and LKN. As of June 30, 2006, the Company had outstanding loans of RMB 1,705.9 million (US$213.4 million), equivalent to approximately S$339.3 million.

The Company is exposed to foreign currency risk as a result of having to obtain certain key components used in the manufacturing of Yuchai s heavy-duty engines from overseas suppliers. At December 31, 2005, the Company did not have any loans that were denominated in a foreign currency.

The following table provides certain interest rate risk information regarding the Company s short-term and long-term bank loans as of December 31, 2004 and 2005:

	As of December 31, 2005				As of December 31, 2004	
	Expected maturity dates		Total carrying amount	Estimated fair value[2]	Total carrying amount	Estimated fair value[2]
	2006	2007				
	(Expressed in Rmb thousands, except interest rate)					
Floating rate debt:						
(i) Short-term bank loans denominated in Rmb	812,835		812,835	812,835	430,000	430,000
Weighted average interest rate[1]	5.53%		5.53%		5.28%	
(ii) Long-term bank loans denominated in Rmb	100,000	50,000	150,000	150,000	100,000	100,000
Weighted average interest rate[1]	5.22%	5.85%	5.43%		5.22%	

(1) Weighted average interest rate is calculated based on the interest rates applicable to individual bank loans outstanding as of December 31, 2005 and 2004.

(2) Fair value was estimated based

on the floating interest rates applicable to similar loan instruments.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.

Not Applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES.

There has not been any dividend arrearage or other material delinquency with respect to preferred stock of either the Company or Yuchai.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS.

Not Applicable.

ITEM 15. CONTROLS AND PROCEDURES.

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its SEC reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to its management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only a reasonable level of assurance of achieving the desired control objectives, and, in reaching a reasonable level of assurance,

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management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company has carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, the Company s Chief Executive Officer and Chief Financial Officer concluded that its disclosure controls and procedures were effective at the reasonable assurance level, except as set forth below.

In connection with the Company s recent business expansion and diversification plan, the Company has made minority equity investments in TCL and LKN, as described elsewhere in this Annual Report. With respect to TCL, the Company has experienced delays in the timely collating and integration of financial information from TCL management for use by the Company in preparing its consolidated financial statements and related disclosures. This situation has primarily arisen from TCL management s lack of familiarity with US GAAP and SEC financial reporting requirements, as TCL maintains its financial statements in accordance with Singapore Financial Reporting Standards. Further, the Company did not have sufficient controls in place to detect timely all deficiencies in the US GAAP information provided by TCL in order for the Company to properly apply the equity method of accounting. The Company is pro-actively taking steps to assist TCL management to develop improved systems and procedures to enhance the quality and timeliness of the US GAAP information provided to the Company. The Company has specifically informed TCL management the importance that all significant matters must be communicated to the Company on a timely basis. The Company will continue to hold regular meetings with TCL management and review closely with the TCL management to record and disclose information received on a timely basis as appropriate. The Company will perform analytical review on the balance sheet and profit and loss statements received on a monthly basis to assess compliance with US GAAP requirements.

Other than with respect to the execution of the Reorganization Agreement and implementation of the Company s business diversification plan described elsewhere in this Annual Report, there have been no significant changes in the Company s disclosure controls and procedures or in other factors that could significantly affect its disclosure controls and procedures during the period covered by this report nor have there been any significant changes subsequent to the date the Company completed its evaluation.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT.

As of the date of this report, the Company s Audit Committee members are Messrs. Tan Aik-Leang (Chairman), Raymond C. K. Ho and Neo Poh Kiat. Please see Item 6. Directors, Senior Management and Employees for their experience and qualifications. Pursuant to the SEC s rules, the Board has designated Mr. Tan Aik-Leang as the Company s Audit Committee Financial Expert.

ITEM 16B. CODE OF ETHICS.

The Company adopted a Code of Business Conduct and Ethics Policy in May 2004 that is applicable to all its directors, senior management and employees. The Code of Business Conduct and Ethics Policy contains general guidelines for conducting the business of the Company. The Company will make available a copy of the Code of Business Conduct and Ethics Policy to any person without charge, if a written request is made to the Company s executive office at 16 Raffles Quay #26-00 Hong Leong Building, Singapore 048581. Since adoption of the Company s Code of Business Conduct and Ethics Policy, the Company has not granted any waivers or exemption therefrom.

ITEM 16C. PRINCIPAL ACCOUNTANTS FEES AND SERVICES.

The following table set forth the total remuneration that was paid by the Company and Yuchai to its independent accountants, KPMG, in each of our previous two fiscal years:

	Audit fees	Audit-related fees	Tax fees	Others	Total
		(Expressed in Rmb thousands)			
2004	3,447	331			3,778
2005	4,404				4,404

Audit fees

Services provided primarily consist of professional services relating to the annual audits of consolidated financial statements as well as statutory audits required by foreign jurisdictions and quarterly reviews.

Audit-related fees

Services provided primarily consist of services connected with securities filing documents, issuance of consents, accounting issues research and technical advice.

Tax fees

Services provided primarily consist of routine corporate tax advisory services and compilation of corporate tax returns.

Others

Services provided primarily consist of provision of training and research materials.

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The Company s Audit Committee has pre-approved the terms of KPMG s engagement by the Company for services to be performed for the Company during 2006.

ITEM 16D. EXEMPTION FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.

Until May 2005, only two of the three members of the Company s Audit Committee qualified as independent directors under NYSE rules, and the Company relied upon an exception from the NYSE rule requiring that the Company s Audit Committee be comprised solely of independent directors. As of May 26, 2005, the Company has changed the composition of its Audit Committee so that it is now fully compliant with the new audit committee requirements promulgated by the SEC and NYSE.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.

Not Applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS.

The Company has elected to provide the financial statements and related information specified in Item 18 in lieu of Item 17.

ITEM 18. FINANCIAL STATEMENTS.

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China Yuchai International Limited

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Consolidated Statements of Stockholders Equity for Years Ended December 31, 2003, 2004 and 2005	F 7
Consolidated Statements of Cash Flows for Years Ended December 31, 2003, 2004 and 2005	F 8
Notes to Consolidated Financial Statements	F 12

ITEM 19. EXHIBITS.

Exhibits to this Annual Report:

1.1 Memorandum of Association of China Yuchai International Limited (the Registrant) (incorporated herein by reference to the Registration Statement on Form F-1, filed by the Registrant on November 9, 1994 (File No. 33-86162) (the Form F-1)).

1.2 Bye-laws of the Registrant (incorporated herein by reference to the Form F-1).

3.1 Subscription and Shareholders Agreement of Diesel Machinery (BVI) Limited, dated November 9, 1994, among Diesel Machinery (BVI) Limited, Hong Leong Asia Ltd. (HLA) and China Everbright Holdings Company Limited (EB Holdings) (incorporated herein by reference to the Form F-1).

3.2 Supplemental Subscription and Shareholders Agreement, dated January 21, 2002, between EB Holdings and HLA (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2001, filed by the Registrant on June 25, 2002 (the Form 20-F FY 2001).

3.3 Second Supplemental Subscription and Shareholders Agreement, dated May 17, 2002, between EB Holdings and HLA (incorporated herein by reference to the Form 20-F FY 2001).

4.1 Contract for the Subscription of Foreign Common Shares in Guangxi Yuchai Machinery Company Limited (Yuchai) and Conversion from a Joint Stock Limited Company into a Sino-Foreign Joint Stock Limited Company, dated April 1, 1993, among Yuchai, Guangxi Yuchai Machinery Holdings Company, Hong Leong Technology Systems (BVI) Ltd., Cathay

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Clemente Diesel Holdings Limited, Goldman Sachs Guangxi Holdings (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd. and Youngstar Holdings Limited, with amendments, dated May 27, 1994 and October 10, 1994 (incorporated herein by reference to the Form F-1).

4.2 Subscription and Transfer Agreement (with Shareholders Agreement), dated April 1993, among Cathay Clemente (Holdings) Limited, GS Capital Partners L.P., Sun Yuan Overseas Pte Ltd., HL Technology Systems Pte Ltd. and Coomber Investments Limited (incorporated herein by reference to the Form F-1).

4.3 Amended and Restated Shareholders Agreement, dated as of November 9, 1994 among the Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte. Ltd., Coomber Investments Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd., and the Registrant (incorporated herein by reference to the Form F-1).

4.4 Form of Amended and Restated Registration Right Agreement, dated as of November 9, 1994, among the Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte. Ltd., Coomber Investments Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd., and the Registrant (incorporated herein by reference to the Form F-1).

4.5 Form of Subscription Agreement between the Registrant, its wholly-owned subsidiaries named therein and Yuchai (incorporated herein by reference to the Form F-1).

4.6 Form of Term Loan Agreement between the Registrant and Yuchai (incorporated herein by reference to the Form F-1).

4.7 Share Purchase and Subscription Agreement, dated as of November 9, 1994, between (i) the Registrant, (ii) China Everbright Holdings Company Limited and (iii) Coomber Investments Limited (incorporated herein by reference to the Form F-1).

4.8 Investment and Shareholders Agreement between CACG Limited IV and Guangxi Yuchai Machinery Company Limited, dated July 14, 1994, with a First Amendment dated September 5, 1994 (incorporated herein by reference to the Form F-1).

4.9 Employment Agreement, dated September 5, 2003, between Yuchai and Wang Jianming (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2003, filed by the Registrant on June 29, 2004 (the Form 20-F FY 2003).

4.10 Form of indemnification agreement entered into by the Company with each of Wrixon Frank Gasteen, Gao Jia Lin, Gan Khai Choon, Raymond C. K. Ho, Kwek Leng Peck, Liu Chee Ming, Wong Hong Ren, Philip Ting Sii Tien, Lim Poh Lea, Sheila Murugasu, Teo Tong Kooi, Neo Poh Kiat and Tan Aik-Leang (incorporated herein by reference to the Form 20-F FY 2003).

4.11 Agreement between the Company and Yuchai, dated July 19, 2003 (incorporated herein by reference to the Form 20-F FY 2003).

4.12 Reorganization Agreement between the Company, Coomber and Yuchai, dated April 7, 2005 (incorporated herein by reference to the Form 6-K filed by the Company on April 7, 2005).

4.13 Reorganization Agreement Amendment (No. 1) between the Company, Coomber and Yuchai, dated December 2, 2005 (incorporated herein by reference to the Form 6-K filed by the Company on December 6,

2005).

8.1 Subsidiaries of the Registrant.

12.1 Certifications furnished pursuant to Section 302 of the Sarbanes-Oxley Act.

13.1 Certifications furnished pursuant to Section 906 of the Sarbanes-Oxley Act.

14.1 Consent of Independent Registered Public Accounting Firm.

The Company has not included as exhibits certain instruments with respect to its long-term debt, the total amount of debt authorized under each of which does not exceed 10% of its total consolidated assets. The Company agrees to furnish a copy of any such instrument to the SEC upon request.

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SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHINA YUCHAI INTERNATIONAL LIMITED

By: /s/ Philip Ting Sii Tien

Name: Philip TING Sii Tien
Title: Chief Financial Officer and Director

Date: August 4, 2006

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Exhibit Index

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CHINA YUCHAI INTERNATIONAL LIMITED
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
China Yuchai International Limited

We have audited the accompanying consolidated balance sheets of China Yuchai International Limited (the Company) and subsidiaries as of December 31, 2004 and 2005, and the related consolidated statements of income, stockholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005, all expressed in Renminbi. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Yuchai International Limited and subsidiaries as of December 31, 2004 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005 in conformity with U.S. generally accepted accounting principles.

As described in Note 5, the Company recognized a provision for uncollectible loans to a related party in the amount of Rmb205 million as of December 31, 2005. Further, as described in Note 34, the Company entered into certain material transactions subsequent to December 31, 2005.

The accompanying consolidated financial statements as of and for the year ended December 31, 2005 have been translated into U.S. dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Renminbi have been translated into U.S. dollars on the basis set forth in Note 3(i) to the consolidated financial statements.

/s/ KPMG
Certified Public Accountants
Hong Kong,
August 4, 2006

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005
(Rmb and US$ amounts expressed in thousands, except per share data)

		Years ended December 31,			
	Note	*2003* Rmb	*2004* Rmb	*2005* Rmb	*2005* US$
Revenues, net [(a)]	3(k), 27, 28, 33	4,569,950	5,582,095	5,829,431	722,340
Cost of goods sold [(a)]	4, 27	(3,192,794)	(4,006,886)	(4,527,046)	(560,958)
Gross profit		1,377,156	1,575,209	1,302,385	161,382
Research and development costs	3(m)	(94,594)	(136,960)	(123,876)	(15,350)
Selling, general and administrative expenses[(a)]	3(m), 4, 14, 27	(561,151)	(658,320)	(807,350)	(100,041)
Provision for uncollectible loans to a related party	5			(205,000)	(25,402)
Gain on transfer of lease prepayment to a related party	27			2,533	314
Operating income		721,411	779,929	168,692	20,903
Interest expense	3(s), 6, 28	(23,624)	(31,757)	(70,527)	(8,739)
Equity in losses of affiliates				(5,106)	(633)
Other (expenses)/income, net[(a)]	7	(881)	5,682	24,183	2,997
Income before income taxes and minority interests		696,906	753,854	117,242	14,528
Income taxes	8	(112,924)	(105,165)	(20,875)	(2,587)
Income before minority interests		583,982	648,689	96,367	11,941
		(145,800)	(157,292)	(27,880)	(3,455)

Minority interests in income of consolidated subsidiaries				
Net income	438,182	491,397	68,487	8,486

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (CONTINUED)
(Rmb and US$ amounts expressed in thousands, except per share data)

		Years ended December 31,			
	Note	*2003* Rmb	*2004* Rmb	*2005* Rmb	*2005* US$
Net earnings per common share					
Basic	3(l)	12.40	13.90	1.88	0.23
Diluted	3(l)	12.40	13.90	1.88	0.23
Weighted average number of shares					
Basic	3(l)	35,340,000	35,340,000	36,459,635	36,459,635
Diluted	3(l)	35,340,000	35,340,000	36,459,635	36,459,635

See accompanying notes to consolidated financial statements.

(a) Includes the following income and expenses resulting from transactions with related parties in addition to those indicated above (see Note 5 and 27)

	2003 Rmb	*2004* Rmb	*2005* Rmb	*2005* US$
Revenues, net	24,957	4,537	7,646	947
Cost of goods sold	(93,056)	(250,549)	(417,816)	(51,772)
Selling, general and administrative expenses	(97,240)	(90,790)	(186,759)	(23,141)
Other (expenses)/income, net			11,922	1,477

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2004 AND 2005
(Rmb and US$ amounts expressed in thousands, except per share data)

	Note	*December 31,*		
		2004	*2005*	*2005*
		Rmb	Rmb	US$
ASSETS				
Current assets				
Cash and cash equivalents		722,672	736,195	91,224
Trade accounts receivable, net	9, 18(a)	875,565	1,146,227	142,032
Amounts due from related parties	10, 27	85,614	233,188	28,895
Loans to a related party	5	205,000		
Loans to customers, net	11		7,904	979
Inventories, net	12	1,346,545	1,636,283	202,756
Prepaid expenses, net		58,565	138,322	17,140
Other receivables, net	13	115,414	140,203	17,373
Income taxes recoverable			43,526	5,394
Deferred income taxes	8	69,704	88,783	11,001
Total current assets		3,479,079	4,170,631	516,794
Property, plant and equipment, net	14, 18(a)	1,158,931	1,442,515	178,746
Construction in progress	15	379,035	459,902	56,988
Lease prepayments, net	16	74,767	70,608	8,749
Investments	17	7,053	191,974	23,788
Goodwill		212,636	212,636	26,348
Deferred income taxes	8	72,747	65,519	8,119
Total assets		5,384,248	6,613,785	819,532
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Short-term bank loans	18(a)	430,000	812,835	100,721
Current instalments of long-term bank loans	18(b)		100,000	12,391
Amount due to the holding company	27	4,143	4,301	533
Amounts due to related parties	10, 27	42,686	75,189	9,317
Trade accounts payable		1,089,717	1,642,980	203,586
Income taxes payable		25,387	4,208	521
Accrued expenses and other liabilities	20	484,920	571,717	70,843

Total current liabilities		2,076,853	3,211,230	397,912
Long-term bank loans, excluding current instalments	18(b)	100,000	50,000	6,196
Total liabilities carried forward		2,176,853	3,261,230	404,108

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2004 AND 2005 (CONTINUED)
(Rmb and US$ amounts expressed in thousands, except per share data)

	Note	*December 31,*		
		2004	*2005*	*2005*
		Rmb	Rmb	US$
Total liabilities brought forward		2,176,853	3,261,230	404,108
Minority interests		724,311	685,514	84,944
Stockholders equity				
Common stock		30,349	31,945	3,958
Ordinary shares US$0.10 par value: authorized 100,000,000 shares; issued and outstanding 37,267,673 shares at December 31, 2005 (December 31, 2004: 35,340,000 shares)				
Special share US$0.10 par value: authorized 1 share; issued and outstanding 1 share at December 31, 2004 and 2005				
Contributed surplus		1,486,934	1,692,251	209,691
Statutory reserves	22	266,229	269,017	33,335
Accumulated other comprehensive income			28,851	3,575
Retained earnings		699,572	644,977	79,921
Total stockholders equity		2,483,084	2,667,041	330,480
Commitments and contingencies	23, 24			
Total liabilities and stockholders equity		5,384,248	6,613,785	819,532

See accompanying notes to consolidated financial statements.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
AND COMPREHENSIVE INCOME
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005
(Rmb and US$ amounts expressed in thousands, except per share data)

	Note	*Common stock* Rmb	*Contributed surplus* Rmb	*Statutory reserves* Rmb	*Retained earnings* Rmb	*Accumulated other comprehensive income* Rmb	*Total stockholders equity* Rmb
Balance at January 1, 2003		30,349	1,486,934	170,806	473,814		2,161,903
Net income					438,182		438,182
Transfer to statutory reserves	22			59,114	(59,114)		
Dividend declared (US$2.08 per share)					(608,398)		(608,398)
Balance at December 31, 2003		30,349	1,486,934	229,920	244,484		1,991,687
Net income					491,397		491,397
Transfer to statutory reserves	22			36,309	(36,309)		
Balance at December 31, 2004		30,349	1,486,934	266,229	699,572		2,483,084
Net income					68,487		68,487
Net unrealized appreciation in fair value of investment securities held by an affiliate, net of nil tax						38,869	38,869
Foreign currency translation adjustment, net of nil tax						(10,018)	(10,018)
Comprehensive income							97,338
Transfer to statutory reserves	22			2,788	(2,788)		

Shares issued in connection with Conversion of 2% convertible debt, 1,927,673 shares	19	1,596	205,317				206,913
Dividend declared (US$0.39 per share)					(120,294)		(120,294)
Balance at December 31, 2005		31,945	1,692,251	269,017	644,977	28,851	2,667,041
Balance at December 31, 2005 (in US$)		3,958	209,691	33,335	79,921	3,575	330,480

See accompanying notes to consolidated financial statements.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005
(Rmb and US$ amounts expressed in thousands)

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Cash provided by operating activities				
Net income	438,182	491,397	68,487	8,486
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of property, plant and equipment, and lease prepayments	125,519	132,789	139,720	17,313
Provision for uncollectible loans to a related party			205,000	25,402
Impairment of property, plant and equipment	12,405			
Loss on disposal of property, plant and equipment	3,359	12,998	10,474	1,298
Gain on transfer of land use rights to a related party			(2,533)	(314)
Deferred income taxes	6,253	1,116	(11,851)	(1,468)
Provision for losses on guarantees			12,318	1,526
Equity in losses of affiliates			5,106	633
Dividend received from an affiliated company			7,815	968
Minority interests	145,800	157,292	27,880	3,455
(Increase)/decrease in assets				
Inventories, net	(34,105)	(469,211)	(289,738)	(35,902)
Amounts due from related parties, net	(36,446)	(5,534)	(115,071)	(14,259)
Trade accounts receivable, net	153,524	(25,954)	(270,662)	(33,538)
Prepaid expenses, net	64,752	(21,069)	(79,757)	(9,883)
Other receivables, net	9,885	(106,581)	(24,789)	(3,072)

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (CONTINUED)
(Rmb and US$ amounts expressed in thousands)

	Years ended December 31,			
	2003 Rmb	*2004* Rmb	*2005* Rmb	*2005* US$
Increase/(decrease) in liabilities				
Trade accounts payable	103,065	357,751	553,263	68,556
Income taxes payable	(11,181)	(21,842)	(64,705)	(8,018)
Accrued expenses and other liabilities	90,154	88,521	71,559	8,867
Amount due to holding company	4,108	(2,065)	158	20
Net cash provided by operating activities	1,075,274	589,608	242,674	30,070
Cash flow from investing activities				
Purchase of property, plant and equipment, lease prepayments and construction in progress	(372,775)	(552,902)	(515,359)	(63,860)
Proceeds from disposal of property, plant and equipment	402	5,883	3,826	474
Proceeds from disposal of land use rights			3,580	444
Repayment of loans by a related party			205,000	25,402
Loans to a related party		(205,000)	(205,000)	(25,402)
Loans to customers, net			(7,904)	(979)
Purchase of investments		(1,348)	(161,358)	(19,994)
Net cash used in investing activities	(372,373)	(753,367)	(677,215)	(83,915)
Cash flow from financing activities				
Proceeds from short-term bank loans	230,000	330,000	1,188,178	147,230
Proceeds from short-term borrowing from a related party	8,000			

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (CONTINUED)
(Rmb and US$ amounts expressed in thousands)

	Years ended December 31,			
	2003 Rmb	*2004* Rmb	*2005* Rmb	*2005* US$
Proceeds from long-term bank loans		100,000	50,000	6,196
Proceeds from 2% convertible bonds			206,913	25,639
Repayment of short-term bank loans	(125,000)	(190,000)	(805,343)	(99,792)
Repayment of long-term bank loans	(130,000)			
Repayment of short-term borrowing from a related party		(8,000)		
Capital contribution from minority stockholders		31,000		
Dividend paid by subsidiaries to minority stockholders	(88,765)	(8,507)	(66,677)	(8,262)
Dividend paid to stockholders	(608,398)		(120,294)	(14,906)
Net cash (used in)/provided by financing activities	(714,163)	254,493	452,777	56,105
Effect of foreign currency exchange on cash and cash equivalents			(4,713)	(584)
Net (decrease)/increase in cash and cash equivalents	(11,262)	90,734	13,523	1,676
Cash and cash equivalents at beginning of year	643,200	631,938	722,672	89,548
Cash and cash equivalents at end of year	631,938	722,672	736,195	91,224

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (CONTINUED)
(Rmb and US$ amounts expressed in thousands)

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Supplemental disclosures of cash flow information				
Cash paid during the year for:				
Interest, net of amount capitalized	23,624	31,757	70,527	8,739
Income taxes	117,852	125,891	97,431	12,073

See accompanying notes to consolidated financial statements.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005
(Rmb and US$ amounts expressed in thousands, except per share data)

1 Background and principal activities

China Yuchai International Limited (the Company) was incorporated under the laws of Bermuda on April 29, 1993. The Company was established to acquire a controlling interest in Guangxi Yuchai Machinery Company Limited (Yuchai), a Sino-foreign joint stock company which manufactures, assembles and sells diesel engines in the People s Republic of China (the PRC). The principal markets for Yuchai s diesel engines are truck manufacturers in the PRC.

The Company owns, through six wholly-owned subsidiaries, 361,420,150 shares or 76.41% of the issued share capital of Yuchai (Foreign Shares of Yuchai). Guangxi Yuchai Machinery Group Company Limited (State Holding Company), a state-owned enterprise, owns 22.09% of the issued share capital of Yuchai (State Shares of Yuchai).

In December 1994, the Company issued a special share (the Special Share) at par value of US$0.10 to Diesel Machinery (BVI) Limited (DML), a company controlled by Hong Leong Corporation Limited, now known as Hong Leong (China) Limited (HLC). The Special Share entitles its holder to designate the majority of the Company s Board of Directors (six of eleven). The Special Share is not transferable except to Hong Leong Asia Ltd. (HLA), the holding company of HLC, or any of its affiliates. During 2002, DML transferred the Special Share to HL Technology Systems Pte Ltd (HLT), a subsidiary of HLC.

Yuchai established three direct subsidiaries, Yuchai Machinery Monopoly Company Limited (YMMC), Guangxi Yulin Yuchai Machinery Spare Parts Manufacturing Company Limited (GYSPM) and Yuchai Express Guarantee Company Limited (YEGCL). YMMC and GYSPM were established in 2000, and are involved in the manufacture and sale of spare parts and components for diesel engines in the PRC. YEGCL, was established in 2004, and is involved in the provision of financial guarantees to mortgage loan applicants in favour of banks in connection with the applicants purchase of automobiles equipped with diesel engines produced by Yuchai. As at December 31, 2005, Yuchai held an equity interest of 71.83%, 97.14% and 76.92% respectively in these companies. As at December 31, 2005, YMMC had direct controlling interests in twenty-one (2004: twenty-one) subsidiaries, which are involved in the trading and distribution of spare parts of diesel engines and automobiles, all of which are established in the PRC.

In March 2005, the Company acquired 14.99% of the common stock of Thakral Corporation Limited (TCL). TCL is a company listed on the main board of the Singapore Exchange Securities Trading Limited (the Singapore Exchange) and is involved in the manufacture, assembly and distribution of high-end consumer electronic products and home entertainment products in the PRC. Three directors out of ten directors on the board of TCL are appointed by the Company. Based on the Company s shareholdings and representation in the board of directors of TCL, management has concluded that the company has the ability to exercise significant influence over the operating and financial policies of TCL. Consequently, the Company s consolidated financial statements included the Company s share of the results of TCL, accounted for an equity basis since acquisition. The Company acquired additional 1.00% of the common stock of TCL in September 2005.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 ***(CONTINUED)***
(Rmb and US$ amounts expressed in thousands, except per share data)

2 Basis of presentation

The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). This basis of accounting differs from that used in the statutory financial statements of Yuchai, which are prepared in accordance with the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises issued by the Ministry of Finance of the PRC (PRC GAAP).

3 Summary of significant accounting policies and practices

(a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company, its majority-owned subsidiaries and those entities that the Company has determined it has a direct or indirect controlling financial interests. All significant intercompany balances and transactions have been eliminated in consolidation. In addition, the Company evaluates its relationships with other entities to identify whether they are variable interest entities as defined by the Financial Accounting Standard Board (the FASB) Interpretation (FIN) No. 46 (R), Consolidation of Variable Interest Entities (FIN 46(R)) and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46(R). The Company was not the primary beneficiary of any variable interest entities during the three years ended December 31, 2005.

(b) Cash and cash equivalents

Cash includes cash on hand and demand deposits with banks. For purposes of the consolidated statement of cash flows, the Company considered all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. None of the Company s cash is restricted as to withdrawal. See Note 29 for discussion of restrictions on the Renminbi.

(c) Trade accounts receivable

Trade accounts receivable are recorded at the invoiced value of goods sold after deduction of trade discounts and allowances, if any. Amounts collected on trade accounts receivable are included in net cash provided by operating activities in the consolidated statement of cash flows. The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in the Company s existing accounts receivable. The Company determines the allowance based on historical write-off experience by industry and national economic data.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 ***(CONTINUED)***
(Rmb and US$ amounts expressed in thousands, except per share data)

3 Summary of significant accounting policies and practices (continued)

(c) Trade accounts receivable (continued)

The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by aging of such balances. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers, except for outstanding bills discounted with banks (see Note 24(e)), that are subject to recourse for non-payment.

(d) Inventories, net

Inventories are stated at the lower of cost and market. Cost is determined using the weighted average cost method. Cost of work in progress and finished goods comprises direct materials, direct labor and an attributable portion of production overheads.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets, taking into account the estimated residual value. The estimated useful lives are as follows:

Buildings	30 to 40 years
Machinery and equipment	5 to 15 years

(f) Construction in progress

Construction in progress represents factories under construction and machinery and equipment pending installation. All direct costs relating to the acquisition or construction of buildings and machinery and equipment, including interest charges on borrowings, are capitalized as construction in progress. No depreciation is provided in respect of construction in progress.

Construction of plant is considered to be complete on the date when the plant is substantially ready for its intended use notwithstanding whether the plant is capable of producing saleable output in commercial quantities.

(g) Lease prepayments

Lease prepayments represent land use rights paid to the PRC land bureau. Land use rights are carried at cost and amortized on a straight-line basis over the respective periods of the rights which are in the range of 15 to 50 years.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 ***(CONTINUED)***
(Rmb and US$ amounts expressed in thousands, except per share data)

3 Summary of significant accounting policies and practices (continued)

(h) Investments

An affiliated company is an entity in which the Company has the ability to exercise significant influence in its financial and operating policy decisions, but does not have a controlling financial interest. Investments in affiliates are accounted for by equity method.

Investments in available-for-sale equity securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income/(loss) until realized. Realized gains and losses from the sale of available-for-sale equity securities are determined on a specific-identification basis. However, equity securities that are not traded in an active market and whose fair values cannot be reliably estimated are accounted for at their acquisition cost.

The Company recognizes an impairment loss when the decline in fair value below the carrying value of an investment is considered other than temporary.

(i) Foreign currency transactions and translation

Transactions denominated in currencies other than Renminbi are translated into Renminbi at the exchange rates quotes by the People s Bank of China (the PBOC) prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi using the applicable exchange quoted by PBOC at the balance sheet dates. The resulting exchange differences are recorded in the consolidated statements of income as part of the related transaction amounts.

During the year ended December 31, 2005, the exchange rate regime of Renminbi was reformed by moving into a managed floating exchange regime based on market supply and demand with reference to a basket of foreign currencies from the unified controlled exchange rate based on market supply and demand.

Assets and liabilities of foreign subsidiaries and affiliates whose functional currency is not Renminbi are translated into Renminbi using the exchange rate on the balance sheet date. Revenues and expenses are translated at average rates prevailing during the year. The gains and losses resulting from translation of financial statements of foreign subsidiaries and affiliates are recorded as a separate component of accumulated other comprehensive income/(loss) within stockholders equity. Cumulative translation adjustments are recognized as income or expense upon disposal or liquidation of a foreign subsidiary and affiliate.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 ***(CONTINUED)***
(Rmb and US$ amounts expressed in thousands, except per share data)

3 Summary of significant accounting policies and practices (continued)

(i) Foreign currency transactions and translation (continued)

For the U.S. dollar convenience translation amounts included in the accompanying consolidated financial statements, the Renminbi equivalent amounts were translated into U.S. dollars at the exchange rate on the balance sheet date which is US$1.00 = Rmb8.0702, the rate quoted by the PBOC at the close of business on December 30, 2005. No representation is made that the Renminbi amounts could have been, or could be, converted into U.S. dollars at that rate or at any other certain rate on December 30, 2005 or at any other date.

(j) Income taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets are reduced by a valuation allowance to the extent the Company concludes it is more likely than not that the assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates, if any, is recognized in the statements of income in the financial year that includes the enactment date.

(k) Revenue recognition

(i) Product sales

Revenue is recognized in accordance with U.S. GAAP as described in the Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 104, Revenue Recognition (SAB 104). SAB 104 generally requires that four basic criteria be met before revenue can be recognized: (i) persuasive evidence of an arrangement exists; (ii) the price is fixed or determinable; (iii) collectibility is reasonably assured; and (iv) product delivery has occurred. For the Company, these criteria are generally considered to be met upon delivery and acceptance of products at the customer site.

Product sales represent the invoiced value of goods, net of value added taxes (VAT), sales returns, trade discounts and allowances. Yuchai and its subsidiaries are subject to VAT which is levied on the majority of their products at the rate of 17% of the invoiced value of sales. Output VAT is borne by customers in addition to the invoiced value of sales. VAT paid by Yuchai and its subsidiaries on its purchases of materials and supplies is recoverable out of VAT collected from sales to their customers.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 ***(CONTINUED)***
(Rmb and US$ amounts expressed in thousands, except per share data)

3 Summary of significant accounting policies and practices (continued)

(k) Revenue recognition (continued)

(ii) Guarantee fee income

Guarantee fees received or receivable for a guarantee issued are recorded in Accrued expenses and other liabilities based upon the estimated fair value of guaranty obligations, and are amortized into revenue on a straight line basis over the respective terms of the guarantees. The Company will record an adjustment to the carrying amount of its obligations through a charge to earnings if it determines that it is probable that the Company will be required to perform under the guaranty.

(iii) Rental income

Rental income receivable under operating lease is recognized in the consolidated statements of income in equal instalments over the period covered by the lease term.

(l) Earnings per share

Basic earnings per share (EPS) is computed by dividing income attributable to common shares by the weighted average number of common shares outstanding for the period.

The reconciliation of the Company s EPS is as follows:

	Years ended December 31,			
	2003 Rmb	*2004* Rmb	*2005* Rmb	*2005* US$
Net income attributable to common shares	438,182	491,397	68,487	8,486
Basic earnings per share				
Weighted average common shares outstanding during the year	35,340,000	35,340,000	36,459,635	36,459,635
Basic earnings per share of common shares	12.40	13.90	1.88	0.23

There were no potentially dilutive securities outstanding as of December 31, 2003, 2004 and 2005.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 ***(CONTINUED)***
(Rmb and US$ amounts expressed in thousands, except per share data)

3 Summary of significant accounting policies and practices (continued)

(m) Advertising, research and development costs

Advertising, research and development costs are expensed as incurred. Advertising cost included in Selling, general and administrative expenses , amounted to Rmb40,961, Rmb48,725 and Rmb45,291 (US$5,612) respectively, for the years ended December 31, 2003, 2004 and 2005.

Research and development expenses are shown net of a government subsidy of Rmb5,915 (US$733) for the year ended December 31, 2005. No such government subsidy was received for the years ended December 31, 2003 and 2004.

(n) Goodwill

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Goodwill is not amortized, but instead is tested for impairment at least annually and when certain circumstances indicate a possible impairment may exist. The Company evaluates the recoverability of goodwill using a two-step impairment test approach at the reporting unit level at the end of each year. In the first step, the fair value of the reporting unit is compared to its carrying value including goodwill. The fair value of the reporting unit is determined based upon discounted future cash flows. In the case that the fair value of the reporting unit is less than its carrying value, a second step is performed which compares the implied fair value of the reporting unit s goodwill to the book value of the goodwill. In determining the implied fair value of the reporting unit goodwill, the fair values of the tangible net assets and recognized and unrecognized intangible assets is deducted from the fair value of the reporting unit. If the implied fair value of reporting unit goodwill is lower than its carrying amount, goodwill is considered impaired and is written down to its implied fair value. The results of the impairment testing in 2003, 2004 and 2005 did not result in any impairment of goodwill.

(o) Product warranty

The Company provides, at the time the product is sold, for the estimated future costs to be incurred under a warranty period or warranty mileage on various engine models, which the Company provides free repair and replacement. Warranties generally extend for a duration (12 months to 18 months) or mileage (80,000 kilometres to 180,000 kilometres), whichever is the lower. Provisions for warranty are primarily determined based on historical warranty cost per unit of engines sold adjusted for specific conditions that may arise and the number of engines under warranty at each financial year-end.

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3 Summary of significant accounting policies and practices (continued)

(p) Use of estimates

The preparation of the consolidated financial statements in accordance with U.S. GAAP requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the recoverability of the carrying amount of long-lived assets including goodwill; realizable values for inventories; valuation allowances for receivables; and obligations for warranty costs. Actual results could differ from those estimates.

(q) Impairment of long-lived assets, other than goodwill

Long-lived assets to be held and used, such as property, plant and equipment, construction in progress and lease prepayments, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

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3 Summary of significant accounting policies and practices (continued)

(r) Commitments and contingencies

Liabilities for loss contingencies, arising from claims, assessments, litigation, fines and penalties and other sources are recorded when it is probable that an obligation has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

(s) Sales of trade accounts receivable

The Company sells trade accounts and bills receivable to banks on an ongoing basis. The buyer is responsible for servicing the receivables upon maturity of the trade accounts receivable. Sales of the trade accounts receivable are accounted for under Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . Accordingly, trade accounts and bills receivable are derecognized, and the Company records a discount equal to the difference between the carrying value of the trade accounts and bills receivable and cash received. The Company has received proceeds for the sales of the trade accounts and bills receivable of Rmb1,730,627, Rmb2,380,569 and Rmb3,423,296 (US$424,190), for the years ended December 31, 2003, 2004 and 2005, respectively. The Company has recorded discounts totalled of Rmb22,042, Rmb31,709 and Rmb44,362 (US$5,497) in respect of sold trade accounts and bills receivable for the years ended December 31, 2003, 2004 and 2005, respectively, which have been included in interest expense.

(t) Recently issued accounting standards

In December 2004, the FASB issued SFAS No.123 (revised 2004), Share-Based Payment , which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. This statement is a revision to SFAS No. 123 and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and its related implementation guidance. This statement will require measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock options. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized. The Company will adopt this statement on January 1, 2006 under the modified prospective method of application. Under that method, the Company will recognize compensation costs for new grants of share-based awards, awards modified after the effect date, and the remaining portion of the fair value of the unvested awards at the adoption date. The initial adoption of this statement will not have any effect on the Company s 2006 consolidated financial statements.

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3 Summary of significant accounting policies and practices (continued)

(t) Recently issued accounting standards (continued)

In December 2004, the FASB issued SFAS No. 151, Inventory Costs , which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Under this statement, such items will be recognized as current-period charges. In addition, the statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement will be effective for the Company for inventory costs incurred on or after January 1, 2006. The initial adoption of this statement will not have a significant effect on the Company s 2006 consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets , which eliminates an exception in APB Opinion No. 29, Accounting for Nonmonetary Transactions , for recognizing nonmonetary exchanges of similar productive assets at fair value and replaces it with an exception for recognizing exchanges of nonmonetary assets at fair value that do not have commercial substance. This statement will be effective for the Company for nonmonetary asset exchanges occurring on or after January 1, 2006. The adoption of this statement will not have a significant effect on the Company s 2006 consolidated financial statements.

In March 2005, the FASB issued FIN No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. The types of asset retirement obligations that are covered by this interpretation are those for which an entity has a legal obligation to perform an asset retirement activity, however the timing and (or) method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ended after December 15, 2005. The initial adoption of FIN 47 did not have an impact on the Company s financial condition and consolidated statements of income.

In September 2005, the EITF issued EITF 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty . EITF 04-13 provides guidance as to when purchases and sales of inventory with the same counterparty should be accounted for as a single exchange transaction. EITF 04-13 also provides guidance as to when a nonmonetary exchange of inventory should be accounted for at fair value. EITF 04-13 will be applied to new arrangements entered into, and modifications or renewals of existing arrangements beginning in the first interim or annual reporting beginning after March 15, 2006. The application of EITF 04-13 is not expected to have a significant impact on the Company s consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 . This statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . This statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets . This statement will be effective for the fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact of the statement to the Company s consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 . This statement amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities , with respect to the accounting for separately recognized servicing assets and servicing liabilities. The statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations and requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The statement also provides guidelines to classification, disclosure and subsequent measurement of servicing assets and servicing liabilities. This statement will be effective for the fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact of the statement to the Company s consolidated financial statements.

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are effective for the fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of the provisions of FIN 48 to the Company s consolidated financial statements.

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4 Depreciation, amortization, sales commissions, shipping and handling expenses

Depreciation of property, plant and equipment and amortization of lease prepayments are included in the following captions:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Cost of goods sold	88,737	84,907	86,491	10,717
Selling, general and administrative expenses	36,782	47,882	53,229	6,596
	125,519	132,789	139,720	17,313

Sales commissions to sales agents are included in the following caption:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Selling, general and administrative expenses	16,724	11,564	39,372	4,879

Sales related shipping and handling expenses not separately billed to customers are included in the following caption:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Selling, general and administrative expenses	64,991	86,163	126,813	15,714

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5 Provision for uncollectible loans to a related party

The amount represents the recognition of specific doubtful debt provisions totaling Rmb205,000 (US$25,402) on the loans due from Yuchai Marketing and Logistic Company Limited (YMLC) as of December 31, 2005. YMLC is wholly owned by Coomber Investment Limited (Coomber), a shareholder of the Company and State Holding Company (collectively, the Chinese Shareholders).

In March and May 2004, Yuchai granted interest-free advances to YMLC at the request of the Yuchai s PRC directors to provide YMLC with initial working capital for its start-up activities. YMLC was set up with the intention of offering a complementary range of services including spare parts distribution, insurance, vehicle financing and warranty servicing. These advances were provided with the approval of the previous Chairman of Yuchai but without the prior approval by the majority of the shareholders of Yuchai.

On December 2, 2004, these advances were converted into formal loans and written agreements were executed between Yuchai and YMLC through an authorized financial institution in the PRC. Under the terms of the loan agreements, the loans were payable in their entirety on December 2, 2005 and interest, at the rate of 5.58% per annum, was payable on a monthly basis. Further, the loans were secured by guarantees given by the Chinese Shareholders. Interest income of Rmb11,922 (US$1,477) was recognized in 2005 (see Note 7).

Because the loans had already been disbursed, the Chinese Shareholders had issued guarantees for these loans, and the Company s relationship with the Chinese Shareholders was improving, the Directors of Yuchai believed that it was in the Company s and Yuchai s best interest to ratify the loans. Consequently, the loans were ratified by the Board of Directors of Yuchai in April 2005.

In 2005, the Company discussed with the Chinese Shareholders the possibility of converting the loans into an equity investment in YMLC, subject to the Yuchai board s approval. This potential alternative was incorporated within the terms of the reorganization agreement entered into by the Company with Yuchai and Coomber on April 7, 2005 (Reorganization Agreement).

When the loans became due in December 2005, Yuchai was requested to extend the maturity date for the loans. However, the Company and Yuchai had been unable to access the financial statements of YMLC. Consequently, the Directors from the Company s and Yuchai s boards had doubts about YMLC s ability to repay the loans. However, the Company s and Yuchai s board of directors considered the request to extend the loans based on representations received from the Chinese Shareholders and management of YMLC concerning their respective abilities and intentions to repay the loans and honor their guarantees, and therefore agreed to extend the repayment date of the loans for an additional year. The extension of the loans was approved by the Board of Directors of Yuchai on December 2, 2005. An agency bank was appointed under PRC requirements to administer the Rmb205,000 loans and the legal method requires such loans to be repaid and the funds re-disbursed. The new loans carry the same terms, including scheduled maturity on December 1, 2006. New guarantees were also granted by the Chinese Shareholders for these loans.

Later in December 2005, after it was agreed to extend the loans, based on mutual understandings between YMLC, the Chinese Shareholders and Yuchai, access to financial records of YMLC were made available. The Company conducted a due diligence review, learned that YMLC was not profitable, and concluded that YMLC s future prospects were dim. The Company therefore decided not to pursue the conversion of loans into an equity investment in YMLC and also concluded that YMLC will probably not have the financial resources to repay the loans when they become due in December 2006.

The Company discussed this matter with the Chinese Shareholders and management of YMLC and also considered the financial position and financial resources of the State Holding Company and Coomber. CYI management has made an assessment of the future cash flows of the State Holding Company and Coomber and concluded that it is

likely they will not be able to honor their respective guarantees in the event YMLC is unable to repay the loans when they become due.

Consequently, CYI management has identified a number of possible courses of action in the event YMLC is unable to repay the loans when they become due. These actions include:

Taking actions to force YMLC to liquidate;

Retaining portions of future dividends declared by Yuchai and payable to State Holding Company until the guarantee obligations are fulfilled; and

Commencing legal action against YMLC and possibly the Chinese Shareholders.

The Company s management has ruled out any form of legal or other enforcement action against the Chinese Shareholders as management believes that Yuchai may not be the first preferred creditor entitled to receive payment of the judgment debt. Moreover, management believes that the process for enforcement of a judgment in China is complex and not as effective when compared with other jurisdictions. In addition management believes that the commencement of legal or other enforcement actions will likely lead to a deterioration in relations with the Chinese Shareholders which could have a materially adverse impact on the Company s investment in Yuchai and could lead to the impairment of shareholder value of the Company. Consequently, management believes that it is currently beneficial to the Company s shareholders for management to continue their dialogue and seek other possible arrangements with YMLC, Coomber and State Holding Company to resolve the repayment of the Rmb205,000 (US$25,402) loans rather than for it to resort to legal and enforcement actions described above. However, considering the financial condition and management s assessment of the future prospects of YMLC and management s intention to not seek legal or enforcement actions pertaining to the loans and related guarantees, management currently believes that it is probable it will be unable to recover any portion of these loans.

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6 Interest cost

The Company capitalizes interest charges as a component of the cost of construction in progress. The following is a summary of interest cost incurred during 2003, 2004 and 2005:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Interest cost capitalized	12,146	19,701	20,991	2,601
Interest cost charged to consolidated statements of income	23,624	31,757	70,527	8,739
Total interest cost incurred	35,770	51,458	91,518	11,340

7 Other (expenses)/income, net

Other (expenses)/income, net consist of:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Interest income (see Note 5)	3,587	3,286	21,744	2,695
Foreign exchange (loss)/gain, net	(27)	(38)	607	75
Dividend income from other investments		4,591		
Rental income			6,078	753
Others, net	(4,441)	(2,157)	(4,246)	(526)
	(881)	5,682	24,183	2,997

8 Income taxes

Bermuda tax

The Company is incorporated under the laws of Bermuda and, under the current Bermuda laws, is not subject to tax on income or capital gains.

The Company has received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of the Exempted Undertakings Tax Protection Act, 1966, which exempts the Company and its stockholders, other than stockholders ordinarily resident in Bermuda, from any Bermuda taxes computed on profit, income or any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax at least until the year 2016.

PRC income tax

As Yuchai is a sino-foreign enterprise in the Western Region of the PRC that is engaged in an encouraged industry, its PRC statutory income tax rate is 15% in 2003, 2004 and 2005 under the relevant PRC income tax laws.

The PRC income tax rates of Yuchai s subsidiaries under the relevant PRC income tax laws are 15% to 33% in 2003, 2004 and 2005.

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8 Income taxes (continued)

Income tax expense in the consolidated statements of income consists of:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Current tax expense	106,671	104,049	32,726	4,055
Deferred tax expense/(benefit)	6,253	1,116	(11,851)	(1,468)
	112,924	105,165	20,875	2,587

Income tax expense reported in the consolidated statements of income differs from the amount computed by applying the PRC income tax rate of 15% for the three years ended December 31, 2005 for the following reasons:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Computed expected tax expense	104,536	113,078	17,586	2,179
Adjustments resulting from:				
Non-deductible expenses	1,232	471	5,703	707
Tax credits (see Note (i))		(16,184)	(43,535)	(5,395)
Change in valuation allowance			45,231	5,605
Rate differential of subsidiaries	7,156	7,800	(4,110)	(509)
Total tax expense	112,924	105,165	20,875	2,587

Notes:

(i) Amounts mainly represents tax credits relating to the purchase of domestic equipment for technological improvement and the approved research and development costs.

(ii) All taxable income and income tax expense are from PRC sources.

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8 Income taxes (continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at December 31, 2004 and 2005 are presented below:

		December 31,	
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Trade accounts receivable	26,006	22,900	2,838
Inventories	6,678	8,336	1,033
Property, plant and equipment	69,247	49,436	6,126
Accrued expenses and other liabilities	37,020	32,961	4,084
Tax losses carried forward	3,500	11,615	1,439
Tax credits		43,535	5,395
Loans to a related party		30,750	3,810
Total gross deferred tax assets	142,451	199,533	24,725
Less: Valuation allowance		45,231	5,605
Net deferred tax assets	142,451	154,302	19,120

The following table represents the classification of the Company s net deferred tax assets:

		December 31,	
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Net deferred tax assets comprise of:			
Current portion	69,704	88,783	11,001
Non-current portion	72,747	65,519	8,119
	142,451	154,302	19,120

As of December 31, 2005, a subsidiary of the Company was granted with tax credits amounted to Rmb43,535 (US$5,395) in relation to the purchase of domestically produced equipment of which Rmb12,502 (US$1,549) would expire in 2008 and the remaining amount would expire in 2009. According to the relevant laws and regulations in the PRC, the amount entitled for deduction each year is limited to the incremental current income tax expense of the subsidiary for the year compared to the current income tax of the subsidiary in the year before the purchase of the equipment.

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8 Income taxes (continued)

Certain subsidiaries of the Company had net operating loss carryforwards for PRC income tax purposes of Rmb47,182 (US$5,846), which are available to offset future taxable income, if any. Of which, Rmb13,328, Rmb13,630 and Rmb20,224 would expire in 2008, 2009 and 2010, respectively.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The management considered that it is more likely than not that tax credits totalling Rmb33,834 (US$4,193) relating to the purchase of domestic equipment cannot be fully utilized as the amount entitled for deduction each year is limited to the incremental current income tax expense of the subsidiary compared to the current tax of the subsidiary for the years 2003 and 2004, when the related domestic equipment was purchased and the management forecasted future taxable income of the subsidiary will not be sufficient to fully utilize the tax credits. In addition, one of the subsidiaries has been loss making since its commencement of operations in 2004 and based on this, management has determined that it is more likely than not that the benefit of deferred tax assets in this entity totalling Rmb11,397 (US$1,412) will not be realized.

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9 Trade accounts receivable, net

Trade accounts receivable, net comprise:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Trade accounts receivable	504,429	574,018	71,128
Less: Allowance for doubtful accounts	107,457	69,047	8,556
	396,972	504,971	62,572
Bills receivable	478,593	641,256	79,460
	875,565	1,146,227	142,032

An analysis of the allowance for doubtful accounts for 2003, 2004 and 2005 is as follows:

		December 31,		
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Balance at beginning of year	158,075	94,423	107,457	13,315
Add:				
Charge to consolidated statements of income		13,034	25,587	3,171
Less:				
Written back to consolidated statements of income	493			
Doubtful debts written off	63,159		63,997	7,930
Balance at end of year	94,423	107,457	69,047	8,556

At December 31, 2004 and 2005, gross trade accounts receivable due from a major customer, Dongfeng Automobile Company and its affiliates (the Dongfeng companies), were Rmb142,788 and Rmb161,930 (US$20,065), respectively. See Note 33 for further discussion of business concentration risk.

As of December 31, 2005, certain trade accounts receivable totalling Rmb42,835 (US$5,308) were pledged as security under certain loan arrangements (see Note 18(a)).

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10 Amounts due from/to related parties

Amounts due from related parties comprise:

		December 31,	
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Due within one year	85,614	233,188	28,895

Amounts due to related parties comprise:

		December 31,	
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Due within one year	42,686	75,189	9,317

Related parties include Hong Leong Management Services Pte, Limited, YMLC, State Holding Company and their subsidiaries and affiliates. At December 31, 2005, the amounts due from/to related parties are unsecured, interest free and arose principally from transactions as disclosed in Note 27. All amounts due from/to related parties are payable on demand.

In June 2006, YMLC and State Holding Company entered into an agreement with Yuchai to enable Yuchai and its subsidiaries to settle the amounts due from/to YMLC, State Holding Company and their subsidiaries on a net basis, i.e. the balance due from/to YMLC, State Holding Company, their subsidiaries and affiliates as of December 31, 2005 were offset.

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11 Loans to customers, net

Loans to customers, net refer to the designated loans lent by the Company through financial institutions to customers. The terms of the loan agreements were designated by the Company. The financial institutions assist the Company to release the principal to the borrowers and collect the repayment on behalf of the Company without bearing the risk of default by customers, if any. The loans carried interest rates ranged from 5.31% to 5.85% and were repayable in instalments within one year. The loans are secured and guaranteed by independent third parties.

12 Inventories, net

Inventories comprise:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Raw materials	699,132	1,027,733	127,349
Work in progress	141,659	33,057	4,096
Finished goods	505,754	575,493	71,311
	1,346,545	1,636,283	202,756

13 Other receivables, net

Other receivables, net comprise:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
VAT recoverable (see Note (i))	91,977	96,151	11,914
Staff loans	8,476	18,075	2,240
Staff advances	3,306	1,726	214
Receivable for factoring (see Note (ii))	6,845		
Others	4,810	24,251	3,005
	115,414	140,203	17,373

Notes:

(i) The VAT recoverable mainly represents a delay in the input VAT approval by the local tax bureau, totalling Rmb58,872 (US$7,295). The amount was subsequently settled in January 2006.

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13 Other receivables, net (continued)

Notes: (continued)

(ii) In December 2004, Yuchai sold trade accounts receivable of Rmb64,827 to a commercial bank. The balance represented 10% of the sales amount withheld by the bank that would be released to the Company upon the settlement of the trade accounts receivable. The amount withheld represented the full amounts which might be claimed by the bank pursuant to recourse provisions. The amount was fully settled in 2005.

14 Property, plant and equipment, net

Property, plant and equipment, net comprise:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Buildings	634,544	709,643	87,934
Machinery and equipment	1,547,112	1,888,567	234,017
	2,181,656	2,598,210	321,951
Less: Accumulated depreciation	1,022,725	1,155,695	143,205
Net property, plant and equipment	1,158,931	1,442,515	178,746

In 2003, management determined that certain property, plant and equipment would no longer be used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets . The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to their estimated fair value. Impairment loss of Rmb12,405 has been included in Selling, general and administrative expenses in 2003. Management has conducted an impairment review on the conditions of the property, plant and equipment in 2004 and 2005 and considered no impairment loss was deemed necessary in 2004 and 2005.

All of Yuchai and its subsidiaries buildings are located in the PRC.

As of December 31, 2004, certain plant and equipment of Yuchai with an aggregate carrying amount of Rmb172,630, was pledged as security under certain loan arrangements (see Note 18(a)). The security was released in 2005.

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14 Property, plant and equipment, net (continued)

Loss on disposal of property, plant and equipment for the years ended December 31, 2003, 2004 and 2005 is included in Selling, general and administrative expenses as follows:

	December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Loss on disposal of property, plant and equipment	3,359	12,998	10,474	1,298

The Company has several non-cancellable operating leases, primarily for offices and warehouses that expire over the next four years. These leases generally contain renewal options for periods ranging from one year to four years.

Future minimum lease payments under non-cancellable operating leases (with initial or remaining lease terms in excess of one year) as of December 31, 2005 are:

	Rmb	US$
2006	2,766	343
2007	2,019	250
2008	1,084	134
2009	541	67
	6,410	794

Rental expense for operating leases is included in Selling, general and administrative expenses as follows:

	December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Rental expense	5,159	9,232	8,726	1,081

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15 Construction in progress

Construction in progress comprises capital expenditures and capitalized interest charges relating to the following construction of facilities and assembly lines projects:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Diesel engine production line and facilities projects	211,418	286,050	35,445
Factories auxiliary facilities	86,134	95,230	11,800
Second foundry	29,570	26,047	3,228
Others	51,913	52,575	6,515
	379,035	459,902	56,988

16 Lease prepayments, net

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Lease prepayments	99,111	98,157	12,163
Less: Accumulated amortization	24,344	27,549	3,414
Lease prepayments, net	74,767	70,608	8,749

The land on which the Company s buildings are erected is owned by the PRC Government. Yuchai and its subsidiaries are granted the land use rights of 15 to 50 years in respect of such land.

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17 Investments

(a) Investments as of December 31, 2004 and 2005 are summarized as follows:

		December 31,	
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Available-for-sale equity securities (see Note)	6,405	6,355	787
Investments in affiliated companies	648	185,619	23,001
	7,053	191,974	23,788

Note: Available-for-sale equity securities are non-marketable equity securities and stated at cost due to the lack of information to determine the fair value. The Company did not observe any event or change in circumstances that would have result in the fair value being significantly less than its carrying amount.

(b) Investments in affiliated companies accounted for using the equity method as of December 31, 2004 and 2005 are as follows:

		December 31,	
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Listed:			
TCL (see Note (i))		185,021	22,927
Unlisted:			
Others (see Note (ii))	648	598	74
	648	185,619	23,001

Notes:

(i) The Company acquired 264,000,000 shares and 17,795,664 shares of TCL s ordinary shares on March 23, 2005 and September 5, 2005, representing 14.99% and 1.00% interests of the enlarged share capital of TCL at a consideration of Singapore dollars (S$) 30,880,000 (equivalent to Rmb152,133) and S$1,400,000 (equivalent to Rmb6,890) respectively. As a result, the Company held a 15.99% stake in TCL as of December 31, 2005. Among the 17,795,664 ordinary shares purchased in September 2005, 6,715,196 ordinary

shares held by the Company as of December 31, 2005 are subject to a call option which is exercisable by certain members of the Thakral family (Thakral Family Members), who are stockholders of TCL.

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17 Investments (continued)

(b) Investments in affiliated companies accounted for using the equity method as of December 31, 2004 and 2005 are as follows: (continued)

Notes: (continued)

The option was granted only to Thakral Family Members by the participating creditors in connection with a scheme of arrangement dated October 24, 2001 in relation to TCL sanctioned by the High Court of Singapore on November 2, 2001 (the Scheme). The option price payable per TCL share under the call option is S$0.25 plus an interest of Singapore Interbank offer rate plus 0.5% from March 27, 2002 until the completion of the sale and purchase of the shares pursuant to an exercise of the call option. The Company has assessed the fair value of the options and determined that the value was not material. The 6,715,196 shares of TCL were held by a share escrow account on trust for the Company pending release to the Company as of December 31, 2005, subject to the call option. Assuming that the call option is not exercised by the Thakral Family Members, all the 6,715,196 shares of TCL will be released by the share escrow agent to the Company by August 31, 2006. As of December 31, 2005, the call option has not been exercised.

The fair value, based on the quoted market price, of the TCL shares held by the Company was Rmb109,434 (US$13,560) as of December 31, 2005. Management considers the decline in fair value below the carrying value to be not other than temporary as the Company has the ability and intent to hold its investment in TCL for a period that should allow it to recover its carrying value.

(ii) Others represent the Company s interest in certain entities in the PRC in which the Company has the ability to exercise significant influence in its financial and operating policy decisions, but does not have controlling financial interests.

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17 Investments (continued)

(c) Summarized financial information regarding TCL as of December 31, 2005 and for the period from March 23, 2005 to December 31, 2005 is as follows:

	December 31, 2005 Rmb	*December 31, 2005* US$
Financial position		
Current assets	932,008	115,488
Property, plant and equipment, net	173,266	21,470
Other assets	453,327	56,173
Total assets	1,558,601	193,131
Current liabilities	337,971	41,879
Non-current liabilities	1,034	128
Long term debts	32,076	3,975
Total liabilities	371,081	45,982
Minority interests	30,416	3,769
Stockholders equity	1,157,104	143,380
Total liabilities and stockholders equity	1,558,601	193,131

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17 Investments (continued)

(c) Summarized financial information regarding TCL as of December 31, 2005 and for the period from March 23, 2005 to December 31, 2005 is as follows: (continued)

	Period from March 23, 2005 to December 31, 2005 Rmb	*Period from March 23, 2005 to December 31, 2005 US$*
Results of operations		
Net sales		
Supply chain management	1,531,913	189,823
Others	109,526	13,572
	1,641,439	203,395
Cost of goods sold	(1,508,247)	(186,890)
Gross profit	133,192	16,505
Selling, general and administrative expenses	(191,161)	(23,688)
Operating loss	(57,969)	(7,183)
Finance cost	(9,338)	(1,157)
Other income	34,906	4,325
Equity in profit of affiliates	281	35
Loss before income taxes and minority interests	(32,120)	(3,980)
Income tax expense	(6,086)	(754)
Loss before minority interests	(38,206)	(4,734)
Minority interests in income of consolidated subsidiaries	6,232	772
Net loss	(31,974)	(3,962)
Other financial information:		

Interest revenue	5,703	707
Interest expenses	9,338	1,157
Depreciation and amortisation	10,576	1,311
Significant non-cash transactions:		
Bad debt expense	11,629	1,441
Provision for inventory write-down	33,493	4,150
Impairment loss to property, plant and equipment	16,031	1,986

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18 Debt

(a) Short-term bank loans

Short-term bank loans were denominated in Renminbi as follows:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Renminbi denominated loans	430,000	812,835	100,721

The weighted average interest rate of short-term bank loans at December 31, 2004 and 2005 was 5.28% and 5.52% per annum, respectively.

As of December 31, 2004, short-term bank loans of Rmb50,000, were secured by the pledge of certain of Yuchai s plant and equipment (see Note 14). The amount was fully repaid in 2005.

As of December 31, 2005, short-term bank loans of Rmb42,835 (US$5,308), were secured by the pledge of certain Yuchai s trade accounts receivable (see Note 9).

(b) Long-term bank loans

Yuchai s long-term bank loans comprise:

	Interest rate at December 31, 2005	December 31,		
		2004	*2005*	*2005*
	(per annum)	Rmb	Rmb	US$
Renminbi denominated loans:				
due in 2006	4.94% - 5.49%	100,000	100,000	12,391
due in 2007	5.85%		50,000	6,196
Total long-term bank loans outstanding		100,000	150,000	18,587
Less: Amounts due within one year included under current liabilities			100,000	12,391
Amounts due after one year		100,000	50,000	6,196

All long-term bank loans were unsecured as of December 31, 2004 and 2005.

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19 Convertible debt

On February 23, 2005, the Company issued US$25,000 (Rmb206,913) in principal amount of convertible debt (the Convertible Debt) on a private placement basis. The Convertible Debt bear interest rate of 2% per annum and mature in 2012, unless redeemed earlier in accordance with the terms of the Convertible Debt. The Convertible Debt were fully exercised and converted to 1,927,673 ordinary shares on June 3, 2005, thereby increasing the Company s issued and outstanding shares from 35,340,000 ordinary shares to 37,267,673 ordinary shares.

20 Accrued expenses and other liabilities

Accrued expenses and other liabilities comprise:

	December 31,		
	2004	*2005*	*2005*
	Rmb	Rmb	US$
Deposits from customers	54,165	96,936	12,012
Staff welfare payable (see Note)	15,041	15,041	1,864
Accrued product warranty (see Note 21)	126,114	142,126	17,611
Wages payable	110,577	98,732	12,234
Management bonus payable	36,574	19,092	2,366
Payable for construction in progress	39,139	39,330	4,873
Accrued research and development expenses	16,472	24,952	3,092
Accrued advertising expense	7,225	3,817	473
Accrued legal fee and other professional fees	2,762	5,050	626
Accrued expenses for litigation and guarantees (see Notes 24(c) and (d))	15,268	18,921	2,344
Individual income tax withholding	8,161	10,250	1,270
Other accruals and liabilities	53,422	97,470	12,078
	484,920	571,717	70,843

Note: Staff welfare payable is determined by Yuchai s Board of Directors. The payable can be applied towards the payment of special bonuses or collective welfare benefits to staff and workers of Yuchai, such as staff dormitories and staff welfare facilities.

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21 Accrued product warranty

An analysis of the accrued product warranty for 2003, 2004 and 2005 is as follows:

	December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Balance at beginning of year	66,864	101,215	126,114	15,627
Allowance charged to consolidated statements of income	162,369	190,205	179,184	22,203
Less: Allowance utilized	(128,018)	(165,306)	(163,172)	(20,219)
Balance at end of year	101,215	126,114	142,126	17,611

22 Statutory reserves

The Company s attributable share in the statutory reserves of Yuchai and its subsidiaries for the three years ended December 31, 2005 is as follows:

	December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Statutory general reserve (see Note (ii))				
Balance at January 1	116,702	156,111	170,041	21,070
Transfer from consolidated statements of income	39,409	13,930	239	30
Balance at December 31	156,111	170,041	170,280	21,100
Statutory public welfare fund (see Note (iii))				
Balance at January 1	28,398	48,103	70,482	8,734
Transfer from consolidated statements of income	19,705	22,379	2,549	316
Balance at December 31	48,103	70,482	73,031	9,050
General surplus reserve				
Balance at January 1 and December 31	25,706	25,706	25,706	3,185

Total	229,920	266,229	269,017	33,335

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22 Statutory reserves (continued)

Notes:

(i) In accordance with the relevant regulations in the PRC, Yuchai and its subsidiaries are required to provide certain statutory reserves which are designated for specific purposes based on the net income reported in the PRC GAAP financial statements. The reserves are not distributable in the form of cash dividends (see Note 30).

(ii) In accordance with the relevant regulations in the PRC, a 10% appropriation to the statutory general reserve based on the net income reported in the PRC financial statements is required until the balance reaches 50% of the authorized share capital of Yuchai and its subsidiaries. Statutory general reserve can be used to make good previous years losses, if any, and may be converted into share capital by the issue of new shares to stockholders in proportion to their existing shareholdings, or by increasing the par value of the shares currently held by them, provided that the reserve balance after such issue is not less than 25% of the authorized share capital.

(iii) Yuchai and its subsidiaries shall determine to transfer 5% to 10% of its net income reported in the PRC financial statements to the statutory public welfare fund. There is no limit on the amount that may be allocated to this fund. This fund can only be utilized on capital expenditure for the collective welfare of Yuchai and its subsidiaries employees, such as the construction of dormitories, canteen and other welfare facilities, and cannot be utilized to pay staff welfare expenses. The transfer to this fund must be made before the distribution of a dividend to stockholders.

23 Commitments

At December 31, 2005, Yuchai had the following commitments:

	December 31,	
	2005	*2005*
	Rmb	US$
Authorized and contracted for:		
Improvement to existing production facilities	214,098	26,529

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24 Contingencies

(a) Product liability

The General Principles of the Civil Law of China and the Industrial Product Quality Liability Regulations imposes that manufacturers and sellers are liable for loss and injury caused by defective products. Yuchai and its subsidiaries do not carry product liability insurance. Yuchai and its subsidiaries have not had any significant product liability claims brought against them.

(b) Environmental liability

The Group s production is subject to certain environment protection laws and regulations in the PRC. In addition, the manufacture and sales of EURO I engines in major urban area became unlawful after December 31, 2004. After that date, the engines equipped with EURO I engines cannot be sold and used in major urban area. The Company considers that the compliance with applicable environment protection laws will not have any material adverse impact to Yuchai and its subsidiaries.

(c) Dispute with Bank of China

In 2003, the Yulin Branch of Bank of China (BOC) initiated legal proceedings to recover Rmb6,603 (US$818) from Yuchai based on an irrevocable letter of guarantee issued by Yuchai to the BOC in 1993 to secure a loan of US$550 to Great Wall Machinery Plant (Great Wall). At trial, a Yulin court ruled that if Great Wall could not pay the loan, Yuchai would be liable to pay the guaranteed sum to the BOC. Yuchai appealed unsuccessfully.

In January 2004, the State Holding Company issued a letter of commitment confirming that it would reimburse Yuchai in the event that Yuchai was required to pay on this guarantee.

Based on the advice from the Company s Legal Counsel, the Company has recorded a loss contingency equal to the amount of the claim. The amounts due to the BOC and from the State Holding Company have been recorded in Accrued expenses and other liabilities and Amounts due from related parties , respectively.

In 2005, there were no new developments in this case.

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24 Contingencies (continued)

(d) Guarantees

YEGCL guaranteed borrowings of Rmb7,605 and Rmb178,480 (US$22,116) granted by commercial banks to unrelated parties in 2004 and 2005, respectively. The borrowings are due in equal monthly or quarterly instalments through one to two years. The guarantees were made to individual persons who applied for mortgage loans from commercial banks to purchase automobiles equipped with diesel engines produced by Yuchai. The guarantees are for the entire amount and term of the borrowings. In return, YEGCL receives a premium fee amounted to 2% to 8% of the amount of borrowings. All guarantees are secured by automobiles at a net book value totalling Rmb11,693 and Rmb242,216 (US$30,014) at December 31, 2004 and 2005, respectively. If the individual defaults on payment, YEGCL would have to perform under the guarantees. It is reasonably possible that YEGCL would be required to make payment under its guarantees. As of December 31, 2004 and 2005, the maximum amount of undiscounted payments that YEGCL would have to make in the event of default is Rmb7,422 and Rmb134,235 (US$16,633). Pursuant to the requirements of FIN 45, the Company accrued Rmb220 and Rmb16,811 (US$2,083) related to its stand ready obligation under the guarantee arrangement in 2004 and 2005, respectively. The amount recognized during the year ended December 31, 2004 and 2005 includes premium received or receivable, which is amortized on a straight line basis over the terms of the guarantees, of Rmb220 and Rmb4,493 (US$557), respectively. The amount of premium being amortized, which were recorded as revenue, for the year ended December 31, 2004 and 2005 were amounted to Rmb 14 and Rmb 1,167 (US$145), respectively. The remaining balance of Rmb 12,318 (US$1,526) as of December 31, 2005 represents the provision for loss contingency related to the guarantees where payment by the Company was probable.

(e) Outstanding bills discounted

As of December 31, 2005, outstanding bills discounted with banks for which the Company has retained a recourse obligation totalled Rmb1,373,723 (US$170,222).

(f) Outstanding letters of credit

As of December 31, 2005, the Company issued irrevocable letters of credit totalled Rmb110,257 (US$13,662).

(g) Other outstanding litigation

In addition to the matters disclosed in Note 24(c), the Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company s consolidated financial position, results of operations, or liquidity.

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25 Dispute with State Holding Company

The Company has from time to time in the period up to 2005 encountered difficulties in obtaining the cooperation of the State Holding Company, and its former Chairman, Mr Wang Jianming, in the daily management and operation of Yuchai, including obtaining payments of the Company s share of the final 2001 dividend declared in August 2002. Mr Wang Jianming ceased to serve as the Chairman, legal representative and chief executive officer of Yuchai, as well as the Chairman and legal representative of the State Holding Company, the principal Chinese shareholder of Yuchai with effect from October 28, 2005. The new Chairman and legal representative of these companies is Mr Yan Ping whose appointment was confirmed on December 2, 2005.

The Chinese stakeholders had previously asserted that the transfer of ownership of shares with respect to Yuchai in November 1994, in connection with the Company s initial public offering (IPO), was not validly approved by the Chinese authorities, and that as a result the Company s exercise of control over Yuchai has been improper.

As a result of a number of meetings between the parties, the Company and Yuchai entered into an agreement in July 2003 (the July 2003 Agreement) to work together in trying to jointly promote mutual plans to enhance the Company s shareholder value.

On April 7, 2005, the Company entered into a Reorganisation Agreement (Reorganisation Agreement) with Yuchai and Coomber in furtherance of the terms of the July 2003 Agreement, and the terms of this agreement were acknowledged and agreed to by the State Holding Company. The Reorganisation Agreement was extended to December 31, 2006 by way of the Reorganisation Agreement Amendment No.1 dated December 2, 2005. The Reorganisation Agreement Amendment No.1 was similarly acknowledged and agreed to by the State Holding Company.

The principal terms contained in the Reorganisation Agreement relating to governance related issues have been addressed by Yuchai.

Yuchai has taken all necessary steps and submitted all necessary documents to enable the amended and restated Articles of Association of Yuchai as approved by its directors and shareholders in 1996 incorporating the corporate governance guidelines approved by its directors and shareholders on November 1, 2002 to be approved, formalized, endorsed, registered and filed with the relevant governmental authorities. The formal approval of these amended Articles of Association is awaited from the PRC Ministry of Commerce (MOC).

Promptly upon receipt of the approval from the MOC of the Articles of Association, Yuchai would formalize the implementation of the corporate governance guidelines approved by its directors and shareholders on November 1, 2002 and establish an appropriate corporate governance structure conforming to international custom and practice.

Yuchai has begun to implement the compliance programme for the internal controls over financial reporting of Yuchai with respect to section 404 of the Sarbanes-Oxley Act.

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25 Dispute with State Holding Company (continued)

Up to the date of this report:

(i) the board and shareholders of Yuchai have, at a duly convened board meeting held on April 21, 2005 and a duly convened shareholders meeting held on May 16, 2005, approved the following principal matters relating to the Reorganisation Agreement:

- the proposed capitalization of YMLC was varied by the board of directors of Yuchai at its meeting on April 21, 2005 and approved by its shareholders. Coomber has assumed the obligation to return Rmb165,400 (US$20,495) of the authorized Rmb205,000 (US$25,402) loan that was made by Yuchai to YMLC and which had been guaranteed by Coomber to Yuchai by December 6, 2005. The remaining Rmb39,600 (US$4,907) loan would remain as a loan by Yuchai to YMLC and would only be injected as share capital of YMLC after the successful spin-off of Yuchai in line with the terms of the Reorganisation Agreement;

- a dividend payment for the financial years ended December 31, 2003 and 2004 in the amount of Rmb302,713;

- the establishment and appointment of members of three sub-committees under the board, comprising the nominations committee, the remuneration committee and the audit committee;

- the establishment of a financial committee to approve all borrowings, guarantees, loans issuance of company debt and investment;

- the termination of the sales of the spare parts business of one of its subsidiaries;

- the payment of US$20,000 to the Company pursuant to the Reorganisation Agreement;

- the acceptance of the appointment of two independent directors of Yuchai and confirmation of the appointment of three directors appointed by holders of States Shares of Yuchai and six directors appointed by holders of Foreign Shares of Yuchai; and

- the appointment of one independent director nominated by the holders of State Shares of Yuchai, and three independent directors nominated by the holders of Foreign Shares of Yuchai.

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25 Dispute with State Holding Company (continued)

(ii) an internationally reputable financial adviser had been engaged by Yuchai to assist Newco (as defined below) to apply for the listing of its shares on the NYSE and assist the Company with the implementation of spin-off. Pursuant to the Reorganization Agreement, a Bermuda corporation (Newco) will be formed where (a) the Company will contribute its 76.4% indirect interest in Yuchai to in exchange for a number of Newco shares equal to the number of outstanding shares of the Company as of April 7, 2005; (b) its board of directors would comprise of nominees from the Company and Yuchai in the same respective proportions to the nominees of the holders of Foreign Shares of Yuchai and the holders of State Shares of Yuchai on the Yuchai board of directors; and (c) its charter documents and officers would be mutually agreeable to the Company and Yuchai and on the completion date of the Restructuring Exercise (as described in the Reorganization Agreement) the Company shall have no appointees to its board of directors. The appointment of the financial adviser was subsequently terminated pending Yuchai s ongoing review of the implementation of the corporate reorganization contemplated in the Reorganization Agreement;

(iii) the Yuchai board of directors subsequently directed a review of YMLC s financial position and the implementation of the recapitalization plans for YMLC has been deferred pending the successful spin-off of Yuchai in line with the terms of the Reorganisation Agreement;

(iv) the Company has received payment of an advisory fee in the amount Rmb12,105 (US$1,500) from Yuchai as provided for under the Reorganisation Agreement; and

(v) the Company has received its share of the dividend declared and paid by Yuchai in respect of the financial years ended December 31, 2003 and 2004 on May 24, 2005 for amount of Rmb225,207 (US$27,906).

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25 Dispute with State Holding Company (continued)

The principal terms of the Reorganisation Agreement Amendment No.1 are as follows:

(1) Clause 1.8 of the Reorganization Agreement was previously stated as:

In consideration of CYI s agreement to ensure that Coomber will under the terms of the share exchange described in clause 2.4 receive no less than 6,354,911 Newco shares, Yuchai shall, within 5 business days from the date that an unqualified audit report is issued on CYI s financial statements in the form substantially similar to that of the unaudited financial statements filed by CYI in its Form 6K dated February 28, 2005, pay CYI an amount of US$20.0 million in cash into such bank account as CYI shall notify Yuchai in writing.

was deleted and replaced with the following text:

In consideration of CYI s agreement to ensure that Coomber will under the terms of the share exchange in Clause 2.4 receive no less that 6,354,911 Newco shares, Yuchai shall on the earlier of (i) the date of the completion of the transactions described in Clause 2.6 and (ii) December 31, 2006 pay CYI an amount of US$20.0 million in cash to such bank account as CYI shall notify Yuchai in writing.

(2) Clause 2.10 of the Reorganization Agreement, which was stated as:

The parties acknowledge and accept that the CYI Group, as majority shareholders of Yuchai and with majority control of the Board of Directors of Yuchai, may cause the employment of Yuchai s current Chief Executive Officer to be terminated in accordance with the terms of his employment agreement. CYI acknowledges and accepts, however, that the successful implementation of the Restructuring Exercise will require the continued uninterrupted involvement and participation of Yuchai s current Chief Executive Officer on and subject to the terms (including remuneration) of his employment agreement. Accordingly, CYI agrees that it will not, and will procure that its appointees to the Board of Directors of Yuchai do not, take any action prior to the completion of the Restructuring Exercise that will interfere with, or cause the termination of, the employment of Yuchai s current Chief Executive Officer except if he were to be prosecuted or convicted for any activities of a criminal nature.

was deleted in its entirety with effect from October 27, 2005.

(3) The Clause 4 of the Reorganization Agreement was previously stated as:

In the event that the parties are unable to complete the events described in each of clauses 2.1, 2.2, 2.4, 2.5 and 2.6 above (not due to the default of either party) by 5:00p.m. on December 31, 2005 (or if such day is not a business day in Hong Kong, the immediately succeeding business day)(or such other date to be mutually agreed between the parties), the provision of this Agreement shall terminate and in such event no party shall have any claim against any other party for any claims, damages, losses or other costs and expenses arising from such termination.

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25 Dispute with State Holding Company (continued)

(3) The Clause 4 of the Reorganization Agreement was previously stated as: (continued)

the date appearing in the third line of Clause 4 of the Reorganization Agreement was deleted and substituted with the words December 31, 2006 or such other date as the parties may agree in writing

Yuchai, Coomber and the State Holding Company have at various times reaffirmed their respective intentions of working with the Company to carry out their respective obligations under the Reorganization Agreement.

26 Retirement and other postretirement benefits

As stipulated by the regulations of the PRC, Yuchai and its subsidiaries participate in defined contribution retirement plans organized by the Guangxi Regional Government and Beijing City Government for its staff. All staff are entitled to an annual pension equal to a fixed proportion of their final basic salary amount at their retirement date. For the years ended December 31, 2003, 2004 and 2005, Yuchai and its subsidiaries were required to make contributions to the retirement plan at a rate of 20.0% of the basic salary of their staff. The Guangxi Regional Government and Beijing City Government are responsible for the entire obligations of all Yuchai and its subsidiaries retirees. Expenses incurred in connection with the plan were Rmb24,101, Rmb29,868 and Rmb33,299 (US$4,126), respectively, for the years ended December 31, 2003, 2004 and 2005.

Yuchai and its subsidiaries have no obligation for the payment of pension benefits or any other postretirement benefits beyond the annual contributions described above.

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27 Other related party transactions

In addition to the loans to YMLC (as discussed in Note 5), the Company has undertaken other significant business transactions with related parties during the three years ended December 31, 2005. The following is a summary of these transactions:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Sales of trucks from customers to Guangxi Yuchai Mechanical and Electronics Company (GYMEC) (see Note (i))	1,346	753		
Sales of diesel engines to State Holding Company, its subsidiaries and affiliates (see Note (ii))	23,611	3,784	7,646	947
Purchase of raw materials and supplies from subsidiaries and affiliates of State Holding Company (see Note (ii))	(93,056)	(142,829)	(235,329)	(29,160)
Purchase of raw materials and supplies from YMLC (see Note (iii))			(60,756)	(7,528)
Purchase of trucks from YMLC (see Note (iii))		(95,391)	(77,324)	(9,581)
Processing fee to YMLC (see Note (iv))		(12,329)	(44,407)	(5,503)
Delivery expense charged by a subsidiary of YMLC (see Note (iv))	(62,206)	(65,468)	(126,028)	(15,616)
General and administrative expenses				
charged by State Holding Company (see Note (v))	(30,607)	(21,180)	(25,931)	(3,213)
charged by HLA (see Note (xii))	(4,427)	(4,142)	(4,035)	(500)
charged by an affiliate of HLA (see Note (vi))			(30,765)	(3,812)

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27 Other related party transactions (continued)

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Gain on disposal of land use rights to a subsidiary of State Holding Company (See Note (vii))			2,533	314
Loan from State Holding Company (see Note (viii))	8,000			
Assignment of debt to GYMEC (see Note (ix))	3,700			
Consultancy fee paid on behalf of Coomber (see Note (x))	13,347			

Notes:

(i) Sales of diesel trucks to GYMEC

GYMEC was formerly a subsidiary of State Holding Company. It became a subsidiary of YMLC following a share transfer from State Holding Company to YMLC in 2004. During 2003 and 2004, Yuchai received diesel trucks from certain customers as part of the settlement of their trade accounts receivable. Pursuant to an agreement between Yuchai and GYMEC, Yuchai sold such diesel trucks at cost to GYMEC, which owns a business license for selling diesel trucks in the PRC. Yuchai recorded a receivable from GYMEC in connection with the truck sales. The amount due from GYMEC is unsecured, interest free and repayable on demand.

(ii) Sale and purchase of raw materials, supplies and diesel engines to/from State Holding Company, its subsidiaries and affiliates.

Certain subsidiaries and affiliates of State Holding Company have acted as suppliers of raw materials and supplies to the Company and certain subsidiaries of State Holding Company have acted as sales agents of the Company. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.

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27 Other related party transactions (continued)

Notes: (continued)

(iii) Purchase of raw materials, supplies and trucks from YMLC

Since July 2004, subsidiaries of YMMC have engaged in the sale of trucks which were mainly supplied by and purchased from YMLC. YMLC has also become a supplier of raw materials and supplies to the Company since 2005. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.

(iv) Processing fee and delivery expense charged by YMLC and its subsidiaries

The fee is for the packaging and delivering of spare parts charged by YMLC, which was recorded in Cost of goods sold and Selling, general and administrative expenses respectively. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.

(v) General and administrative expenses

State Holding Company charges Yuchai for certain general and administrative expenses in respect of rental of certain office premises, property management services rendered by State Holding Company. The expenses are charged to Yuchai and its subsidiaries by State Holding Company on an actual incurred basis. The Company believes that the expenses charged to Yuchai by State Holding Company would not have been materially different on a stand-alone basis because Yuchai could provide these services for itself at approximately the same amount.

(vi) Service fee to an affiliate of HLA

The fee was paid to Hong Leong Management Services Pte Ltd., an affiliate of HLA. Service fee includes Rmb9,167 (US$1,136) in relation to the consultancy services performed for the acquisition of interests in TCL during 2005 and LKN-Princefield Limited (LKN) in 2006 (see Note 34(a)). The remaining amounts were mainly in relation to secure additional credit facilities and enter into the Reorganization Agreement. The transactions were approved by the Board of Directors. The Company considers that the transactions were entered into in the normal course of business.

(vii) Gain on disposal of land use rights to a subsidiary of State Holding Company

The Company has disposed of certain land use rights with net book value of Rmb1,047 (US$130) to a subsidiary of SHC for a consideration of Rmb3,580 (US$444). The Company considers that the transaction was entered into in the normal course of business.

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27 Other related party transactions (continued)

Notes: (continued)

(viii) Loan from State Holding Company

In 2003, GYSPM has entered into an agreement with State Holding Company for a borrowing of Rmb8,000 for its operating activities as of December 31, 2003. As of December 31, 2003, GYSPM pledged certain of its assets with net book value of Rmb17,132 against bank loan of Rmb8,000 borrowed by State Holding Company. The terms set out in the loan agreement entered into between State Holding Company and the bank and the loan agreement entered into between GYSPM and State Holding Company are identical. The loan proceeds from the bank borrowed by State Holding Company were solely lent to GYSPM. State Holding Company would make repayments to the bank upon receipt of loan repayment from GYSPM. The loan was fully repaid in 2004.

(ix) Assignment of debt to GYMEC

In 2003, the Company entered into a deed of assignment (the Deed) whereby one of the Company s customers assigned all the rights and liabilities of the outstanding amount due to the Company totalling approximately Rmb15,000 to GYMEC. Pursuant to the Deed, GYMEC became one of the sales agents of this customer who is principally engaged in manufacturing and sales of motor vehicles. As of December 31, 2004, the outstanding balances due from GYMEC related to this assignment was Rmb3,700 and the amount was fully repaid in 2005.

(x) Consultancy fee paid on behalf of Coomber

In 2003, the Company entered into an agreement, totalling Rmb60,000 with a consultancy company in connection with the design of an information system for YMLC to be undertaken by Coomber pursuant to which Coomber has agreed to pay for all expenses incurred by the Company in respect of this project on or before 31 December 2004. In 2003, the Company incurred payments totalling Rmb13,347 in respect of the project, which have been recorded in amounts due from related parties. The amount was subsequently repaid in 2004.

(xi) Amounts due from/to related parties

Amounts due from/to related parties arise mainly from the transactions as stated above.

In addition to the above, Yuchai also entered into transactions with other PRC Government owned enterprises. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms. Balances with other PRC entities are excluded from this caption.

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27 Other related party transactions (continued)

Notes: (continued)

(xii) Amount due to the holding company

Amount due to the holding company comprise mainly general and administrative expenses charged by the holding company in relation to the management, financial planning and control and other services provided to Yuchai. The balance is unsecured, interest free and repayable on demand.

28 Segment information

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information , establishes standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company s operating segments are Yuchai and TCL for the year ended December 31, 2005. Prior to the purchase of TCL, the Company s only operating segment was Yuchai.

The segment result for Yuchai is based on income before income taxes and minority interests. The segment result for TCL is the Company s equity in the net income or losses or TCL. Segment assets for Yuchai are based on total assets of Yuchai. Segment assets for TCL are based on the Company s net investment in TCL. Substantially all of the Company s operations including TCL are in the PRC. Consequentially no geographic information is presented. Further segment information about TCL is included in Note 17(c).

Following is the segment information for the year ended December 31, 2005:

	Yuchai Rmb	*TCL* Rmb
Segment revenue from external customers	5,829,431	
Interest revenue	21,744	
Interest expenses	70,527	
Depreciation and amortization	139,720	
Equity in losses of affiliates	50	
Segment profit / (loss)	171,585	(5,056)
Significant non-cash items:		
Provision for uncollectible loans to a related party	205,000	
Bad debt expense	25,587	
Provision for inventory write-down	15,990	
Provision for losses on guarantees	12,318	
Segment assets	6,168,814	185,021
Total expenditures for additions to long-lived assets	515,359	

Reconciliation of segment information to the consolidated financial statements for the years ended December 2003, 2004 and 2005.

	2003 Rmb	2004 Rmb	2005 Rmb
Total segment profit	722, 341	773, 571	166, 529
Service fee to an affiliate of HLA (see Note 27)			(30,765)
Other corporate general and administrative expenses	(25,435)	(19,717)	(18,522)
Consolidated income before income taxes and minority interests	696,906	753,854	117,242
Total assets for reportable segment	3,896,463	5,268,660	6,353,835
Corporate cash and cash equivalents	129,795	108,514	247,332
Other corporate assets	7,374	7,074	12,618
Consolidated total assets	4,033,632	5,384,248	6,613,785

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28 Segment information (continued)

Revenues from external customers by product category are summarized as follows:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Revenues, net				
4108 Light-Duty Diesel Engines	174,173	325,242	688,265	85,285
4110 Light-Duty Diesel Engines	328,993	544,297	596,565	73,922
4112 Light-Duty Diesel Engines	266,639	314,453	322,266	39,933
6105 Medium-Duty Diesel Engines	911,190	1,143,535	1,748,847	216,704
6108 Medium-Duty Diesel Engines	1,504,140	1,372,073	810,859	100,475
6112 Heavy-Duty Diesel Engines	1,003,791	1,203,558	786,989	97,518
6113 Heavy-Duty Diesel Engines	3,697	97,368	193,280	23,950
Diesel Engine Parts	228,500	446,135	489,480	60,653
Others *	148,827	135,434	192,880	23,900
	4,569,950	5,582,095	5,829,431	722,340

* Others mainly represent the revenues earned through sales of motor vehicle chassis and power generators.

29 Foreign currency exchange

The Renminbi is not fully convertible into foreign currencies. All foreign exchange transactions involving Renminbi must take place either through the PBOC or other institutions authorized to buy and sell foreign exchange. The exchange rate adopted for the foreign exchange transactions are the rates of exchange quoted by the PBOC which are determined largely by supply and demand.

Foreign currency payments, including the remittance of earnings outside of the PRC, must be arranged through banks authorized to conduct foreign exchange business.

30 Distribution of profits

The Company s sources of cash flow are its share of the dividends, if any, paid by Yuchai and TCL to the Company. With respect to dividends by Yuchai, applicable PRC laws and regulations require that, before it can distribute profit to its stockholders it must satisfy all tax liabilities, recover losses in previous years and make contributions to certain statutory reserves as discussed in Note 22. Such dividends may be paid partly in Renminbi and partly in foreign currency. In the event that dividends are distributed in Renminbi, the dividends may be converted into foreign currency and remitted in accordance with relevant PRC laws, regulations and policies and to the extent permitted by PRC market conditions. Dividends of Yuchai are determined based on distributable profit reported in its PRC GAAP financial statements, after appropriation to statutory reserves. Such distributable

profits differ from the amounts reported under U.S. GAAP. No similar provisions were imposed with respect to dividends by TCL.

Under the Companies Act of 1981 of Bermuda (as amended), the Company s contributed surplus is available for distribution to stockholders.

31 Derivative instrument and hedging activities

For the periods presented, the Company and its subsidiaries did not enter into transactions with respect to derivative instruments. The Company and its subsidiaries do not hedge risk exposures or speculate using derivative instruments.

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32 Fair value of financial instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. The carrying amount of cash and cash equivalents, trade accounts receivable, bills receivable, short term amounts due from related parties, prepaid expenses, other receivables, short-term bank loans, current instalments of long-term bank loans, trade accounts payable, amount due to the holding company and amounts due to related parties approximates their fair value because of the short maturity of these instruments. It was not practicable for Yuchai to estimate the fair value of its equity investment for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation appears excessive considering the materiality of the equity investment to Yuchai. Yuchai does not believe the carrying value of the equity investment will be significantly different from its fair value.

Cash and cash equivalents of Yuchai and its subsidiaries denominated in foreign currencies have been translated at the balance sheet date into Renminbi at rates quoted by the PBOC. Yuchai does not have and does not believe it will have any difficulty in exchanging its foreign currency cash for Renminbi.

The carrying amount of long-term bank loans approximates their fair value based on the borrowing rates currently available for bank loans with similar terms and average maturities.

33 Significant concentrations and risks

(a) Customer concentration

Substantially all of the Company s customers are located in the PRC. The following are the customers that individually comprise 10% or more of gross revenue in any of the relevant periods:

	Years ended December 31,			
	2003	*2004*	*2005*	*2005*
	Rmb	Rmb	Rmb	US$
Liuzhou Dongfeng Automobile (see Note (i))	391,086	830,018	385,049	47,712
Hubei Dongfeng Automobile (see Note (ii))	613,448	344,910	333,452	41,319

Notes:

(i): Sales to Liuzhou Dongfeng Automobile for the year ended December 31, 2003, 2004 and 2005 was approximately 8.6%, 14.9% and 6.6% of total sales.

(ii): Sales to Hubei Dongfeng Automobile for the year ended December 31, 2003, 2004 and 2005 was approximately 13.4%, 6.2% and 5.7% of total sales.

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33 Significant concentrations and risks (continued)

All the above customers are controlled by or affiliated with Dongfeng Automobile Company. At December 31, 2004 and 2005, approximately 29% and 13% of gross trade accounts receivable, respectively, were due from these customers. The Company considers its relationships with these major customers to be good; however, the loss of one or more of the Company s major customers would have a material adverse effect on the Company s results of operations.

(b) Nature of operations

During periods of economic expansion, the demand of trucks, construction machinery and other application of diesel engines generally increases. Conversely, during economic slowdowns the diesel engine industry is generally adversely affected by a decline in demand. As a result, the performance of Chinese economy will affect the Company s business and prospects by a significant degree.

(c) Transactions involving Yuchai's Chinese shareholders

Although the Company has proper legal ownerships and a controlling financial interest of 76.41% interest in Yuchai, the Company has from time to time encountered difficulties in obtaining the cooperation of the State Holding Company and Coomber. As part of the terms of the Reorganization Agreement, Yuchai and State Holding Company acknowledged and reaffirmed the Company s continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai s board of directors. However, no assurance can be given that disagreements or difficulties with Yuchai s management of State Holding Company and Coomber will not recur. In addition, as described in Note 5, Yuchai has entered into transactions that involves the Chinese Shareholders that have resulted in losses. No assurance can be given that future transactions involving the State Holding Company, Coomber and their related parties will be conducted on an arm-length basis or otherwise be beneficial to the Company. Consequently, such disagreements, or difficulties and transactions involving State Holding Company, Coomber and their related parties could have a material adverse impact on the Company s consolidated financial position, operating results and cash flows.

34 Subsequent events

(a) Acquisition of debt and equity in an investment-holding company

In February 2006, the Company acquired S$129 million (equivalent to Rmb 626 million) in principal amount of secured bonds (the Bonds), 123,010,555 redeemable convertible preference shares (the Preference Shares), and 191,413,465 ordinary shares (the Ordinary Shares) (collectively, the Sale Securities) issued by LKN for an aggregate purchase consideration of approximately S$132 million (equivalent to approximately Rmb639 million) (the Aggregate Purchase Consideration) from certain banks, financial institutions, corporations and individuals (collectively the Sellers). Immediately following the purchase, the Company hold 29.13% of the Ordinary Shares based on LKN s total issued and outstanding Ordinary Shares or approximately 40.30% of the Ordinary Shares of LKN assuming full conversion of the 123,010,555 Preference Shares.

LKN is a company listed on the Main Board of the Singapore Exchange and is primarily engaged in the business of investment holding, including investing in rental property and hospitality business in Asia.

The Company initially intends to account for the Ordinary Shares of LKN using equity method and the Bonds and Preference Shares as available-for-sale securities.

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34 Subsequent events (continued)

(b) Right issue of LKN

On February 28, 2006, LKN announced a proposed renounceable rights issue of zero coupon unsecured non-convertible bonds due 2009 (the New Bonds) and non-redeemable convertible cumulative preference shares in the capital of LKN (the New NCCPS) (the Rights Issue). The purpose of the Rights Issue of LKN is to raise funds for redeeming the existing Bonds and for working capital purpose. The Company has provided LKN an irrevocable undertaking to subscribe in full and by way of excess application, all New Bonds and New NCCPS not taken up by other stockholders of LKN.

On July 4, 2006, the Company was alloted 196,201,374 of New NCCPS and S$130,800,917 of New Bonds at a consideration of S$135 million (equivalent to approximately Rmb655 million). Assuming full conversion of the existing Preference Shares and New NCCPS, the Company s equity interest in LKN would increase from 40.3% to 51.7%. In the event the Company obtains a controlling financial interest in LKN, then LKN would become a subsidiary of the Company and its financial statement would be included in the consolidated financial statements of the Company from that point forward.

(c) Rights issue of TCL

In January 2006, TCL conducted a renounceable non-underwritten rights issue of new shares (Rights Shares) at an issue price of S$0.08 (equivalent to approximately Rmb0.39) for each Rights Share; and a renounceable non-underwritten rights issue of unsecured 2% convertible bonds due 2009 (Convertible Bonds) in the denomination of S$0.8 (equivalent to approximately Rmb3.9) for each Convertible Bond.

On February 16, 2006, the Company was allotted 87,860,288 Rights Shares and 52,933,440 Convertible Bonds in TCL for an aggregate cash consideration of S$49,400,000 (equivalent to approximately Rmb239,758).

As a result of the rights issues, the Company s equity interest in TCL increase from 15.99% to 19.36%, and would increase to 36.85% assuming full conversion of the Convertible Bonds held by the Company.

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34 Subsequent events (continued)

(d) New bank facility

In January to March 2006, the Company entered into additional unsecured credit facilities with certain banks for approximately S$170 million (equivalent to approximately Rmb825 million). The facilities may only be utilized by the Company in connection with certain limited circumstances relating to its business expansion activities. The terms of the facilities require, among other things, that HLA retains ownership of the Company s special share and that the Company remains a consolidated subsidiary of HLA. The terms of the facilities also include certain financial covenants with respect to the Company s tangible net worth and net gearing ratio throughout the tenor of the facility, as well as negative pledge provisions and customary drawdown requirements and events of default.

(e) Issuance of corporate bonds by Yuchai

In March 2006, Yuchai applied to the PBOC to issue short term bonds up to Rmb1,000,000 (US$123,912). The application was approved by PBOC on May 30, 2006 and the first tranche of bonds of Rmb500,000 (US$61,956) was issued on June 12, 2006. The bonds were issued at a discount and an amount totalling Rmb488 million was received by Yuchai. The bonds mature on March 9, 2007 and the funds will be used to pay off existing bank loans.