CHINA YUCHAI INTERNATIONAL LTD
Form 20-F
July 17, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from ______ to ______

OR

¨

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)

Not Applicable	**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, 2006, 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 ¨ No x

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 ¨ No x

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 ¨ No x

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 ¨	Accelerated filer x	Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP x	International Financial Reporting Standards as issued ¨ by the International Accounting Standards Board	Other ¨

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 ¨ Item 18 x

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 ¨ No x

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes ¨ No ¨

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CHINA YUCHAI INTERNATIONAL LIMITED

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, al references in this Annual Report to US dollars, dollars, US$ or $ are to United States dollars; all references to Renminbi or Rmb Renminbi, the legal tender currency of China; all references to S$ are to Singapore dollars, the legal tender of Singapore. Unless otherwise specified, translation of amounts for the convenience of the reader has been made in this Annual Report (i) from Renminbi to US dollars at the rate of Rmb 6.8591 = US$1.00, the rate quoted by the People s Bank of China, or PBOC, on June 30, 2008 and (ii) from Singapore dollar to US dollars at the rate of S$1.3608 = US$1.00, 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 on June 30, 2008. No representation is made that the Renminbi amounts or Singapore dollar amounts could have been, or could be, converted into US dollars at rates specified herein or any other rate.

Our consolidated financial statements are reported in Renminbi and prepared in conformity with accounting principles generally accepted in the United States of America, or US GAAP. Totals presented in this Annual Report may not correctly total due to rounding of numbers. References to a particular fiscal year are to the period ended December 31 of such year.

As used in this Annual Report, unless the context otherwise requires, the terms the Company , CYI , we , us , our and our company refer t Yuchai International Limited and its subsidiaries. All references herein to Yuchai are to Guangxi Yuchai Machinery Company Limited and its subsidiaries and, prior to its incorporation in July 1992, to the machinery business of its predecessor, Guangxi Yulin Diesel Engine Factory, or 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, or the State Holding Company, which became a shareholder of Yuchai. All references to HLGE are to HL Global Enterprises Limited (formerly known as HLG Enterprise Limited); and all references to the HLGE group are to HLGE and its subsidiaries. All references to TCL are to Thakral Corporation Ltd; and all references to the TCL group are to TCL and its subsidiaries. This Annual Report includes certain 2007 data regarding the Company that is derived from unaudited estimated information.

As of December 31, 2006, 37,267,673 shares of our common stock, par value US$0.10 per share, or Common Stock, and one special share, par value US$0.10, of our Common Stock were issued and outstanding. The weighted average shares of common stock outstanding during the year was 37,267,673. Unless otherwise indicated herein, all percentage share amounts with respect to the Company are based on the weighted average number of shares of 37,267,673 for 2006. As of May 30, 2008, 37,267,673 shares of our Common Stock and one special share, par value US$0.10, of our Common Stock were issued and outstanding.

Cautionary Statements with Respect to Forward-Looking Statements

We wish 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 our interpretation of factors affecting our business and operations. We believe that the following important factors, among others, in some cases have affected, and in the future could affect, our actual consolidated results and could cause our actual consolidated results for 2007 and beyond to differ materially from those described in any forward-looking statements made by us or on our behalf:

- 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, our diesel engine customers, the demand, sales volume and sales prices for our diesel engines and our levels of accounts receivable;

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

- the effects of existing material weaknesses in our internal control over financial reporting and our ability to implement and maintain effective internal control over financial reporting;

- our ability to collect and control our levels of accounts receivable;

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

our ability to successfully manufacture and sell our 4108, 4110, 4110Q, 4110ZQ, 4112, 4F, 4G, 6105, 6108, 6112, 6L/6M (formerly referred to as 6113) heavy-duty diesel engines and any new products;

our ability to finance our working capital and capital expenditure requirements, including obtaining any required external debt or other financing;

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

our ability to successfully implement the Reorganization Agreement, as amended by the Cooperation Agreement (both as defined in Item 4. Information on the Company History and Development Reorganization);

our ability to control Yuchai and consolidate Yuchai s financial results;

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

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

the effects of competition in the consumer electronics market and the demand for the TCL group s consumer electronics products;

the effects of adverse economic conditions in consumer spending patterns and its impact on the demand for the TCL group s consumer electronics;

the ability of TCL to obtain shareholder approval for, and successfully implement, its announced strategy of repositioning its principal business from consumer electronics distribution to real estate and related infrastructure investment in the pan-Asian region;

the effects of changes to the international, regional and economic climate and market conditions in countries where the HLGE group s hospitality operations are located, as well as related global economic trends that adversely impact the travel and tourism industries;

the outbreak of communicable diseases, such as the Avian flu, if not contained, and its potential effects on the operations of the HLGE group and its business in the hospitality industry; and

the impact of terrorism, terrorist events, airline strikes, hostilities between countries or increased risk of natural disasters or viral epidemics that may affect travel patterns and reduce the number of travelers and tourists to the HLGE group s hospitality operations.

Our actual results, performance, or achievement may differ from those expressed in, or implied by, the forward-looking statements contained in this Annual Report. Accordingly, we can give no assurances that any of the events anticipated by these forward-looking statements will transpire or occur or, if any of the foregoing factors or other risks and uncertainties described elsewhere in this Annual Report were to occur, what impact they will have on these forward-looking statements, including our results of operations or financial condition. In view of these uncertainties, you are cautioned not to place undue reliance on these forward-looking statements. We expressly disclaim any obligation to publicly revise any forward-looking statements contained in this Annual Report to reflect the occurrence of events after the date of this Annual Report.

PART I

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

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE.

Not Applicable.

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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 our audited consolidated financial statements and the notes thereto included in this Annual Report. Our consolidated financial statements are prepared in conformity with US GAAP.

On May 30, 2008, the Company filed an amendment to its annual report on Form 20-F for the year ended December 31, 2005 containing the restated financial statements as of and for the year ended December 31, 2005 to reflect certain adjustments to correct accounting errors mainly at Yuchai for such period.

We currently own, through six of our wholly-owned subsidiaries, 76.4% of the outstanding shares of Yuchai. Our ownership interest in Yuchai is our main operating asset. As a result, our financial condition and results of operations depend primarily upon Yuchai s financial condition and results of operations, and the implementation of the Reorganization Agreement, as amended by the Cooperation Agreement.

Following an announcement in February 2005 by the Board of Directors of the Company of its approval of the implementation of our business expansion and diversification plan, we have looked for new business opportunities to seek to reduce our financial dependence on Yuchai. As of December 31, 2006, we had a 36.6% interest in the outstanding ordinary shares of TCL and a 45.4% interest in the outstanding ordinary shares of HLGE. As of June 30, 2008, we had a 34.4% interest in the outstanding ordinary shares of TCL (as a result of issuance of additional ordinary shares by TCL pursuant to the exercise of options and convertible securities) and a 45.4% interest in the outstanding ordinary shares of HLGE. For further information on the Company s investments in TCL and HLGE, see Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan.

The selected consolidated balance sheet data as of December 31, 2005 and 2006 and the selected consolidated statement of operations data and selected consolidated statement of cash flows data set forth below for the years ended December 31, 2004, 2005 and 2006 are derived from our audited consolidated financial statements included in this Annual Report. Our selected consolidated balance sheet data set forth below as of December 31, 2002, 2003 and 2004 and selected consolidated statement of operations data and selected consolidated statement of cash flows data for the years ended December 31, 2002 and 2003 are derived from our audited consolidated financial statements not included in this Annual Report.

	Year Ended December 31,					
	2002 Rmb	2003 Rmb	2004 Rmb	2005 Rmb	2006 Rmb	2006 US$(1)
	(in thousands, except earnings per share)					
Consolidated Statement of Operations Data:						
Revenues, net	3,513,047	4,569,950	5,582,095	5,816,740	6,920,528	1,008,956
Gross profit	1,141,967	1,377,156	1,575,209	1,143,383	1,272,121	185,465
Research and development costs	(75,532)	(94,594)	(136,960)	(123,793)	(167,653)	(24,442)
Provision for uncollectible loans to a related party				(202,950)		
Operating income	640,307	721,411	779,929	26,020	304,479	44,391
Other income/(expense), net	10,287	(881)	5,682	25,449	38,856	5,665
Equity in losses of affiliates				(6,032)	(22,449)	(3,273)
Earnings / (loss) before income taxes and minority interests	625,450	696,906	753,854	(25,090)	203,395	29,654
Income taxes	(83,242)	(112,924)	(105,165)	(10,148)	(30,466)	(4,442)
Income / (loss) before minority interests	542,208	583,982	648,689	(35,238)	172,929	25,212
Minority interests in (income) losses of consolidated subsidiaries	(129,775)	(145,800)	(157,292)	2,947	(61,645)	(8,987)
Net income / (loss)	412,433	438,182	491,397	(32,291)	111,284	16,225
Basic and diluted earnings / (loss) per common share	11.67	12.40	13.90	(0.89)	2.99	0.44
Weighted average number of shares	35,340	35,340	35,340	36,460	37,268	37,268

Consolidated Balance Sheet Data:

Working capital[(2)]	1,340,832	1,031,830	1,402,226	823,324	457,449	66,693
Property, plant and equipment, net	772,968	735,641	1,158,931	1,440,712	1,795,405	261,755

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	Year Ended December 31,					
	2002 Rmb	2003 Rmb	2004 Rmb	2005 Rmb	2006 Rmb	2006 US$(1)
	(in thousands, except earnings per share)					
Total assets	3,985,459	4,033,632	5,384,248	6,679,630	7,961,357	1,160,700
Long-term bank loans, excluding current installments	50,000		100,000	50,000	675,454	98,476
Minority interests	487,491	544,526	724,311	654,687	693,296	101,077
Total stockholders equity	2,161,903	1,991,687	2,483,084	2,566,263	2,728,399	397,778
Consolidated Statement of Cash Flows Data:						
Net cash provided by operating activities	659,500	1,075,274	589,608	234,770	634,146	92,452
Capital expenditures(3)	174,850	372,775	552,902	515,359	323,781	47,205

(1) The Company s functional currency is the U.S. dollar and its reporting currency is Renminbi. The functional currency of Yuchai is Renminbi. Translation of amounts from Renminbi to US 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 6.8591 = US$1.00, the rate quoted by the People s Bank of China at the close of business on June 30, 2008. 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 June 30, 2008 or any other date. The rate quoted by the People s Bank of China at the close of business on December 29, 2006 was Rmb 7.8087 = US$1.00. The Renminbi has appreciated against the U.S. dollar since December 29, 2006.

(2) Current assets less current liabilities.

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

Dividends

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

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

Chinese laws and regulations applicable to a Sino-foreign joint stock company require that before Yuchai distributes profits, it must (i) recover losses in previous years; (ii) satisfy all tax liabilities; and (iii) make contributions to the statutory reserve fund in an amount equal to 10% of net income for the year determined in accordance with generally accepted accounting principles in the PRC, or PRC GAAP. However, the allocation of statutory reserve fund will not be further required once the accumulated amount of such fund reaches 50.0% of the registered capital of Yuchai.

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 shall 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 us) 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.

The following table sets forth a five-year summary of dividends we have paid to our shareholders as well as dividends paid to us by Yuchai:

Period	Dividend paid by the Company to its shareholders (per share)	Dividend paid by Yuchai to the Company[(1)] (in thousands)
2002	US$0.19	Rmb 245,766 (US$29,694)[(2)]
2003	US$2.08	Rmb 61,433 (US$7,422)
2004	Nil	Rmb 231,309 (US$27,906)[(3)]
2005	US$0.39	Rmb 72,282 (US$9,039)[(4)]
2006	US$0.02 [(5)]	Rmb 72,284 (US$9,598) [(6)]
2007	US$0.10[(7)]	Not yet declared

(1) Dividends paid by Yuchai to us, as well as to other shareholders of Yuchai, were declared in Renminbi and paid in US dollars (as shown in parentheses) based on the exchange rates at local designated foreign exchange banks on the respective payment dates. For dividends paid for 2002, 2003, 2004, 2005 and 2006, the exchange rate used was Rmb 8.2767 = US$1.00, Rmb 8.2767 = US$1.00, Rmb 8.2765 = US$1.00, Rmb 7.9967 = US$1.00 and Rmb 7.5310 = US$1.00, respectively.

(2) The dividend declared for 2002 by Yuchai was paid to us in 2003 following the execution of the July 2003 Agreement (as defined in Item 4. Information on the Company History and Development Reorganization Agreement).

(3) The dividend declared for 2004 by Yuchai was paid to us in 2005 following the execution of the Reorganization Agreement.

(4) On June 26, 2006, Yuchai declared a dividend to all shareholders in respect of the fiscal year ended December 31, 2005 and the amount attributable to the Company was Rmb 72.3 million (US$9.0 million). We received this dividend on July 28, 2006.

(5) On December 4, 2006, we declared an interim dividend to all shareholders in respect of the fiscal year ended December 31, 2006. This dividend was paid to the shareholders on December 28, 2006.

(6) The dividend declared for 2006 by Yuchai was paid to us on September 17, 2007.

(7) On September 28, 2007, we declared a second interim dividend of US$0.10 per ordinary share amounting to US$3.7 million to all shareholders in respect of the fiscal year ended December 31, 2006. This dividend was paid to the shareholders on October 24, 2007.

Historical Exchange Rate Information

On December 29, 2006, 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 was Rmb 7.8041 = US$1.00. On December 31, 2007, the noon buying rate was Rmb 7.2946 = US$1.00. On June 30, 2008, the noon buying rate was Rmb 6.8591 = US$1.00.

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

	Noon Buying Rate[(1)] (Rmb per US$1.00)	
Period	**High**	**Low**
November 2007	7.4582	7.3800
December 2007	7.4120	7.2946
January 2008	7.2946	7.1818
February 2008	7.1973	7.1100
March 2008	7.1075	7.0105
April 2008	7.0185	6.9840
May 2008	7.0000	6.9377
June 2008	6.9633	6.8591

Noon Buying Rate[(1)]
(Rmb per US$1.00)

Period	Period End	Average[2]	High	Low
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	7.8041	7.9579	8.0702	7.8041
2007	7.2946	7.5806	7.8127	7.2946
2008 (through June 30, 2008)	6.8951	7.0152	7.2946	6.8591

(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 PBOC. As a result, since April 1994, the noon buying rate and the PBOC rate have been substantially similar. The PBOC rate at the end of 2006 was Rmb 7.8087, compared with Rmb 7.9579 for the noon buying rate (average) for the year ended December 31, 2006. The PBOC rate at the end of 2007 was Rmb 7.0000, compared with Rmb 7.5806 for the noon buying rate (average) for the year ended December 31, 2007.

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

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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 and the Cooperation Agreement.

We own 76.4% of the outstanding shares of Yuchai, and one of our primary sources 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 Investments Limited, or Coomber, entered into the Reorganization Agreement in April 2005, as amended in December 2005 and November 2006, and agreed on a restructuring plan for our company intended to be beneficial to our shareholders. In June 2007, we, along with Yuchai, Coomber and the State Holding Company, entered into the Cooperation Agreement. The Cooperation agreement amends certain terms of the Reorganization Agreement and as so amended, incorporates the terms of the Reorganization Agreement. Pursuant to the amendments to the Reorganization Agreement, the Company has agreed that the restructuring and spin-off of Yuchai will not be effected, and, recognizing the understandings that have been reached between the Company and the State Holding Company to jointly undertake efforts to expand the business of Yuchai, the Company will not seek to recover the anti-dilution fee of US$20 million that was due from Yuchai. See Item 4. Information on the Company History and Development Reorganization Agreement. No assurance can be given as to when the business expansion requirements relating to Yuchai as contemplated by the Reorganization Agreement and the Cooperation Agreement will be fully implemented, or that implementation of the Reorganization Agreement and the Cooperation 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 HLGE. See Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan. 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 to implement the terms of the Reorganization Agreement and Cooperation Agreement, including our continued expansion and diversification, could have a material adverse effect on our financial condition, results of operations, business or prospects. Additionally, although the Cooperation Agreement amends certain provisions of the Reorganization Agreement and also acknowledges the understandings that have been reached between us and the State Holding Company to jointly undertake efforts to expand and diversify the business of Yuchai, no assurance can be given that we will be able to successfully implement those efforts or as to when the transactions contemplated therein will be consummated.

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

Although we own 76.4% of the outstanding shares of Yuchai, 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 protection 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, the Reorganization Agreement and the Cooperation 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 the Company s continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai s Board of Directors. Yuchai s Articles of Association have been amended and such amended Articles of Association entitle the Company to elect nine of Yuchai s 13 directors, thereby reaffirming the Company s right to effect all major decisions relating to Yuchai. However, Yuchai s amended Articles of Association are not yet effective pending approval of the Ministry of Commerce, PRC. While Yuchai has affirmed the Company s continued rights as Yuchai s majority shareholder and authority to direct the management and policies of Yuchai, 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 and the Cooperation Agreement, corporate governance matters or related party transactions. Such disagreements and difficulties could ultimately have a material adverse impact on our consolidated financial position, results of operations and cash flows.

We have identified material weaknesses in our internal control over financial reporting and have been required to restate our historical financial statements in the past. We cannot assure you that additional material weaknesses will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in material misstatements in our financial statements which could require us to restate financial statements in the future, cause investors to lose confidence in our reported financial information and have a negative effect on our stock price.

In Amendment No. 1 to our Annual Report on Form 20-F for the year ended December 31, 2005, we restated our consolidated financial statements for the year ended December 31, 2005 and reported material weaknesses in our internal control over financial reporting and concluded that as of December 31, 2005, our disclosure controls and procedures were not effective. In addition, in connection with management s ongoing assessment of the effectiveness of our internal control over financial reporting for the period covered by this Annual Report, management has identified material weaknesses in our internal control over financial reporting and has concluded that as of December 31, 2006, our disclosure controls and procedures and internal control over financial reporting were not effective. See Item 15T Controls and Procedures.

Despite our efforts to ensure the integrity of our financial reporting process, we cannot assure you that additional material weaknesses or significant deficiencies in our internal control over financial reporting will not be identified in the future. Although the assessment by the Company s management of the effectiveness of the Company s internal control over financial reporting as of December 31, 2007 is continuing, the Company s management currently expects to disclose one or more material weaknesses in its internal control over financial reporting.

Any failure to maintain or improve existing controls or implement new controls could result in additional material weaknesses or significant deficiencies and cause us to fail to meet our periodic reporting obligations which in turn could cause our shares to be de-listed or suspended from trading on the NYSE. In addition, any such failure could result in material misstatements in our financial statements and adversely affect the results of annual management evaluations regarding the effectiveness of our internal control over financial reporting. Any of the foregoing could cause investors to lose confidence in our reported financial information, leading to a decline in our share price.

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 2006, sales to the Dongfeng Group accounted for 21.7% of our total net revenues, of which sales to our two largest customers, Liuzhou Dongfeng Automobile and Hubei Dongfeng Automobile, accounted for 9.9%. Although we consider our relationship 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 from us 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.

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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 China 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;
- increased production capacity of competitors;
- increased utilization of unused capacity by competitors; and
- price competition.

In addition, if restrictions on the import of motor vehicles and motor vehicle parts into China are reduced, foreign competition could increase significantly.

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, although there is a perceived shift in the market demand from medium-duty engines to heavy-duty diesel engines, general credit tightening by banks may however affect this trend. In 2006, 6108 medium-duty engine sales volumes declined 53.1% compared to its sales in 2005. In 2007, however, 6108 medium-duty engine sales volumes improved approximately 85% compared to its sales in 2006. With the improved highway road system as a result of the Chinese government s investment in infrastructure, truck market sales growth is trending towards heavy-duty engines.

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 China 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 and introduced the 6M heavy-duty engine family for heavy-duty trucks and passenger buses in 2004. 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. Yuchai s first sales of the 4F engines occurred in March 2005. Yuchai expects growth of this new engine to strengthen over the next few years and become a significant contributor to sales growth for Yuchai. Although there had been an increase in sales of our 4-Series engines from 2003 to 2007, 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. In 2006, the 4-Series engines continued a healthy growth of 18.5% over 2005 in unit sales amid increasing selling price pressure due to strong growth in light-duty engine truck sectors and the Chinese government s subsidy to the agriculture sector. In 2007, the 4-Series engines had a growth of approximately 56% in unit sales over 2006. 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.

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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 five fiscal years, with net sales increasing by 4.2% from 2004 to Rmb 5,816.7 million in 2005 and by 19.0% to Rmb 6,920.5 million (US$1,009.0 million) in 2006. 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 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 the continued economic growth in China.

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

- obtaining the necessary supplies, including the availability of raw materials;
- 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;
- controlling production costs; and
- obtaining adequate funding on commercially reasonable terms for future growth.

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 affecting our business.

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, however, sales for trucks and other commercial vehicles declined by approximately 1.0% due to a credit tightening policy by the Chinese government. In 2006, sales for commercial vehicles increased 14.2% due to the strong economic growth achieved and continued investment in infrastructure building by the Chinese government. *(Source:*

China Automotive Industry Newsletter for 2006). In 2007, sales for commercial vehicles increased by approximately 26.0% due to the continued economic growth in China. *(Source: China Automotive Industry Newsletter for 2007)* 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 from time to time introduced measures to avoid overheating in certain sectors of the economy, including tighter 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 or successfully enter into other market segments, 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, develop new diesel engine products and diversify into other market segments 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 as well as the success of any entry into new market segments. Future products may utilize different technologies and different market segments 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 or any delay or failure to enter into other market segments could have a material adverse effect on our financial condition, results of operations, business or prospects.

As the Chinese automotive industry continues to develop, we will have to continuously improve our existing engine products, develop new diesel engine products and enter into new market segments 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 and enter into new market segments. 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 or enter into new markets with an early-entrant advantage. Any failure by our company to introduce, or any delays in the introduction of, new or improved products at competitive prices or entering into new market segments could have a material adverse effect on our financial condition, results of operations, business or prospects.

On April 10, 2007, Yuchai signed a Cooperation Framework Agreement with Zhejiang Geely Holding Group Co., Ltd (Geely) and Zhejiang Yinlun Machinery Co., Limited (Yinlun) to consider establishing a proposed joint venture company to develop diesel engines for passenger cars in China. In December 2007, further to the Cooperation Framework Agreement, Yuchai entered into an Equity Joint Venture Agreement with Geely and Yinlun, to form two joint venture companies in Tiantai, Zhejiang Province and Jining, Shandong Province. The joint venture companies will be primarily engaged in the development, production and sales of a proprietary diesel engine and its parts for passenger vehicles. See Item 4. Information on the Company Products New Products for more information. There can be no assurance that these joint ventures will be successful or profitable.

If China s inflation worsens or the prices of energy or raw materials continue to rise, we may not be able to pass the resulting increased costs to our customers and this may adversely affect our profitability or cause us to suffer operating losses.

Economic growth in China has been accompanied by periods of high inflation. The Chinese government has implemented various policies from time to time to control inflation. For example, the Chinese government has from time to time introduced measures in certain sectors to avoid overheating of the economy, including tighter bank lending policies, increases in bank interest rates, and measures to curb inflation. Inflation and an increase in energy prices generally could cause our costs for raw materials required for the production of products to increase, which would adversely affect our financial condition and results of operations if we cannot pass these added costs along to customers.

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.

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 plan. See Item 5. Our 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 US dollars, Singapore dollars or Renminbi. An increase in interest rates, or fluctuations in exchange rates between the Renminbi or Singapore dollars and US dollars, 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. In addition, an increase in interest rates may reduce the fair value of the debt securities issued by HLGE.

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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 US dollars, has been based on rates set by the PBOC. 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 US dollar. From July 20, 2005 to December 29, 2006, Renminbi appreciated about 5.7% against the US dollar, and has appreciated since then. On December 29, 2006, the noon buying rate was Rmb 7.8041 = US$1.00, and on June 30, 2008, the noon buying rate was Rmb 6.8591 = US$1.00. 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.

The manufacture and sales of Euro 0 and Euro I engines in major urban areas became unlawful after August 31, 2004. After that date, the engines equipped with Euro 0 and Euro I engines are not permitted to be sold and used in major urban areas. The manufacture and sale of Euro II engines is also being progressively phased out starting June 30, 2008 and the PRC emission standard equivalent to Euro III is expected to be implemented progressively throughout China from 2008. There can be no assurance that Yuchai will be able to comply with these emission standards or that the introduction of these and other environmental regulations will not result in a material adverse effect on our business, financial condition and results of operations.

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.

Risks relating to our shares and share ownership

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

Our controlling shareholder, Hong Leong Asia Ltd., or Hong Leong Asia, 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. Hong Leong Asia controls us through its wholly-owned subsidiary, Hong Leong (China) Limited, or Hong Leong China, and through HL Technology Systems Pte Ltd, or HL Technology, a wholly-owned subsidiary of Hong Leong China. HL Technology owns approximately 21.0% of the outstanding shares of our Common Stock and is, and has since August 2002 been, the registered holder of the special share. Hong Leong Asia also owns, and has since May 2005 owned, through another wholly-owned subsidiary, Well Summit Investments Limited, approximately 0.2% of the outstanding shares of our Common Stock. Hong Leong Asia is a member of the Hong Leong Investment Holdings Pte. Ltd., or Hong Leong Investment, group of companies. Prior to August 2002, we were controlled by Diesel Machinery (BVI) Limited, or Diesel Machinery, which, until its dissolution, was a holding company controlled by Hong Leong China and was the prior owner of the special share. Through HL Technology s stock ownership and the rights accorded to the Special Share under our bye-laws and various agreements among shareholders, Hong Leong Asia is able to effectively approve and effect most corporate transactions. See Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Shareholders Agreement. In addition, our shareholders do not have cumulative voting rights. There can be no assurance that Hong Leong Asia s actions will be in the best interests of our other shareholders. See also Item 7. Major Shareholders and Related Party Transactions Major Shareholders.

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We may experience a change of control as a result of sale or disposal of shares of our Common Stock by our controlling shareholders.

As described above, HL Technology, a subsidiary of Hong Leong Asia, owns 7,831,169 shares of our Common Stock, as well as the special share. If HL Technology reduces its shareholding to less than 7,290,000 shares of our Common Stock, our Bye-Laws provide that the special share held by HL Technology will cease to carry any rights, and Hong Leong Asia 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 HL Technology sells or disposes of all of the shares of our Common Stock, we cannot determine what control arrangements will arise as a result of such sale or disposal (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.

In addition, our financing arrangements have a covenant requiring Hong Leong Asia to retain ownership of the special share and that we remain a principal subsidiary (as defined in such arrangements) of Hong Leong Asia. A breach of that covenant may require us to pay all outstanding amounts under those financing arrangements. There can be no assurance that we will be able to pay such amounts or obtain alternate financing.

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 availability of raw materials used in our engine production, particularly steel and cast iron;
- the public s reaction to our press releases and announcements and our filings with the Securities and Exchange Commission, or SEC, in particular the restatement of our 2005 financial statements and identification of material weaknesses in our internal control over financial reporting;
- 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; or
- increases in labor and other costs.

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.

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 from time to time introduced measures in certain sectors to avoid overheating of the economy, including tighter bank lending policies, increases in bank interest rates, and measures to curb property, stock market speculation and inflation. In August 2007, the Chinese government increased its capital reserve requirements for banks in an effort to control liquidity and slow down loan growth. 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.

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 protection 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 precedent 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 27 years has significantly enhanced the protection 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 and may not be consistent or predictable as in other more developed jurisdictions which may limit the legal protection available to foreign investors.

Our operations in China are subject to PRC regulations governing PRC companies. These regulations contain provisions that are required to be included in the articles of association of PRC companies and are intended to regulate the internal affairs of these companies. The PRC Company Law and these regulations, in general, and the provisions for the protection of shareholders rights and access to information, in particular, are less developed than those applicable to companies incorporated in the United States, Hong Kong or other developed countries or regions. In addition, the interpretation of PRC laws may be subject to policy changes which reflect domestic political changes. As China s legal system develops, the promulgation of new laws, changes to existing laws and the pre-emption of local regulations by national laws may have an adverse effect on our prospects, financial condition and results of operations.

At the National People s Congress held in March 2007, 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 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, Yuchai, and are denominated in Renminbi, while a portion of our indebtedness is, or in the future may be, denominated in US dollars and other

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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, overseas borrowings by Chinese entities and proceeds of overseas public offering by Chinese entities. Some of the conversions between Renminbi and foreign currency under capital account are subject to 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.

Outbreaks of infectious diseases, such as severe acute respiratory syndrome (SARS) and the Avian 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. In addition, an infectious strain of influenza known as the Avian 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.

Risks relating to our investments in HLGE and TCL

As of December 31, 2006, we had a 45.4% interest in HLGE and a 36.6% interest in TCL. As of June 30, 2008, we had a 45.4% interest in HLGE and a 34.4% interest in TCL. See Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan. Set forth below are risks related to our equity interests in these entities.

The HLGE group s hotel ownership and management business may be adversely affected by risks inherent in the hotel industry.

The HLGE group operates hotels primarily in the PRC and Malaysia. The HLGE group s financial performance is dependent on the performance of each of the hotels it operates. The HLGE group s hotel ownership and management business are exposed to risks which are inherent in and/or common to the hotel industry and which may adversely affect the HLGE group s financial performance, including the following:

- changes to the international, regional and local economic climate and market conditions (including, but not limited to; changes to regional and local populations, changes in travel patterns and preferences, and oversupply of or reduced demand for hotel rooms that may result in reduced occupancy levels and performance for the hotels it operates);

- changes to the political, economic, legal or social environments of the countries in which the HLGE group operates (including developments with respect to inflation, interest rates, currency fluctuations, governmental policies, real estate laws and regulations, taxation, fuel costs and expropriation);

- increased threat of terrorism, terrorist events, airline strikes, hostilities between countries or increased risk of natural disasters or viral epidemics that may affect travel patterns and reduce the number of travelers and tourists;

changes in laws and governmental regulations (including those relating to the operation of hotels, preparation and sale of food and beverages, occupational health and safety working conditions and laws and regulations governing its relationship with employees);

competition from other international, regional and independent hotel companies, some of which may have greater name recognition and financial resources than the HLGE group (including competition in relation to hotel room rates, convenience, services or amenities offered);

losses arising out of damage to the HLGE group s hotels, where such losses may not be covered by the insurance policies maintained by the HLGE group;

increases in operating costs due to inflation, labor costs (including the impact of unionization), workers compensation and health-care related costs, utility costs, insurance and unanticipated costs such as acts of nature and their consequences;

fluctuations in foreign currencies arising from the HLGE group s various currency exposures;

dependence on leisure travel and tourism;

the outbreak of communicable diseases, such as the Avian flu, which if not contained, could potentially adversely affect the operations of the HLGE group and its business in the hospitality industry; and

adverse effects of a downturn in the hospitality industry.

The above factors may materially affect the performance of those hotels and the profitability and financial condition of the HLGE group.

The hospitality business is a regulated business.

The operation of hotels in the PRC and Malaysia is subject to various laws and regulations. The withdrawal, suspension or non-renewal of any of the hotels licenses, or the imposition of any penalties, as a result of any infringement or non-compliance with any requirement, will have an adverse impact on the business and results of operations of the hotels that the HLGE group operates. Further, any changes in such laws and regulations may also have an impact on the businesses at the hotels and result in higher costs of compliance. In addition, any failure to comply with these laws and regulations could result in the imposition of fines or other penalties by the relevant authorities. This could have an adverse impact on the revenues and profits of HLGE group or otherwise adversely affect the operations of the hotels.

The TCL group s recently announced strategy of repositioning its principal business from consumer electronics distribution to real estate and related infrastructure investment in pan-Asian region, if approved by its shareholders, may not be successful.

TCL announced in May 2008 that it plans to reposition its principal business from consumer electronics distribution to real estate and related infrastructure investment in pan-Asian region. TCL also announced that TCL may divest those assets that will no longer form part of the core activity of the Company going forward. This plan is subject to TCL receiving any required regulatory and shareholders approvals. There can be no assurance that such approvals will be obtained. Even if such approvals are obtained, there is no assurance that this repositioning of TCL s business will be successful or profitable.

The TCL group s principal business involves the distribution of third party branded and proprietary branded consumer electronic products with operations mainly in the PRC (including Hong Kong). This business is highly competitive and faces significant competition from other renowned brands.

The TCL group faces intense competition from a large number of established companies and emerging companies in the consumer electronics market and it expects this competition to continue or even intensify as the consumer electronic market evolves.

The consumer electronic markets in which the TCL group operates are characterized by frequent product introductions, short product lifecycles, aggressive pricing practices and downward pressure on gross margins. Many of the TCL group s current and potential competitors have substantially greater resources including financial, manufacturing, marketing and distribution resources. Some of the TCL group s competitors may also have greater name recognition and market presence, longer operating histories, greater market power and product depth, lower cost structures and larger customer bases.

The TCL group s competitors may be able to adapt more quickly to new technologies and changes in consumer preferences by introducing new products at competitive prices, which may result in loss of market share by the TCL group and may force the TCL group to lower price on the products it distributes, which may result in reduced margins for those products. These competitive pressures may also cause the TCL group s potential customers to delay or defer their purchasing decisions in anticipation of potential new products, lowering prices, or both. If the TCL group is not able to compete successfully in the future with its existing or potential competitors, there will be a material adverse effect on the TCL group s business and financial results.

Consumer spending patterns for products such as consumer electronics are affected by, among other things, prevailing economic conditions, currency fluctuations, wage rates, inflation, consumer confidence and consumer perception of economic conditions. A general slowdown in the economy of the PRC specifically or the consumer electronics industry globally or an uncertain economic outlook could have a material adverse effect on the sales of the TCL group.

Both the HLGE group and the TCL group may need to raise additional capital for growth.

Each of the HLGE group and the TCL group will require funds for its core businesses and to invest in future growth opportunities. There is no assurance that either the HLGE group or the TCL group would be able to generate sufficient internal funds to finance such endeavors. Accordingly, the HLGE group and/or the TCL group may, depending on the cash flow requirements and financial condition, need to raise additional funds by issuing equity or a combination of equity and debt or by entering into strategic relationships or through other arrangements. Any additional equity financing by HLGE or TCL may dilute our equity interests in HLGE and TCL, respectively. Any debt financing may contain restrictive covenants with respect to dividends, future capital raising and other financial and operational matters. Failure to obtain additional financing where such financing is required on acceptable terms, will adversely affect the HLGE group s and/or the TCL group s business, financial performance and financial position and the HLGE group s and/or the TCL group s ability to pursue its growth plans.

The HLGE group may be unable to raise sufficient funds to pay our debt.

The HLGE group will require funds to repay its outstanding debt owed to us. There is no assurance that the HLGE group would be able to generate sufficient internal funds to redeem the outstanding bonds held by us. Failure to obtain sufficient funds to repay outstanding debt will adversely affect the HLGE group s business, financial performance and financial position and the HLGE group s ability to redeem its outstanding bonds held by us which could have an adverse effect on our financial condition and results of operations.

ITEM 4. INFORMATION ON THE COMPANY.

This section includes certain 2007 data regarding the Company that is derived from unaudited estimated information.

History and Development

The Company

China Yuchai International Limited is a Bermuda holding company established on April 29, 1993 to own a controlling interest in Yuchai. We currently own, through six of our wholly-owned subsidiaries, 76.4% of the outstanding shares of Yuchai. We operate as an exempted company limited by shares under The Companies Act 1981 of Bermuda. Our principal operating office is located at 16 Raffles Quay #39-01A, Hong Leong Building, Singapore 048581. Our telephone number is (+65) 6220-8411. Our transfer agent and registrar in the United States is BNY Mellon Shareowner Services. On March 7, 2008, we registered a branch office of the Company in Singapore.

Until August 2002, we were controlled by Diesel Machinery, a company that was 53.0% owned by Hong Leong Asia, through its wholly-owned subsidiary, Hong Leong China. Hong Leong China owns HL Technology which held shares in us through Diesel Machinery. Diesel Machinery was also 47.0% owned by China Everbright Holdings Company Limited, or China Everbright Holdings, through its wholly-owned subsidiary, Coomber. Hong Leong Asia, a company listed on the Singapore Exchange Securities Trading Limited, or Singapore Exchange, is part of the Hong Leong Investment group, which was founded in 1941 by the Kwek family of Singapore and remains one of the largest privately-controlled business groups in Southeast Asia. China Everbright Holdings is a state-owned enterprise of China. In 2002, China Everbright Holdings and Coomber gave notice to Diesel Machinery and the other shareholders of Diesel Machinery to effect a liquidation of Diesel Machinery. As a result of the liquidation, Hong Leong Asia acquired the special share through HL Technology which entitles Hong Leong Asia to elect a majority of our directors and also to veto any resolution of our shareholders. China Everbright Holdings sold its shareholding in Coomber, which held shares of our Common Stock, in October 2002 to Goldman Industrial Limited, or Goldman, and China Everbright Holdings is no longer a shareholder of our company. Goldman was a subsidiary of Zhong Lin Development Company Limited, or Zhong Lin, an investment vehicle of the city government of Yulin in Guangxi, China until September 29, 2006 when Zhong Lin sold its shareholding in Goldman to the State Holding Company.

We provide certain management, financial planning and other services to Yuchai and have designated eight persons in key management positions, including two Sarbanes-Oxley managers, to work full-time at Yuchai s principal manufacturing facilities in Yulin City as part of Yuchai s day-to-day management team.

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To our knowledge, since January 1, 2006, there have not been any public takeover offers by third parties in respect of shares of our Common Stock, nor, except as described in Item 5. Operating and Financial Review and Prospects Business Diversification and Business Plan, have we made any public takeover offers in respect of the shares of other companies.

Our main operating asset has historically been, and continues to be, our ownership interest in Yuchai, and our primary source of cash flow has historically been our share of the dividends, if any, paid by Yuchai and investment income 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. Following such announcement, we have looked for new business opportunities to seek to reduce our financial dependence on Yuchai.

In March 2005, we acquired a 15.0% interest in the then capital of TCL through our wholly-owned subsidiary, Venture Delta Limited, or Venture Delta. We have since increased our shareholding in TCL through various transactions, and as of December 31, 2006, we had a 36.6% interest in the outstanding ordinary shares of TCL.

As part of the business expansion and diversification plan, in February 2006, we acquired debt and equity securities in HLGE through our wholly-owned subsidiaries, Grace Star Services Ltd., or Grace Star, and Venture Lewis Limited, or Venture Lewis. We have since increased our shareholding in HLGE following the conversion of the preference shares held by Grace Star into ordinary shares of HLGE, and as of December 31, 2006, we had an interest of 45.4% of the outstanding ordinary shares of HLGE. See Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan.

We have seven directly wholly-owned subsidiaries which hold investments in Yuchai, HLGE and TCL, as described below:

- Through our 76.4% interest in Yuchai, we primarily conduct our manufacturing and sale of diesel engines which are mainly distributed in the PRC market;

- As of June 30, 2008, we had a 45.4% interest in HLGE. The HLGE group is engaged in hospitality and property development activities conducted mainly in the PRC and Malaysia; and

- As of June 30, 2008, we had a 34.4% interest in TCL as a result of issuance of additional ordinary shares by TCL pursuant to the exercise of options and convertible securities. As of December 31, 2006, we had a 36.6% interest in TCL. The TCL group primarily conducts distribution of consumer electronic products with operations mainly in the PRC (including Hong Kong). TCL also has other business activities relating to contract manufacturing, property development and investment in the PRC.

HLGE and TCL are each listed on the Singapore Exchange.

We account for Yuchai as a subsidiary and hence its financial statements are consolidated into our financial statements. We account for our investments in the ordinary shares of HLGE and TCL as affiliated companies using the equity method. An affiliated company is an entity in which we do not have a controlling financial interest but we have the ability to exercise significant influence over its financial and operating policy decisions.

In order to finance the acquisition of shares and bonds of TCL and HLGE, as well as other strategic acquisitions which we may consider from time to time as part of our business diversification strategy, in February 2005, we issued $25.0 million in principal amount of convertible bonds due 2012 in a private placement. Upon the conversion of the convertible bonds by the bondholders, we issued 1,927,673 shares of our Common Stock in June 2005.

Yuchai

Yuchai is a diesel engine manufacturer 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 6.0 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 the machinery business of Yulin Diesel. 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, or 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, or Legal Person Shares.

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

Our initial shareholders, consisting of HL Technology, Sun Yuan Overseas (BVI) Ltd., or Sun Yuan BVI, the Cathay Investment Fund, Limited, or Cathay, GS Capital Partners L.P., or GSCP, and Coomber, then a wholly-owned subsidiary of China Everbright Holdings and, thus, controlled by China Everbright International Limited, or China Everbright International, made their initial investments in Yuchai in May 1993, when their respective wholly-owned subsidiaries purchased for cash in the aggregate 200 million newly-issued shares of Yuchai (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 our Common Stock (after giving effect to a 10-for-1 stock split in July 1994, or 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 the approval of the Ministry of Commerce, or MOC, the successor entity to the Ministry of Foreign Trade and Economic Cooperation of China, or 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 organizations 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, we purchased from an affiliate of China Everbright Holdings 78,015,500 Foreign Shares of Yuchai in exchange for the issuance of 7,801,550 shares of our Common Stock (after giving effect to the Stock Split), or the China Everbright Holdings Purchase. The 78,015,500 Foreign Shares of Yuchai held by Earnest Assets Ltd, a subsidiary of China Everbright Holdings and China Everbright International before its sale to us, 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 Systems (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd., Cathay Diesel Holdings Ltd., Goldman Sachs Guangxi Holdings (BVI) Ltd., Youngstar Holdings Limited and Earnest Assets Limited.

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

In connection with our purchase, through our six wholly-owned subsidiaries, of additional Foreign Shares in Yuchai with proceeds of our initial public offering, 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 our subsidiaries was able to acquire these additional Foreign Shares in Yuchai. 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 s 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, or SABSP, and the State Committee of Economic System Reform, or 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 our 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 noted 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.

Reorganization Agreement

On April 7, 2005, we entered into the Reorganization Agreement with Yuchai and Coomber, which is intended to be in furtherance of the implementation of the restructuring contemplated in the agreement dated July 19, 2003 between the Company and Yuchai with respect to the Company s investment in Yuchai (the July 2003 Agreement), as amended and incorporated into the Cooperation Agreement on June 30, 2007. 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 our continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai s Board of Directors.

Subsequent to the execution of the Reorganization Agreement, 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 us in 2005. Yuchai has also declared and paid dividends to its shareholders from profits earned in the fiscal 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 we declared dividends representing approximately 50% of the amount of dividends paid to us by Yuchai, as contemplated in Section 1.5(c) of the Reorganization Agreement. Yuchai declared dividends in respect of the fiscal year ended December 31, 2005 and the amount of Rmb 72.3 million due to the Company was received in 2006. Yuchai declared dividends in respect of the fiscal year ended December 31, 2006 and the amount of Rmb 72.3 million (US$10.5 million) was received in 2007.

Cooperation Agreement

On June 30, 2007, we entered into the Cooperation Agreement with Yuchai, Coomber and the State Holding Company. The Cooperation Agreement amends certain terms of the Reorganization Agreement, as amended, among CYI, Yuchai and Coomber, and as so amended, incorporates the terms of the Reorganization Agreement. The Reorganization Agreement was scheduled to terminate on June 30, 2007.

Pursuant to the amendments to the Reorganization Agreement, the Company agreed that the restructuring and spin-off of Yuchai would not be effected, and, recognizing the understandings that have been reached between the Company and the State Holding Company to jointly undertake efforts to expand the business of Yuchai, the Company would not seek to recover the anti-dilution fee of US$20 million from Yuchai.

The Cooperation Agreement provides that the parties will explore new business opportunities and ventures for the growth and expansion of Yuchai s existing businesses. Although the parties to the Cooperation 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 consummated.

While various amendments to Yuchai s Articles of Association had been ratified and adopted by Yuchai, these amendments are still in the process of being approved by the Ministry of Commerce, PRC. As of May 30, 2008, the parties were continuing to seek the required approvals.

During 2004, Yuchai granted loans of Rmb 205 million to YMLC, a subsidiary of Coomber, with an interest rate of 5.58% for one year. The loans were guaranteed by Coomber and the State Holding Company as guarantors (together, the Guarantors). The loans were repaid in 2005 and were subsequently re-loaned with a maturity date of June 1, 2007 and further extended to May 30, 2008. In July 2007, Yuchai s Board of Director s agreed in principle to a proposal by the State Holding Company to settle the amount due from YMLC, along with various other amounts receivable from YMLC (collectively, the receivables), by forgiving the receivables in exchange for the transfer of ownership of a hotel in Yulin, PRC and YMLC s central office building in Guilin, PRC. Yuchai has, pursuant to a share transfer contract acquired all the outstanding share capital of Guangxi Yulin Hotel Company Ltd (Yulin Hotel Company) for Rmb 245.6 million in repayment of the Rmb 205 million loan. The balance of the consideration payable for the purchase of Yulin Hotel Company will be offset against certain trade receivables due from YMLC, the Guarantors and other related parties. The acquisition by Yuchai of Yulin Hotel Company was ratified by the Board of Directors of Yuchai and its shareholders subject to the original shareholders of Yulin Hotel Company obtaining approval for the transaction from the regulatory agency in China by November 30, 2008. If such approval from the regulatory agency in China is not obtained by November 30, 2008, Yuchai has the right to sell to the State Holding Company, who shall be obligated to buy, 100% of the equity in Yulin Hotel Company at the original purchase price of Rmb 245.6 million as set out in the share transfer contract. In the event that Yuchai elects to exercise this option and should the State Holding Company be unable to pay the entire purchase price of Rmb 245.6 million, whether in cash or in kind, the Company may have to make a provision for such amount as necessary. This condition is contained in the guarantee letter provided by the original shareholders of Yulin Hotel Company. As a result of the acquisition of 100% equity of Yulin Hotel Company, the loan agreements with YMLC have been terminated and the guarantees provided by the Guarantors have been discharged.

Product Development Yuchai

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. Yuchai 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 announced as a policy objective in 1994 that motor vehicles weighing five tons or more should principally have diesel engines after 2000 which are more efficient than gasoline engines. High powered and fuel efficient diesel engines are increasingly an important transportation means for ground freights as the manufacturing and distribution of goods spread throughout China.

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New and refurbished highways, trade, tourism and mass transit have all contributed to the demand for trucks and buses in China and are factors that affect Yuchai s growth and product development. In 2005, a majority of China s diesel engines was using the Euro II emission standard. Yuchai s production of Euro III compliant 6L, 6G and 4G electric control diesel engines competed directly with these Euro II engines. In the first half of 2006, Yuchai s Euro III engines were introduced to the China domestic bus market. Yuchai s Euro III engines are primarily sold in areas with stringent emission control such as Beijing, Guangzhou, Shenzhen and Macao.

Products

Yuchai produces light, medium and heavy-duty diesel engines, industrial diesel engines, diesel powered generators (Genset) and diesel parts. A majority of the production and sales volumes is from the medium-duty diesel engines for trucks with a load capacity of five to seven tons. Yuchai s core medium-duty diesel engines products are its 6105 and 6108 medium-duty engines. In the heavy-duty sector Yuchai offers the 6112 engines and in the light-duty sector Yuchai offers the 4-series diesel engines.

New Products

The 2008 Beijing Olympics have led to an early implementation of the Euro IV standard. Yuchai s competitors have introduced Euro IV engines in the market which are being used by two major bus companies in China. From May 2007, Yuchai s Euro IV engines have been used by Jinghuai bus company. Yuchai Euro IV engine adapted the German Benz technology which has been tested by the market since 2004 and uses the selective catalytic reduction (SCR) resolution which has a higher sulfur content than the domestic diesel fuel. Yuchai s latest Euro IV compliant engines include the BOSCH E-controlled common rail fuel injection system, the 6J-40/6L-40 series and the Delphi EUP fuel injection system 6L-40 series.

The following table sets forth the description of Yuchai s new BOSCH E-controlled and Delphi EUP products;

EURO IV	Series	Description
BOSCH E-controlled	6J-40 6L-40	Yuchai believes that these products have improved energy efficiency and emission reduction, fully E-controlled, low operation cost, and high operating efficiency. Co-developed on the basis of German technology, BOSCH E-controlled common rail system, integral structure finite element, E-controlled pre-injection.
Delphi EUP	6L-40	Yuchai believes that these products have improved energy efficiency and emission reduction, fully E-controlled, low operating cost, and high operating efficiency. Co-designed and developed with German companies, higher power, higher reliability, low consumption and longer service life. The first heavy-duty diesel engine in China conforms to Euro IV standard, certified by the German TUV, in energy efficiency and emission reduction.

The following table sets forth the technical specifications of the 6J and 6L Euro IV diesel engines.

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Type and Technical Specifications	YC6J	YC6J BoschCR	YC6L DelphiEUP
Type	Vertical, in-line, water-cooled, 4-stroke, turbo-charged and inter-cooled	Vertical, in-line, water-cooled, 4-stroke, turbo-charged and inter-cooled	Vertical, in-line, water-cooled, 4-stroke, turbo-charged, inter-cooled
No. of Cylinders	6	6	6
No. of Valves per cylinder	4	4	4
Displacement L	6.5	8.42	8.42
Fuel injection system	BOSCH E-controlled common rail	BOSCH common rail	Delphi EUP
After treatment system	BOSCH Selective Catalytic Reduction	Selective Catalytic Reduction (SCR)	Selective Catalytic Reduction
Compression ratio	17.5:1	17.5:1	17.5:1
Combustion chamber type	Direct injection	Direct injection	Direct injection
Rated power kW	132 - 180	191 - 243	177 - 243
Rated rotation speed rpm	2500	2200	2200
Max. torque N.m	650 - 890	1030 - 1280	950 - 1280
Max. Torque speed rpm	1200-1700	1200-1600	1200-1600
Max. continuous idling speed rpm	2700-2750	2450-2500	2450-2500
Idling speed rpm	600-650	650-700	650-700
Min. fuel consumption fully-loaded g/kW.h	≤195	≤193	≤193
Free-accelerated smoke level FSN	≤1.0	≤1.0	≤1.0
Emission Level	Euro IV	Euro IV	Euro IV
Lubricating Method	Pressure & Flash combined	Pressure & Flash combined	Pressure & Flash combined
Starting	Electric	Electric	Electric

In December 2006, Yuchai established a new wholly-owned subsidiary called Xiamen Yuchai Engines Co. Ltd. This new subsidiary was created to facilitate the construction of a new diesel engine assembly factory in Xiamen Fujian province in China. The projected assembly capacity for the initial phase is approximately 30,000 engines and is expected to incur investment costs of Rmb 186.0 million (US$27.1 million) for the new factory and equipment. This new factory is expected to be ready for commercial production by the fourth quarter of 2008.

On April 10, 2007, Yuchai signed a Cooperation Framework Agreement with Zhejiang Geely Holding Group Co., Ltd (Geely) and Zhejiang Yinlun Machinery Co., Limited (Yinlun) to consider establishing a proposed joint venture company to develop diesel engines for passenger cars in China. The location of the proposed joint venture was to be at Tiantai, Zhejiang Province in China. Yuchai was to be the largest shareholder followed by Geely as the second largest shareholder. In December 2007, further to the Cooperation Framework Agreement, Yuchai entered into an Equity Joint Venture Agreement with Geely and Yinlun, to form two joint venture companies in Tiantai, Zhejiang Province and Jining, Shandong Province. The joint venture companies (JV Cos) will be primarily engaged in the development, production and sales of a proprietary diesel engine and its parts for passenger vehicles. The main product is a 4D2.0L diesel engine and the technology for this new diesel engine will be purchased by the JV Cos from Geely subject to certain specified design technology standards being met. The total design production capacity of both JV Cos will be 300,000 diesel units, with each JV Co starting with a capacity for 50,000 diesel engine units and then adding capacity to reach 150,000 units annually. Yuchai will be the controlling shareholder with 52 percent with Geely and Yinlun holding 30 percent and 18 percent shareholding respectively in both JV Cos. There can be no assurance that the proposed joint ventures, when established, will be successful. See Item 3. Key Information Risk Factors Risks relating to our company and our business If we are not able to continuously improve our existing engine products and develop new diesel engine products, or successfully enter into other market segments, we may become less competitive, and our financial condition, results of operations, business and prospects will be adversely affected.

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Products

The following table sets forth Yuchai s list of engines by application:

	Series
Trucks	YC4D, YC4E, YC4F, YC4G, YC6A, YC6G
Bus	YC6M Mono-fuel, YC6M, YC6L, YC6J, YC6J mono-fuel, YC6G
Construction	YC4B, YC4F, YC6J125G, YC6M, YC4108G/ZG, YC6108G/ZG
Agriculture	YC4AT, YC4BT, YC6AT, YC6BT, YC4BT, YC4F
Marine	YC6112, YC6015/08, YC4108C, YC6M, YC6A/6B
G-Drive	YC4D, YC6A190D(A8100), YC6A225D(A8500), YC6B125D, YC6B145D, YC6B180D, YC6B150D, YC6M, YC6T600L

The following table sets forth the technical specifications of our 4F engine, the 4110ZQ engine, the 6105 engine, the 6108 engine, the 6112 engine, the 6L engine and the 6M engines:

Type and Technical Specifications	4F Engine	4110ZQ Engine	6105 Engine	6108 Engine	6112 Engine	6L Engine*	6M Engine*
Type	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-charged, inner-cooling or water-cooling, 4 valve per cylinder in-line vertical
Rated 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 horsepower (288 kw)
Number of Cylinders	4	4	6	6	6	6	6
Cylinder Displacement	2.66L	4.257L	6.494L	7.255L	7.8L	8.424L	9.84L
Rated Speed	3200 r/min	2800 r/min	2500 r/min	2300 r/min	2400 r/min	2200 r/min	2100 r/min
Maximum Torque	300 N.m	392 N.m	810 N.m	1100 N.m	980 N.m	1400 N.m	1680 N.m
Speed at Maximum Torque	2200 r/min	1600 r/min	1700 r/min	1600 r/min	1500 r/min	1400 r/min	1600 r/min
Bore 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 mm
Minimum Fuel Consumption	≤ 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.h
Consumption Ratio of Oil to Fuel	≤ 0.2%	< 0.5%	< 0.1%	< 0.15%	< 0.1%	< 0.1%	< 0.1%
Noise	≤ 96 dB(A)	< 99 dB(A)	< 99 dB(A)	< 97 dB(A)	< 97 dB(A)	< 97 dB(A)	< 96 dB(A)
Smoke	≤ 2 Bosch	< 3.5 Bosch	< 2.5 Bosch	< 2.5 Bosch	< 2.5 Bosch	< 2 Bosch	< 2 Bosch
	320 kg	350 kg	650 kg	600 kg	700 kg	750 kg	880 kg

Net Machine Weight							
Dimensions (length x width x height)	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 x 1095 mm

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

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Light-Duty Diesel Engines

4-Series Light-Duty Diesel Engines

The 4-Series engines utilize much of the same technology as the 6112 heavy-duty engine, but are 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 certain advantages of the 6112 engine, including reliability, high performance and a longer life span. The 4110Q engine is suitable for light vehicles and agricultural trucks. The 4110ZQ engine, with a low, Euro II compliant emission level and low noise levels, is suitable for light commercial vehicles and medium-size passenger vehicles. The 4-Series light-duty engines comprise the 4F, 4G, 4108, 4110, 4110Q, 4110ZQ and 4112 engines (collectively, the 4-Series engines). Trial production of the 4-Series engines commenced in late 1999.

The 4110Q and 4110ZQ engines were developed primarily to compete in the light-duty diesel engine market. Sales of the 4110 engines in 2000 were weak due to strong competition, minor technical problems and a high pricing structure.

The 4108 engine was based on the 6105 and the 6108 engines. The 4108 engine is designed for light trucks and passenger vehicles and commercial production of the 4108 engine began in 2001.

The 4112 engine was primarily based on the 6112 engine and 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. Commercial production of the 4112 engine began in late 2001.

The 4F/4G engine is a four-cylinder, four-stroke engine with a rated power ranging from 90 to 115 horsepower. The 4F/4G 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.

Both the 4108 and 4112 engines experienced minor technical problems previously which have since been resolved. Significant improvements to the technical specifications of the 4-Series engines have resulted in higher customer acceptance resulting in consistent sales since 2004. The growth is mainly attributed to increased demand for light trucks and agricultural machinery, and the Chinese government s subsidy in the agricultural sector. Yuchai expects the continuing growth of the 4-series engines to become a significant contributor to sales growth for Yuchai.

Medium-Duty Diesel Engines

6105 Medium-Duty Diesel Engines

The 6105 medium-duty engine is a six-cylinder, four-stroke engine that offers up to 230 horsepower. The 6105 engine was historically Yuchai s primary product and was 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.

6108 Medium-Duty Diesel Engines

In response to the introduction of high-power medium-duty engines by its competitors in 1995, Yuchai began the development of its 6108 medium-duty engine which offers improved overall performance compared to the 6105 engine, principally because of greater horsepower, increased reliability and improved acceleration.

Commercial production of the 6108 engine began in the third quarter of 1997, when Yuchai began offering the 6108 engine to its customers as a premium model, along-side its standard 6105 engine. Commercial production of the 6108 engine began in the third quarter of 1997, when Yuchai began offering the 6108 engine to its customers as a premium model, along-side its standard 6105 engine. Yuchai s existing and planned production facilities for medium-duty diesel engines are designed to produce 6108 engines without major modification. The customer base for the 6108 engines is similar to that for the 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. In 2004, unit sales of the 6108 engines were higher than the 6105 engines. The trend reversed in 2005 due to the introduction of the Euro III emission standard which resulted in an increase in the prices of the 6108 engine resulting in a reduction in market demand. In 2007, however, unit sales of the 6108 engine increased by approximately 85% over that achieved in 2006, partly due to sales to customers for end use in the construction industry.

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Heavy-Duty Diesel Engines

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, which we refer to as the 6112 Engine Factory. The facilities were designed to have a production capacity of approximately 50,000 units per year and could support the production of medium-duty engines when necessary. The facilities included product testing, production equipment repair and maintenance, factory automation and other support functions.

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 China domestic component manufacturers, the 6112 engine encountered significant technical problems during the 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. The 6112 Engine Factory was completed in 1995 and commercial production of these engines began in the second half of 1999.

Production of the 6112 engine increased steadily between 2002 and 2004 to meet an increase in demand. Sales of the 6112 engine decreased between 2005 and 2007, largely due to shrinking demand arising from the Chinese government s macroeconomic cooling-off measures and competition. Production was also reduced in 2005 and 2006 to reflect the decline in demand.

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 launched the 6L engine in November 2003.

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. The 6M engine has adopted the unique combustion system technology of German FEV and the European forced cooling piston technology. It has a 10-liter displacement and power ranging from 280 to 390 horsepower. Yuchai s first commercial sales of 6M engines occurred in January 2004. Sales increased between 2004 and 2006 due to a strong growth in heavy-duty engine truck sector.

Industrial Engines

Yuchai produces industrial engines such as excavator wheel loads, track tractors, forklifts and truck backhoes. The main products include the following 10 series: YC13, YC18, YC25, YC30, YC35, YC55, YC65, YC85, YC135 and YC225, and more than sixty types of full hydraulic-power small excavators. These engines are equipped with advanced-level hydraulic parts. The products have passed the safety certification of the European CE. These products are suitable for use in engineering construction and production operations of industries such as transportation, farmland, municipal construction and water conservancy.

Other Products

Diesel Power Generators

Yuchai has a history of more than 40 years for producing diesel generator set, with wide application in civil, military and marine sectors. 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. The Gensat includes an intelligent digital controlling system, remote control, group control, remote monitoring, automatic parallel operation, and automation protection against breakdown.

Special Vehicles

Yuchai also produces special vehicles such as waste transfer equipment, constrictive dumpcart, demountable carriage dumpcart, pendular dumpcart, dumpcart, adsorb dung vehicle, tank car and others.

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Diesel Engine Parts

Yuchai supplies diesel engine parts to its nationwide chain of customer service stations in China. 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.

Product Sales

In 2000, Yuchai began commercial production of the light-duty 4-Series engines. Strong competition and high pricing structure, contributed to weak sales of the 4-Series engines. However, during the credit tightening period of 2005 to 2006, the 4-Series engines became more affordable compared to the medium-duty engines contributing to increased sales during such period.

Yuchai entered the commercial production and marketing of the 6112 heavy-duty engine in 1999. The product enjoyed steady growth and witnessed declining sales in 2005 to 2006 due to the austerity measures introduced by the central government in China. Yuchai also commenced engine development work on its new heavy-duty 6L and 6M engines in 2003. These two series of engines enjoyed steady growth due to its quality, market suitability and competitive cost.

The following table sets forth a breakdown of Yuchai s sales by major product category for each of the four years ended December 31, 2004, 2005, 2006 and 2007, respectively:

	2004			2005			2006			2007
	Revenues, net	% of Revenues, net	Units Sold	Revenues, net	% of Revenues, net	Units Sold	Revenues, net	% of Revenues, net	Units Sold	Units Sold (Approximately)
	Rmb (in thousands)			Rmb (in thousands)			Rmb (in thousands)			
Diesel engines:										
6105	1,143,535	20.5%	50,609	1,744,953	30.0%	69,379	1,705,399	24.6%	66,627	80,500
6108	1,372,073	24.6%	57,908	809,054	13.9%	37,560	991,190	14.3%	45,562	64,200
6112	1,203,558	21.6%	24,073	785,236	13.5%	14,788	725,288	10.5%	14,150	12,700
6L	60,056	1.1%	963	46,501	0.8%	782	98,060	1.4%	1,526	5,000
6M	37,312	0.6%	818	146,349	2.5%	3,471	267,657	3.9%	6,654	14,200
4-Series	1,183,992	21.2%	71,562	1,551,319	26.7%	103,598	2,222,531	32.1%	148,941	206,500
Diesel power generators & others(1)	581,569	10.4%	695	733,328	12.6%	650	910,403	13.2%	123	180
	5,582,095	100.0%	206,628	5,816,740	100.0%	230,228	6,920,528	100.0%	283,583	383,280

(1) Others comprise diesel engine parts.

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, or the 6108 Engine Factory, the 6112 Engine Factory and various testing and supporting facilities.

In 2004, with the completion of the new second foundry and 6L and 6M heavy-duty diesel engines assembly lines, 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, resulting in a total production capacity of approximately 250,000 units at the end of 2004. Yuchai s total production capacity increased to approximately 400,000 units based on 2.5 shifts five-day week at the end of 2007.

The following table sets forth the breakdown of Yuchai s production by major product category for each of the years ended December 31, 2002, 2003, 2004, 2005, 2006 and 2007.

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	Year Ended December 31,											
	2002		2003		2004		2005		2006		2007	
	Units	% of total units	Units	% of total units	Units	% of total units	Units	% of total units	Units	% of total units	Units (Approximately)	% of total units
Diesel Engines:												
6105	39,644	27.4%	43,325	24.0%	55,910	24.4%	70,052	29.2%	66,439	23.9%	82,300	21.4%
6108	61,950	42.9%	64,054	35.5%	62,394	27.2%	35,627	14.8%	39,057	14.1%	66,500	17.3%
6112	17,201	11.9%	22,024	12.2%	27,410	12.0%	15,990	6.7%	14,358	5.2%	12,900	3.4%
6L	n/a	n/a	129	0.1%	1,444	0.6%	1,008	0.4%	1,366	0.5%	5,600	1.5%
6M	n/a	n/a	55	0.0%	1,594	0.7%	5,991	2.5%	7,331	2.6%	15,800	4.1%
4-Series	25,668	17.8%	50,836	28.2%	80,458	35.1%	111,393	46.4%	149,347	53.7%	201,300	52.3%
Total	144,463	100.0%	180,423	100.0%	229,210	100.0%	240,061	100.0%	277,898	100.0%	384,400	100.0%

n/a = not applicable

Sourcing of Major Engine Parts

Yuchai manufactures engine blocks, cylinder heads, crankshaft, camshaft and certain other key parts. Third party suppliers provide the remaining engine parts. The production process involves the complete assembly and testing of the finished product. The key components for 6105, 6108 and 6112 are manufactured internally.

Engine Block

Yuchai cast and molded approximately 128,000 engine blocks in 2006 representing a large portion of its engine blocks used in production. Contingency supply comes from a long term domestic supplier.

Pump

Yuchai/ASIMCO Components Company Limited, or Yuchai/ASIMCO, is one of Yuchai s principal suppliers of fuel injection pumps through two of its related companies.

Yuchai/ASIMCO is a joint venture between Yuchai and a subsidiary of Asian Strategic Investments Corporation, or 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, 2006, Yuchai had contributed Rmb 5.7 million to Yuchai/ASIMCO and owned a 8.0% interest in the common stock of Yuchai/ASIMCO.

Raw Materials

Yuchai purchases raw materials, principally steel and cast iron, from domestic suppliers. There has been an increase in the prices of these raw materials which increases our costs of production. See Item 3. Key Information Risk Factors Risks relating to our company and our business If China s inflation worsens or the prices of energy or raw materials continue to rise, we may not be able to pass the resulting increased costs to our customers and this may adversely affect our profitability or cause us to suffer operating losses

Imports

The main parts for the 6112 heavy-duty engine, which comprise engine blocks, cylinder heads, crankshaft and fuel injection pumps, are imported from foreign suppliers. The remaining parts are purchased from the domestic suppliers. Yuchai reduced its reliance on imported parts and components in 2006 and expects to further reduce its reliance on such imported parts and components in 2007.

Yuchai has a policy of practising sound procurement policy by requiring the same product procurement from at least two distinct sources. The same practice applies to all other externally procured engine parts. Yuchai is continually seeking to improve its procurement strategy by seeking new suppliers with competitive prices and quality. For contingency supply of engine blocks, Yuchai has a long term purchase agreement with one domestic foundry.

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Quality Assurance, Control & Safety

All raw materials, external supplied parts and components are checked for conformity with the required quality and specifications. Each stage of the production process is monitored by a quality control procedure and the final product undergoes standard conformity and specification testing using automated testing laboratory.

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.

Manufacturing Capacity Expansions

Yuchai believes that the current production capacity of all engine lines will meet the expected demand in the short- term. Yuchai is continuously assessing the market demand and devising production strategies to secure market opportunities.

In early 2003, Yuchai started a capital expenditure program to increase the production capacity of heavy-duty engines by 20,000 units per year. This expansion included a new foundry that manufactured engine blocks and cylinder heads to reduce Yuchai s reliance on imports and thus reducing the overall cost of the product.

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 supply of these spare parts.

Research and Development

Yuchai has committed substantial resources to continually improve the technology of its products and maintain the competitiveness of its products. Yuchai s internal development effort focuses primarily on designing new products, improving manufacturing processes and adapting foreign technology to the Chinese market. Yuchai has committed 3% of its revenue annually to continually improve the technology of its products. In addition, Yuchai 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, 2006, Yuchai employed over 495 engineers, approximately 19 of whom held engineering doctorates and 172 were devoted to research and development, product enhancement and new designs while the remaining were in the production department and after sales service. As of December 31, 2007, Yuchai employed over 617 engineers, approximately 298 of whom were devoted to research and development, product enhancement and new designs while the remaining were in the production department and after sales service. In 2004, 2005 and 2006, Yuchai spent approximately Rmb 137.0 million, Rmb 123.8 million and Rmb 167.7 million (US$24.4 million), respectively, on research and development. Yuchai 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. The increase in research and development costs in 2006 is mainly due to higher expenditures relating to Yuchai s engine development of Euro III and IV compliant engines. In 2007, Yuchai s research and development efforts were focused on the development of new products such as heavy duty engines 6T and 6K and Euro V prototype products.

Future Products

Yuchai believes that China s automotive industry is a growth sector. Yuchai s long-term business prospects will largely depend upon its ability to develop and introduce new or improved products with higher quality and competitive pricing. Future products may utilize different technologies and may require knowledge of markets that Yuchai does not currently possess.

Presently, 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 dependence to continue. The introduction of new diesel engine products will also require significant capital expenditures, such as purchases of foreign manufacturing equipment and technologies.

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Sales, Marketing and Services

Sales and Marketing

Yuchai distributes most of its engines directly to auto plants and agents from its primary manufacturing facilities in Yulin City. In addition, Yuchai operates a number of regional offices in major geographic regions in China. With a sales force of approximately 800 persons nationwide in China, 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 Month, 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 routine maintenance check and 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. Yuchai further believes that it leads its competitors in providing high quality after-sales services by its more than 1,200 service stations which are able to provide emergency services to its end-users within a 40-km radius in central, eastern and southern part of China.

Advertising expenses decreased by 6.0% to Rmb 42.6 million (US$6.3 million) in 2006 from Rmb 45.3 million in 2005 due to a change in focus to more public-relations related activities and on the quality of after-sales services. Sales commissions decreased to Rmb 32.2 million (US$4.7 million) in 2006 compared to Rmb 39.4 million in 2005 due to the discontinuing of sales commissions to Yuchai s dealers on certain types of 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:

	2004			2005			2006			2007
	Sales Revenue Rmb (in thousands)	% of Sales Revenue	Unit Sales	Sales Revenue Rmb (in thousands)	% of Sales Revenue	Unit Sales	Sales Revenue Rmb (in thousands)	% of Sales Revenue	Unit Sales	Unit Sales
Total Domestic Sales	5,518,582	98.86%	204,812	5,703,360	98.05%	226,073	6,893,551	99.6%	282,516	382,410
Total Export Sales	63,513	1.14%	1,816	113,380	1.95%	4,155	26,977	0.4%	1,067	870
	5,582,095	100.0%	206,628	5,816,740	100.0%	230,228	6,920,528	100.0%	283,583	383,280

Vietnam, Saudi Arabia, Taiwan, Cuba and Kazakhstan (in descending order) represented Yuchai s top five export markets in 2005 in terms of unit sales. In 2006, the top five export markets of Yuchai (in descending order) are Vietnam, Cuba, Egypt, Algeria and Malaysia. In particular, Yuchai exported 510, 339 and 700 diesel engine units to Cuba in 2004, 2005 and 2006, 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. In 2007, the top five export markets of Yuchai (in descending order) are Cuba, Vietnam, Russia, Egypt and Saudi Arabia.

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 28.8% and 19.8% of Yuchai s total net revenues in 2004 and 2005, respectively. In 2006, the Dongfeng Group accounted for 21.7% of total net revenues, of which our two largest customers, Liuzhou Dongfeng Automobile and Hubei Dongfeng Automobile, accounted for 9.9%. 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 our total current assets as of the same date. As of December 31, 2005, Yuchai had net trade accounts receivable of Rmb 1,178.9 million, representing 27.9% of our consolidated current assets as of the same date. As of December 31, 2006, Yuchai had net trade accounts receivable of Rmb 1,480.9 million (US$215.9 million), representing 34.3% of our consolidated 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 in China 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 s warranty obligations vary depending upon the warranty type and such provisions are determined at fiscal year end based upon 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. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Product Warranty Obligations.

In March 2004, at the State Holding Company s initiative, Yuchai established a new company, Yuchai Express Guarantee Company Limited, or YEGCL, which provides credit guarantee to Yuchai s customers to purchase trucks that are mounted with Yuchai s diesel engines. Yuchai 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 and is currently continuing to provide service for the outstanding guarantee obligations to its existing customers until such obligations terminate but has ceased to provide new guarantees after 2006 to any new customers.

Trademarks

The State Holding Company owns and maintains Chinese trademark registrations of its principal trademarks. Yuchai uses these trademarks with the consent of the State Holding Company at no charge and Yuchai believes that the Yuchai logo is well recognized as a quality brand in China. As Yuchai currently sells most of its products in the China domestic market, registration of its principal trademarks is not maintained in countries outside China. The State Holding Company 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 in China of over 1,124 authorized service stations and 18 repair training centers, gives Yuchai a competitive advantage over other diesel engine producers.

Most of Yuchai s major China 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 some of Yuchai s other major customers. In 2006, sales to the Dongfeng Group accounted for 21.7% of our total net revenues, of which our two largest customers, Liuzhou Dongfeng Automobile and Hubei Dongfeng Automobile, accounted for 9.9%. 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. Yuchai believes that its current production capacity is adequate to meet expected higher demand from and unit sales to 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 6108 engine exceeded unit sales of the 6105 engine. However, unit sales of the 6108 engines was lower than 6105 engines in 2005, 2006 and 2007 due to poor market demand for the more expensive 6108 engines as a result of the more stringent Euro III environmental compliance standards and competition. 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 China domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is relatively price sensitive. Yuchai intends to continue to manufacture its 6112 heavy-duty diesel engines although there has been a decline in unit sales in 2005 and 2006 mainly due to changes in customers demand to light-duty diesel engines. In 2006, the sales volume of the 6112 engine was 14,150 units, 4.3% lower than the 14,788 units sold in 2005 which was 38.6% lower than the 24,073 units sold in 2004. In 2007, the sales volume of the 6112 engine was approximately 12,700 units, approximately 10.2% lower than 2006. This trend is 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. In 2006 and 2007, the demand for 6112 engines was also adversely affected by the trend of truck owners moving to higher horsepower engines in order to maximize the haulage of each trip and reduce the operating cost per trip. This trend is a result of the improved highway system after heavy investment by the Chinese government in infrastructure building. 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 Weichai 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 market leader in the short-term.

As the Chinese automotive industry develops, Yuchai will have to continuously improve its existing engine products, develop new diesel engine products and enter into other market segments 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 as well as the success of any entry into new market segments. 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 or any delay or failure to enter into other market segments could have a material adverse effect on the financial condition, results of operations, business or prospects of Yuchai.

Government policies on import tariffs and restrictions affect our business. For example, reduction in import restrictions and/or lower tariffs may lead to increased imports of foreign diesel engines and, therefore, to increased competition in the China 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 possible strategic joint ventures to develop and manufacture new diesel engines.

The HLGE group

As of December 31, 2006 and June 30, 2008, we had a 45.4% interest in the outstanding ordinary shares of HLGE. See Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan.

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HLGE is listed on the Main Board of the Singapore Exchange. HLGE s share price on the Singapore Exchange closed at S$0.15 on June 30, 2008. The core businesses of the HLGE group are that of hospitality operations and property development. One of the key areas of focus in HLGE s expansion plans will be the serviced apartment sector, which is a subset of the hospitality business.

Investment holding activities

The HLGE group owns an investment property known as Wisma LKN in Johor Bahru, Malaysia.

Hospitality operations

The HLGE group, through its joint venture companies, owns a number of Equatorial hotels in Shanghai, PRC, and Cameron Highlands, Malaysia, and a Copthorne hotel in Qingdao. The HLGE group also owns a service apartment building in Shanghai. It also manages, among other things, these hotels in Qingdao, PRC, and Cameron Highlands, Malaysia. A more detailed description of the various hotel properties is set out below:

Hotel Equatorial Shanghai

Hotel Equatorial Shanghai is located in the heart of Shanghai. The property has more than 500 saleable guest rooms which have all been fully refurbished over the last 18 months and a new lounge. Other facilities comprise six food and beverage outlets, ballroom space and a health club.

Copthorne Hotel, Qingdao

The property is located in the commercial district of Qingdao. The property has approximately 450 saleable guest rooms, and has restaurants and bars, ball rooms and function rooms, entertainment facilities, offices and retail space.

Changning Equatorial Service Apartments

The property comprises a 16-storey building located in the downtown Shanghai. The property has approximately 125 apartment units, a self-service launderette, meeting rooms and a business centre.

Hotel Equatorial Cameron

The property is a tudor styled resort comprising more than 100 self-contained low-rise and high-rise units. Each suite is equipped with a living room, a kitchenette and a balcony. The hotel tower comprises 270 saleable guest rooms.

Renovation and maintenance. To maintain the competitiveness of its hotels and to improve guests stay experience, HLGE carries out renovation programs at its hotels from time to time as required.

The TCL group

The TCL group is a distributor of consumer electronic products with operations mainly in the PRC (including Hong Kong). TCL is also involved in providing electronic manufacturing services, ranging from basic contract manufacturing to full turnkey projects and creating state-of the-art technology products. We had a 36.6% interest in the outstanding ordinary shares of TCL as of December 31, 2006. As of June 30, 2008, we had a 34.4% interest in the outstanding ordinary shares of TCL as a result of issuance of additional ordinary shares by TCL pursuant to the exercise of options and convertible securities.

TCL announced in May 2008 that it plans to reposition its principal business from consumer electronics distribution to real estate and related infrastructure investment in the pan-Asian region. TCL also announced that TCL may divest those assets that will no longer form part of the core activity of the Company going forward. This plan is subject to TCL receiving any required regulatory and shareholders approvals. There is no assurance that such approvals will be obtained. Even if such approvals are obtained, there is no assurance that this repositioning of TCL s business will be successful or profitable.

Third party branded products

The TCL group is engaged in the distribution of a portfolio of branded consumer electronics products, such as Panasonic, Creative, Casio, Apple, Asus, Fuji, Kodak, Lenovo, Olympus, Pentax, Samsung, Sony, Trust and Canon. Some of the products that the TCL group markets under these brand names include digital video cameras, digital still cameras, and audio products like MPEG Audio Layer 3 MP3 players, plasma televisions, desktop and notebook computers, personal digital assistants and digital video discs home entertainment software.

Proprietary branded products

The TCL group has created and marketed consumer products under its own brand name, namely YES brand, which is associated with a range of MP3 players and accessories compatible with the iPod, liquid crystal display televisions, portable DVD players, digital photo frames and memory cards.

Distribution network

The TCL group has distribution and sourcing network in its principal markets of PRC and Hong Kong and is also building up a distribution network in India and Indochina where demand for consumer electronics is increasing. The TCL group is planning its own chain of retail stores to further bring its suppliers closer to its end customers.

Competition

The consumer electronics sector in China is extremely competitive. The TCL group has a dual focus on expanding sales and controlling costs and plans to continue to widen its product and brand portfolio and its diversification efforts.

Other businesses

The TCL group also has other business activities relating to contract manufacturing, property development and investment in the PRC.

Organizational Structure

The following chart illustrates the organizational structure of the Company and Yuchai as of May 30, 2008, and is based on information generally known to the 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 relevant PRC laws and regulations with respect to labor management. In accordance with these laws and 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 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, or PRC GAAP. However, the allocation of statutory reserve fund will not be further required once the accumulated amount of such fund reaches 50.0% 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, we believe affiliates of the State Holding Company caused various Chinese government agencies to raise allegations of irregularities regarding the status of our ownership of and rights of control over Yuchai, which we believe was intended to try to limit our rights to exercise control over Yuchai. We further believe that such allegations were based on an inaccurate understanding of the structure of our ownership of and rights of control over Yuchai. We also believe that Yuchai s ownership structure has been validly approved by the relevant Chinese authorities, and that the shares of Yuchai held by our six wholly-owned subsidiaries are legally and validly held under Chinese law. We have obtained legal opinions from two Chinese law firms confirming these matters (see the reports on Form 6-K filed by the Company with the SEC on April 1, 2005). We have also taken steps to communicate to the relevant Chinese government agencies the reasons for our position with respect to these matters. We believe the July 2003 Agreement, the Reorganization Agreement, as amended, and the Cooperation Agreement, when fully implemented will resolve the issues raised by the various Chinese governmental agencies relating to our share ownership in Yuchai and the continued corporate governance and other difficulties which we have had from time to time with respect to Yuchai. Based upon the above-mentioned legal opinions, we believe that in the event of a future dispute with the Chinese stakeholders at Yuchai, we expect to pursue as appropriate legal remedies in appropriate jurisdictions to seek to enforce our legal rights as the majority shareholder with a controlling financial interest in Yuchai to protect our investment for our benefit and the benefit of our shareholders. See also Item 3. Key Information Risk Factors.

Property, Plant 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 a number of regional sales offices in China. 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. In 2006 and 2007, production capacity was approximately 325,000 and 400,000 units, respectively, based on 2.5 shifts five-day week.

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 resulting from its production of diesel engines. The PRC emission standard equivalent to Euro III is expected to be implemented progressively throughout China from 2008. Yuchai believes it will be able to comply with the new standard. See Risk Factors We may be adversely affected by environmental regulations.

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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.

ITEM 4A. UNRESOLVED STAFF COMMENTS.

As of the date of filing of this Annual Report, we have no unresolved comments from the SEC.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS.

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the related notes included elsewhere in this Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause future results to differ significantly from those projected in the forward-looking statements include, but are not limited to, those discussed below and elsewhere in this Annual Report. Our consolidated financial statements are prepared in conformity with US GAAP.

On May 30, 2008, the Company filed an amendment to its annual report on Form 20-F for the year ended December 31, 2005 containing the restated financial statements as of and for the year ended December 31, 2005 to reflect certain adjustments to correct accounting errors mainly at Yuchai for such period.

During the fiscal years ended December 31, 2004, 2005 and 2006, our main asset has been our 76.4% ownership interest in Yuchai. As a result, our financial condition and results of operations have depended primarily upon Yuchai s financial condition and results of operations. Our 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.

Business Expansion and Diversification Plan

Following the implementation of our business expansion and diversification plan, we have looked for new business opportunities to seek to reduce our financial dependence on Yuchai.

Thakral Corporation Ltd (TCL)

The first step in implementing this plan occurred in March 2005 when through our wholly-owned subsidiary, Venture Delta, we acquired a 15.0% interest in TCL for a consideration of approximately S$30.9 million. In September 2005, Venture Delta acquired an additional 1.0% interest in TCL for a consideration of S$1.4 million. As a result, we held a 16.0% stake in TCL as of December 31, 2005.

In February 2006, we increased our interest in TCL to 19.4% through an acquisition by Venture Delta of ordinary shares and convertible bonds of TCL pursuant to a rights issue by TCL for an aggregate cash consideration of approximately S$49.4 million (approximately US$36.3 million). Venture Delta converted all of its TCL convertible bonds into TCL ordinary shares in August 2006 and, as a result of the conversion, triggered the mandatory conditional cash offers under The Singapore Code on Take-over and Mergers for all of the TCL ordinary shares and TCL bonds which Venture Delta did not already own, control or agree to acquire. The mandatory offers lapsed on October 20, 2006 and no securities were purchased by Venture Delta.

As of December 31, 2006, our interest in TCL was 36.6% of TCL s outstanding ordinary shares and our aggregate investment in TCL amounted to approximately S$81.7 million (approximately US$60.0 million), before taking into account dividends and interest income of approximately

S$1.9 million (approximately US$1.4 million), in the aggregate, earned from these investments. As of June 30, 2008, our interest in TCL was 34.4% of TCL s outstanding ordinary shares as a result of issuance of additional ordinary shares by TCL pursuant to the exercise of options and convertible securities.

We continue to account for our investment in TCL using the equity method and we have continued to reflect our proportionate share of the TCL group s results in our consolidated statement of operations since March 2005.

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HL Global Enterprises Limited (formerly known as HLG Enterprise Limited) (HLGE)

In February 2006, through the following wholly-owned subsidiaries, we also acquired debt and equity securities in HLGE for an aggregate consideration of approximately S$132 million (approximately US$96.7 million):

(a) Grace Star acquired

i. 191,413,465 ordinary shares representing approximately 29.1% of the total number of HLGE s ordinary shares at that time,

ii. 15,376,318 Series A redeemable convertible preference shares in the capital of HLGE, or the Existing HLGE RCPS A. The Existing HLGE RCPS A are mandatorily redeemable by HLGE upon the disposal of certain properties and upon any new issue of HLGE ordinary shares with the purpose of raising funds for the redemption of Existing HLGE RCPS A. Any outstanding Existing HLGE RCPS A will be mandatorily redeemed in March 2015. The Existing HLGE RCPS A can also be converted into ordinary shares at the conversion ratio of 1:1 upon the passing of a special resolution at a meeting of the holders of Existing HLGE RCPS A at any time prior to March 2015.

iii. 107,634,237 Series B redeemable convertible preference shares in the capital of HLGE, or the Existing HLGE RCPS B (and together with the Existing HLGE RCPS A, the Existing HLGE RCPS). The Existing HLGE RCPS B are neither mandatorily redeemable nor redeemable at the option of the Company. Any Existing HLGE RCPS B, which are not redeemed prior to March 2010, are mandatorily converted to ordinary shares at the conversion ratio of 1:1 in March 2010. The Existing HLGE RCPS B are redeemable upon the disposal of certain properties and upon any new issue of HLGE ordinary shares with the purpose of raising funds for the redemption of Existing HLGE RCPS B. The Existing HLGE RCPS B can also be converted into ordinary shares at the conversion ratio of 1:1 upon the passing of a special resolution at a meeting of the holders of Existing HLGE RCPS B at any time prior to March 2010.

(b) Venture Lewis acquired approximately S$129.4 million (approximately US$95.1 million) in principal amount of outstanding secured non-convertible bonds issued by HLGE, or the Existing HLGE Bonds.

In June and December of 2006, HLGE partially redeemed a portion of Existing HLGE RCPS A and Existing HLGE RCPS B as required by the terms of the preference share agreement as a result of the disposals of certain assets. The proceeds from the partial redemptions amounted to S$2.4 million (approximately US$1.6 million) and resulted in a reduction in the number of Existing HLGE RCPS that we held from 123,010,555 to 113,159,191.

In July 2006, pursuant to a rights issue by HLGE, through Grace Star and Venture Lewis, respectively, we were allotted 196,201,374 non-redeemable convertible cumulative preference shares, or the New HLGE NCCPS, and S$130,800,917 in principal amount of zero coupon unsecured non-convertible bonds due 2009 in HLGE, or the New HLGE Bonds, for an aggregate consideration of approximately S$135 million (approximately US$99.0 million). In conjunction with the allotment, the Existing HLGE Bonds were redeemed by HLGE at their principal value of S$129.4 million. At settlement, the aggregate consideration payable by the Company to HLGE of S$134.7 million was partially offset against S$129.4 million payable by HLGE to the Company, and the balance of S$5.3 million (approximately US$3.9 million) was paid by the Company in cash.

In November 2006, Grace Star converted all of its 196,201,374 New HLGE NCCPS into HLGE ordinary shares resulting in an increase in its equity interest in HLGE from 29.1% to 45.4% thereby triggering the mandatory conditional cash offers under The

Singapore Code on Take-over and Mergers for all the HLGE ordinary shares, the Existing HLGE RCPS and the New HLGE NCCPS which Grace Star did not already own, control or agree to acquire. The mandatory offers lapsed on December 27, 2006 and no securities were purchased by Grace Star.

As of December 31, 2006, we held (i) 387,614,839 HLGE ordinary shares, representing approximately 45.4% of the total number of HLGE ordinary shares; (ii) 113,159,191 Existing HLGE RCPS; and (iii) S$130,800,917 in principal amount of the New HLGE Bonds. Our aggregate investment in HLGE to-date amounted to approximately S$136.9 million (approximately US$100.6 million), before taking into account previous interest income earned from these investments and partial redemption of the Existing HLGE RCPS of approximately S$6.7 million (approximately US$4.9 million) in the aggregate.

In June 2007, HLGE made a partial redemption of the New HLGE Bonds. The redemption amount we received amounted to approximately S$17.9 million (approximately US$13.2 million) and resulted in a reduction in the principal amount of the New HLGE Bonds that we held from S$130,800,917 to S$112,886,727.

In April 2008, HLGE made an additional partial redemption of the Existing HLGE RCPS. The redemption amount we received amounted to approximately S$0.98 million (approximately US$0.7 million) on April 30, 2008 and resulted in a reduction in the number of Existing HLGE RCPS that we held from 113,159,191 to 107,186,403.

We account for our investment in HLGE ordinary shares using the equity method and have reflected our proportionate share of the HLGE group s results in our consolidated statement of operations since February 2006.

Assuming the full conversion of the Existing HLGE RCPS B held by Grace Star, which would trigger the full conversion of the Existing HLGE RCPS B by the other holders of the Existing HLGE RCPS B, and assuming that none of the other holders of the New HLGE NCCPS convert their New HLGE NCCPS, our interest in HLGE would increase from 45.4% as of June 30, 2008 to 51.4%.

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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 2006.

With continued rapid economic growth, domestic commercial vehicle market sales rebounded in 2006 and our net revenues in 2006 increased by 19.0% to Rmb 6,920.5 million (US$1,009.0 million) compared to Rmb 5,816.7 million in 2005. This increase was primarily a result of higher unit sales of the 4-Series light-duty diesel and industrial engines. We had income before minority interests of Rmb 172.9 million (US$25.2 million) in 2006 compared to loss before minority interests of Rmb 35.2 million in 2005. Sales of the 6108 medium-duty and 6112 heavy-duty engines accounted for 14.3% and 10.5%, respectively, of our net revenues in 2006. Sales of the 6L and 6M heavy-duty diesel engines accounted for 1.4% and 3.9%, respectively, of our net revenues in 2006. 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 average selling price of these light-duty diesel and industrial engines are lower than the medium and heavy-duty engines. The overall gross margin of 18.4% for 2006 was lower than the 19.7% gross margin of 2005 mainly due to competition, product sales mix and higher raw material costs. Yuchai generated 32.1% and 26.7% of our net revenues in 2006 and 2005, respectively, from the lower margin light-duty diesel engines, and 54.7% and 60.7% of our net revenues in 2006 and 2005, respectively, from the higher margin medium-duty and heavy-duty diesel engines.

In 2006, we continued our efforts to control production costs and operating expenses. However, the costs and expenses related to the production of our diesel engines are not subject to significant variations which limits our ability to significantly reduce our costs and expenses. Our cost of goods sold mainly includes cost of materials consumed, factory overhead, direct labor provision for product warranty and depreciation. We analyze our cost of goods sold based on our 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 2006, cost of materials consumed accounted for approximately 84.1% of the cost of manufacturing. Our selling, general and administrative, or SG&A, expenses include advertising expenses, salaries and wages, freight charges, sales commission expenses and a large number of smaller expenses.

We had effective income tax rates of 14.0%, (40.0)% and 15.0% in 2004, 2005 and 2006, 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 2008, Yuchai has fulfilled the requirements to qualify for the reduced tax rate of 15%, although pending approval of the tax authority, which we have assessed to be more than probable. In the event that this is not approved, Yuchai will be subject to tax at a rate of 18%. Some of Yuchai s subsidiaries were subject to tax at a rate of 33% which has been lowered to 25% with effect from January 1, 2008 as these are registered PRC companies. 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 if these dividends are derived from revenues accumulated before January 1, 2008. Under the New Income Tax Law and the Implementation Rules in China, the dividends that are derived from revenues accumulated from and after January 1, 2008, could be subject to a PRC withholding tax levied at a rate of 10% unless exempted or reduced pursuant to an applicable double-taxation treaty or other exemptions. See Item 10. Additional Information Taxation People s Republic of China Taxation.

Yuchai 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, Yuchai was not able to benefit from the competitive advantages of an early entry into the China 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, 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 2006 due mainly to changes in customers demand to light-duty diesel engines. In 2006 and 2007, the sales volume of the 6112 engine were 14,150 units and approximately 12,700 units, which was 4.3% lower than 14,788 units in 2005 and approximately 10.2% lower than in 2006 respectively, 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. In 2006 and 2007, the demand for 6112 engines was also adversely affected by the trend of truck owners moving to higher horsepower engines in order to maximize the haulage of each trip and reduce the operating cost per trip. This trend is a result of the improved highway system after heavy investment by the Chinese government in infrastructure building. 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 Weichai Power Co., Ltd.) or any new entrants.

Our future financial condition and results of operations could also be adversely affected as a result of China macroeconomic policy changes by the Chinese government. The Chinese government has from time to time introduced 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 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.

Economic growth in China has been accompanied by periods of high inflation resulting in higher prices of raw materials. A further increase in inflation could lead to a further rise in the prices of raw materials required by us. See Item 3. Key Information Risk Factors Risks relating to our company and our business If China s inflation worsens or the prices of energy or raw materials continue to rise, we may not be able to pass the resulting increased costs to our customers and this may adversely affect our profitability or cause us to suffer operating losses .

We may use borrowings from time to time to supplement our working capital requirements and to finance our business expansion and diversification plan. A portion of our borrowings may be structured on a floating rate basis and denominated in US dollars or other foreign currencies. An increase in fluctuations in exchange rates between the Renminbi and other currencies may increase our borrowing costs. See Item 3. Key Information Risk Factors Risks relating to our company and our business 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 .

Critical Accounting Policies

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

Certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations and require the application of significant assumptions and estimates by our management. We refer to these accounting policies as our critical accounting policies. Our management uses our historical experience and analyses, the terms of existing contracts, historical cost convention, industry trends, information provided by our agents and information available from other outside sources, as appropriate, when forming our assumptions and estimates. However, this task is inexact because our 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 we believe that all aspects of our consolidated financial statements should be studied and understood in assessing our current expected financial condition and results, we believe 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;
- recoverability of the carrying values of equity method investments and other investments;

realization of deferred tax assets;

impairment of long-lived assets; and

provision for loss contingency for guarantees granted by YEGCL.

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. Management determines the allowance based on historical write-off experience by industry and national economic data. Management reviews its allowance for doubtful accounts monthly. In 2005, management examined the debtors ageing report and noted that there was a significant change in the amounts owing by one of its major customers, the Dongfeng Group. For the year ended December 31, 2006, the Dongfeng Group accounted for about 22% of the trade debtors outstanding as compared to approximately 12% as of December 31, 2005. Likewise, the top 20 non-Dongfeng Group customers had decreased their significance in our sales and accounted for about 43.3% of the gross accounts receivable at the end of 2006 from 44% at the end of 2005. We analyzed our customer s trends, repayment patterns and ageing analysis in 2006. The balances that were past due 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.

Changes in the allowances for doubtful accounts for each of the years in the three-year period ended December 31, 2006 are summarized as follows:

	December 31,			
	2004	2005	2006	2006
	Rmb	Rmb	Rmb	US$
	(in thousands)			
Balance at beginning of year	94,423	107,457	69,047	10,066
Add: Charged to consolidated statements of operations	13,034	25,587	21,582	3,146
Less: Doubtful accounts written off		(63,997)	(264)	(38)
Balance at end of year	107,457	69,047	90,365	13,174

We believe that the present level of our allowance for doubtful accounts 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 our allowance. If economic or specific industry trends change, we would adjust our allowance for doubtful accounts by recording additional expense or benefit. A decrease or increase of 5.0% in historical allowances for doubtful accounts experience over the last three fiscal years would impact the provision for doubtful accounts by approximately Rmb 1.0 million (US$0.2 million).

Realization of the carrying value of inventories

Our inventories are valued at the lower of cost or net realizable value as of 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 net realizable values of the inventories may change and result in further inventory write-downs. In the preceding three years, there were no significant inventory write-downs.

Product warranty obligations

We accrue a liability for estimated future costs to be incurred under a warranty period or warranty mileage on various engine models, for which we provide 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 first achieved. Provisions for warranty are primarily determined based on historical warranty cost per unit of engine sold adjusted for specific conditions that may arise and the number of engines under warranty at each fiscal year end.

Changes in the accrued product warranty liability for each of the years in the three-year period ended December 31, 2006 are summarized as follows:

	December 31,			
	2004 Rmb	2005 Rmb	2006 Rmb	2006 US$
	(in thousands)			
Balance at beginning of year	101,215	126,114	142,126	20,721
Add: Provision charged to consolidated statements of operations	190,205	179,184	200,892	29,288
Less: Amounts utilized	(165,306)	(163,172)	(179,317)	(26,143)
Balance at end of year	126,114	142,126	163,701	23,866

We recognized a liability for warranty at the time the product is sold and our estimate of our warranty obligations is re-evaluated on an annual basis. In previous years, warranty claims have typically not been higher than the relevant provisions made in our consolidated balance sheet. If the nature, frequency and average cost of warranty claims change, we would adjust our 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. A decrease or increase of 5.0% in historical utilization experience over the last three fiscal years would impact the provision for product warranty by approximately Rmb 8.5 million (US$1.2 million).

Recoverability of carrying values of equity method investments and other investments

We assess impairment of our investments in affiliates when adverse events or changes in circumstances indicate that the carrying amounts may not be recoverable. If the value of our investment is below its carrying amount and that loss in value is considered other than temporary, then an impairment charge is recognized. As of December 31, 2006, the Company s carrying value of its equity method investments in TCL and HLGE were S$76.3 million (US$56.1 million) and S$23.2 million (US$17.0 million), respectively. The fair value, based on the quoted market prices, of the TCL ordinary shares and the HLGE ordinary shares held by the Company was S$80.9 million (US$59.5 million) and S$32.9 million (US$24.2 million), respectively, as of December 31, 2006.

We recognise an impairment loss when the decline in fair value below the carrying value of an available-for-sale or cost-method investment is considered other than temporary. In determining whether a decline in fair value is other than temporary, we consider various factors including market price of underlying holdings when available, investment ratings, the financial conditions and near term prospect of the investee s, the length of time and the extent to which the fair value has been less than cost and the Group s intent and ability to hold the investment for a reasonable period of time sufficient to allow for any anticipated recovery of the fair value. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for fair values of investments.

Realization of deferred tax assets

Deferred tax assets are reduced by a valuation allowance to the extent that we conclude it is more likely than not that the assets will not be realized. 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 can be utilized. Our 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 estimates used in determining the valuation allowances could result in future adjustments to the allowance. The realization of the deferred tax assets is subject to the various local tax regulations and not solely dependent on generating future taxable income. For example, tax credits relating to the purchase of China 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 China domestic equipment was purchased. Tax credits may also have a validity period. It is therefore possible that a subsidiary has taxable income but is unable to utilize a tax credit. Deferred tax assets relating to tax losses incurred by certain subsidiaries that are not likely to be realized in the future are considered in connection with the assessment for valuation allowance. Based upon the results of prior years taxable income and forecasts for future taxable income over the next five years in which the tax credits are deductible and tax losses carried forward, we believe we will realize the benefits of only some of these deductible differences and tax losses carried forward as of December 31, 2006. For the years ended December 31, 2005 and 2006, we concluded that a deferred tax asset valuation allowance of Rmb 45.2 million and Rmb 38.7 million (US$5.6 million), respectively, was necessary. The valuation allowances were primarily for tax credits that we believe will expire unused and deferred tax assets of a loss-making subsidiary that we believe will not be realized. This resulted in a valuation allowance charged to expense of Rmb 45.2 million in 2005, which was reduced by Rmb 6.5 million (US$0.9 million) in 2006. The reduction in 2006 arises from the reversal of a valuation allowance for deferred tax assets of a subsidiary that was previously loss-making and assessed to be realizable in 2006.

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.

We periodically conduct an impairment review on the conditions of the property, plant and equipment. In 2004, we did not identify any circumstances indicating that the carrying value of the property, plant and equipment may not be recoverable, and hence no impairment loss was recognized. In 2005, it was determined that certain fixed assets of Yuchai were idle or other factors existed that suggested that the recovery of their respective carrying values may have been impaired. An impairment loss of Rmb 4.9 million was charged to the consolidated statement of operations in 2005 under selling, general and administrative expense. In 2006, an impairment analysis was performed and the estimated undiscounted future cash flows generated from certain property, plant and equipment were less than their carrying value. Hence, an impairment loss of Rmb 2.3 million (US$0.3 million) was recognized and included in selling, general and administrative expenses in 2006.

Provision for loss contingency for guarantees granted by YEGCL

YEGCL provides guarantees of loans granted by commercial banks in the PRC to unrelated third-party individuals who have obtained the loans to purchase automobiles equipped with diesel engines produced by Yuchai. During the years ended December 31, 2004, 2005 and 2006, YEGCL guaranteed borrowings of Rmb 7.4 million, Rmb 153.5 million and Rmb 89.0 million (US$13.0 million), respectively. YEGCL did not issue any such guarantees prior to 2004. The guarantees cover the entire principal amount of the loan, which generally has a term of one to two years with equal monthly or quarterly installment payments by the borrower. The guarantees are secured by cash deposits from the individuals to YEGCL and by the automobile. In the event of defaults on payment, YEGCL would be required under its guarantee to make payments to the banks on behalf of the borrowers. On a monthly basis, management reviews its guarantee portfolio with regard to loans in default one month or more. On an individual basis, management then evaluates those loans in default against the security held in the form of cash deposits and the estimated recovery value of the automobile to determine the need for additional provision for estimated losses on guarantees.

In return for issuing the guarantee, YEGCL receives a premium fee ranging from 2% to 8% of the loan amount for the years ending December 31, 2005 and 2006, respectively, which is considered to be the fair value of YEGCL s guarantee at its inception and is recorded as a liability in accordance with the provisions of FIN 45. YEGCL received Rmb 0.2 million, Rmb 4.3 million and Rmb 4.3 million (US$0.6 million) of premium fees in 2004, 2005 and 2006, respectively, which are recognized as revenue on a straight line basis over the terms of the respective guarantee. Guarantee fees recognized as revenue in 2004, 2005 and 2006 amounted to Rmb 0.01 million, Rmb 1.2 million and Rmb 4.7 million (US$0.7 million), respectively. As of December 31, 2004, 2005 and 2006, deferred guarantee fee revenue amounted to Rmb 0.2 million, Rmb 3.3 million and Rmb 2.9 million (US$0.4 million), respectively.

Subsequent to initial measurement and recognition of the liability for YEGCL s obligations under these loan guarantees, management evaluates YEGCL s guarantee portfolio and accounts for potential loss contingencies associated with the guarantees based on the estimated losses resulting from known and expected defaults. As of December 31, 2005 and 2006, YEGCL had gross receivables of Rmb 3.3 million and Rmb 26.9 million (US$3.9 million), respectively, relating to payments made by YEGCL to the banks in conjunction with loans that were in default, and to be recovered from the individual borrowers. YEGCL recorded a bad debt allowance in the amount of Rmb 1.3 million and Rmb 12.5 million (US$1.8 million) leaving a net receivable amount of Rmb 2.0 million and Rmb 15.2 million (US$2.2 million) at December 31, 2005 and 2006, respectively.

As of December 31, 2005 and 2006, the maximum potential amount of future undiscounted payments YEGCL could be required to make under the guarantees was Rmb 134.2 million and Rmb 132.4 million (US$19.3 million), respectively. YEGCL held cash deposits of Rmb 6.9 million and Rmb 12.4 million as of December 31, 2005 and 2006, respectively, and security interests in automobiles with an aggregate initial purchase value of Rmb 242.2 million and Rmb 431.8 million as of December 31, 2005 and 2006, respectively. If, in the event of default the cash deposits and the amount of recoveries, if any, from repossession of the automobile may not entirely mitigate YEGCL s losses, YEGCL then accumulates the total expected risk against the total expected recoverable amount and provides for any expected shortfall. Accordingly, we recorded an accrual for potential losses associated with the guarantees in the amount of Rmb 12.3 million and Rmb 2.6 million (US$0.4 million) as of December 31, 2005 and 2006, respectively.

Results of Operations

The following table sets forth our consolidated statement of operations as a percentage of our net revenues for the last three fiscal years ended December 31, 2004, 2005 and 2006, respectively:

	Percentage of Net Revenues Year Ended December 31,		
	2004	2005	2006
Revenues, net	100.0%	100.0%	100.0%
Cost of goods sold	71.8%	80.3%	81.6%
Gross profit	28.2%	19.7%	18.4%
Research and development costs	2.5%	2.1%	2.4%
SG&A expenses	11.8%	13.6%	11.5%
Provision for uncollectible loans to a related party		3.5%	
Operating income	14.0%	0.4%	4.4%
Interest expense	0.6%	1.2%	1.7%
Equity in net losses of affiliates		0.1%	0.3%

Other income, net	0.1%	0.4%	0.5%
Earnings / (loss) before income taxes and minority interests	13.5%	(0.4)%	2.9%
Income taxes	1.9%	(0.2)%	(0.4)%
Income / (loss) before minority interests	11.6%	(0.6)%	2.5%
Minority interests in income / (loss) of consolidated subsidiaries	(2.8)%	0.1%	(0.9)%
Net income / (loss)	8.8%	(0.6)%	1.6%

2006 Compared to 2005

Net revenue increased by 19.0% to Rmb 6,920.5 million (US$1,009.0 million) in 2006 compared to Rmb 5,816.7 million in 2005. The increase in net revenue was primarily due to a 23.2% increase in sales volume, or 53,355 units, to 283,583 units in 2006 from 230,228 units in 2005. The higher unit sales in 2006 came mainly from the higher unit sales of the 4-Series light-duty engines sold in 2006 over 2005. In 2006, net revenues of the 4-Series light-duty diesel engines increased by approximately 43.3% as compared to 2005.

Cost of goods sold increased by 20.9% to Rmb 5,648.4 million (US$823.5 million) in 2006 from Rmb 4,673.4 million in 2005, and increased as a percentage of net revenues to 81.6% in 2006 from 80.3% in 2005. Cost of manufacturing increased by 20.6% to Rmb 5,447.5 million (US$794.2 million) in 2006 from Rmb 4,517.0 million in 2005, and increased as a percentage of net revenue to 78.7% in 2006 from 77.7% in 2005. Cost of materials consumed included in costs of manufacturing increased by 29.8% to Rmb 4,688.9 million (US$683.6 million) in 2006 from Rmb 3,612.6 million in 2005 (due to higher production throughput in 2006), while cost of materials consumed as a percentage of net revenue increased to 67.8% in 2006 from 65.5% in 2005. Factory overhead (which does not include depreciation and salaries) included in cost of manufacturing decreased by 11.8% to Rmb 360.7 million (US$52.6 million) in 2006 from Rmb 409.0 million in 2005, due to cost savings in consumables. Factory overhead as a percentage of net revenue decreased to 5.2% for 2006 from 7.0% for 2005. Depreciation and lease prepayments included in cost of manufacturing increased to Rmb 90.8 million (US$13.2 million) in 2006 from Rmb 87.0 million in 2005. Depreciation as a percentage of net revenue decreased from 1.6% in 2005 to 1.3% in 2006.

Gross profit increased by 11.3% to Rmb 1,272.1 million (US$185.5 million) in 2006 from Rmb 1,143.4 million in 2005. Gross profit margin (gross profit divided by net revenue) decreased to 18.4% in 2006 compared to 19.7% in 2005 due to competition, product sales mix and higher raw materials costs. Yuchai generated 32.1% of its net revenue from the lower margin light-duty engines in 2006 compared to 2005.

SG&A expenses (excluding research and development) increased by 1.1% to Rmb 801.8 million (US$116.9 million) in 2006 from Rmb 793.2 million in 2005 and decreased as a percentage of net revenue from 13.6% in 2005 to 11.5% in 2006. This increase in SG&A expenses was primarily due to higher administrative staff costs and audit fees.

Advertising expenses included in SG&A decreased by 6.0% to Rmb 42.6 million (US$6.3 million) in 2006 from Rmb 45.3 million in 2005. Advertising expenses as a percentage of net revenue decreased to 0.6% in 2006 from 0.8% in 2005. The decrease in advertising and promotion expenses is mainly due to greater economies of scale achieved with our main advertising partners.

Sales commission expenses included in SG&A expenses decreased by 18.3% to Rmb 32.2 million (US$4.7 million) in 2006 from Rmb 39.4 million in 2005. Sales commission expenses as a percentage of net revenue decreased to 0.5% in 2006 from 0.7% in 2005. The decrease in sales commissions is mainly due to the discontinuing of sales commissions to its dealers on certain types of engines.

Included in the 2005 consolidated statement of operations is a provision for non-trade loans to a related party of Rmb 203.0 million. See Note 5 to our consolidated financial statements. There is no such provision made in 2006. Salaries and wages as a percentage of net revenues was 8.9% in 2006 and 7.9% in 2005. As a result of the foregoing, profits from operations increased to Rmb 304.5 million (US$44.4 million) in 2006 compared to Rmb 26.0 million in 2005.

Interest expense increased to Rmb 117.5 million (US$17.1 million) in 2006 from Rmb 70.5 million in 2005, primarily due to the higher working capital loans utilized by Yuchai and the bank loans obtained by the Company to finance the Company s acquisition of its interest in HLGE and TCL in 2006.

Equity in losses of affiliates increased from Rmb 6.0 million in 2005 to Rmb 22.4 million (US$3.3 million) in 2006. The 2005 loss relates solely to our share of equity in the loss of TCL. In 2006, our share of equity in the loss of TCL increased to Rmb 23.9 million (US$3.5 million) as a result of higher net loss recorded by TCL as it continued to face heavy competition in its principal markets and losses from discontinued operations. Our share of the equity in the income of HLGE was Rmb 1.4 million (US$0.3 million) in our 2006 results.

Other income, net increased to Rmb 38.9 million (US$5.7 million) in 2006 from Rmb 25.4 million in 2005. This increase is mainly attributable to (i) Rmb 25.2 million (US$3.7 million) of interest income on TCL bonds and HLGE bonds acquired in 2006 compared to nil in 2005; (ii) Rmb 28.5 million (US$4.1 million) gain on redemption of debt and equity securities of TCL and HLGE compared to nil in 2005; and (iii) Rmb 10.5 million interest income collected on the Rmb 205 million loan; and offset by (a) Rmb 3.6 million (US$0.5 million) loss on changes in fair values of derivatives that were embedded in some of these securities in 2006 compared to nil in 2005; and (b) exchange losses of Rmb 41.9 million (US$6.1 million) mainly arising on Singapore dollar denominated loans.

Earnings before income taxes and minority interests in 2006 were Rmb 203.4 million (US$29.7 million), as compared to a loss before income taxes and minority interests of Rmb 25.1 million in 2005.

Income tax expense in 2006 was Rmb 30.5 million (US$4.4 million) compared to income tax expense of Rmb 10.1 million in 2005. Yuchai was subject to PRC income tax at a rate of 15.0% in both 2005 and 2006. Our effective tax rates were (40.0)% and 15.0% for 2005 and 2006, respectively. The higher effective tax rate in 2005 was due to higher non-deductible expenses, while in 2006 the reversal of a valuation allowance for deferred tax assets that were previously believed to be non-recoverable and the higher amount of estimated recoverable tax credits generated contributed to the lower rate.

As a result of the foregoing factors, we had profit before minority interests of Rmb 172.9 million (US$25.2 million) in 2006 compared to loss before minority interests of Rmb 35.2 million in 2005, and a net income of Rmb 111.3 million (US$16.2 million) in 2006 compared to a net loss of Rmb 32.3 million in 2005.

2005 Compared to 2004

Net revenue increased by 4.2% to Rmb 5,816.7 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 31.0% and net revenues of the 6105 medium-duty engines increased by approximately 52.6% as compared to 2004.

Cost of goods sold increased by 16.6% to Rmb 4,673.4 million in 2005 from Rmb 4,006.9 million in 2004, and increased as a percentage of net revenues to 80.3% in 2005 from 71.8% in 2004. Cost of manufacturing increased by 18.4 % to Rmb 4,517.0 million in 2005 from Rmb 3,816.7 million in 2004, and increased as a percentage of net revenue to 77.7% in 2005 from 68.4% in 2004. Cost of materials consumed included in costs of manufacturing increased by 20.6% to Rmb 3,812.4 million in 2005 from Rmb 3,159.9 million in 2004 (due to higher production during 2005, while cost of materials consumed as a percentage of net revenue increased to 65.5% 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 in 2005 from Rmb 419.2 million in 2004, due to lower variable factory expenses. The factory overhead as a percentage of net revenue decreased to 7.0% in 2005 from 7.5% in 2004. Depreciation and lease prepayments included in cost of manufacturing increased to Rmb 90.4 million from Rmb 84.9 million in 2004. Depreciation as a percentage of net revenue increased to 1.6% in 2005 from 1.5% in 2004.

Gross profit decreased by 27.4% to Rmb 1,143.4 million in 2005 from Rmb 1,575.2 million in 2004. Gross profit margin (gross profit divided by net revenue) decreased to 19.7% 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 20.5% to Rmb 793.2 million in 2005 from Rmb 658.3 million in 2004 and increased as a percentage of net revenue from 11.8% in 2004 to 13.6% in 2005. This increase in SG&A was primarily due to the increase in sales, legal and professional costs and bad debt expense. The increase in legal and professional costs was due to the higher management fees in connection with shareholder negotiations. Research and development expenses decreased to Rmb 123.8 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 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 to Rmb 39.4 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 consolidated statement of operations is a provision for non-trade loans to a related party of Rmb 203.0 million. See Note 5 to the Company s Consolidated Financial Statements. Salaries and wages as a percentage of net revenues was 7.9% in 2005 and 7.4% in 2004. As a result of the foregoing, profits from operations decreased to Rmb 26.0 million in 2005 compared to Rmb 779.9 million in 2004. Interest expense increased to Rmb 70.5 million in 2005 from Rmb 31.8 million in 2004, primarily due to increase in bank borrowings.

Loss before income taxes and minority interests in 2005 was Rmb 25.1 million, as compared to a profit of Rmb 753.9 million in 2004.

Income tax expense in 2005 was Rmb 10.1 million compared to income tax expense 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 (40.0)% for 2004 and 2005 respectively. The increase in the effective tax rate for 2005 was primarily due to additional non-deductible expenses for tax purposes and a decrease in the amount of estimated recoverable tax credits added in 2005.

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As a result of the foregoing factors, the Company had a loss before minority interests of Rmb 35.2 million in 2005 compared to income before minority interests of Rmb 648.7 million in 2004, and a net loss of Rmb 32.3 million in 2005 compared to a net income of Rmb 491.4 million in 2004.

Inflation

The general annual inflation rate in China was approximately 3.9%, 1.8%, 1.5% and 4.8% in 2004, 2005, 2006 and 2007, respectively. Our results of operations may be affected by inflation, particularly rising prices for parts and components, labor costs and other operating costs.

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 Liquidity and Capital Resources.

Liquidity and Capital Resources

Our primary sources of cash are funds from operations generated by Yuchai, as well as debt financing obtained by us. Our operations generated positive cash flow in 2004, 2005 and 2006. Our primary cash requirements are for working capital, capital expenditures to complete the expansion of production capacity and funding our business expansion and diversification plan. We believe that our sources of liquidity are sufficient for our operational requirements over the next twelve months from the date of this Annual Report. Factors which may affect our 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 our products, our ability to collect and control our level of accounts receivable, the status of our investment in Yuchai under Chinese law and the implementation of the Reorganization Agreement and the Cooperation Agreement. See Item 4. Information on the Company History and Development Reorganization Agreement.

As of December 31, 2006, we had approximately Rmb 745.9 million (US$108.8 million) in cash and cash equivalents on a consolidated basis. We believe that if we are considered on a stand-alone basis without our investment in Yuchai, we would find it difficult to raise new capital (either debt or equity) on our own.

We expect that cash generated from operations and credit collection arrangements should provide us 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, we may use periodic bank borrowings to supplement our 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. During its April 2006 board meeting, the Yuchai s Board of Directors approved an increase in Yuchai s borrowing limit to Rmb 2,000 million. Yuchai had outstanding borrowings of Rmb 906.5 million (US$132.2 million) as of December 31, 2006. The interest rate applicable to the amounts borrowed ranges from 4.08% and 5.85% per annum. This includes Rmb 497.0 million (US$72.5 million) of unsecured bonds issued at a discount in June 2006 pursuant to an application approved by the PBOC for short-term bonds issuing limit of up to Rmb 1,000 million (US$145.8 million). The bonds matured on March 9, 2007 and have since been refinanced with short-term loans from three local banks which are interest bearing at 5.022% per annum and are repayable on demand. On April 18, 2007, Yuchai issued the second tranche of short term bonds of Rmb 650.0 million (US$94.8 million) under approval given by PBOC on May 30, 2006 and the funds were used to pay off the short term loans from three local banks. The bonds were issued at discount and an amount totaling Rmb 637.0 million was received by Yuchai. The bonds matured on January 18, 2008. As of May 15, 2008, Yuchai had outstanding borrowings of Rmb 1,005.0 million. The unutilized loans limits amount to Rmb 2,603.0 million. We believe that should there be a need for further loans from banks, Yuchai could seek to drawdown additional amounts up to such limit from the domestic Chinese banks. However, no assurance can be given that such additional borrowings would be approved by such banks.

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

	For Year ended December 31,			
	2004 Rmb	2005 Rmb	2006 Rmb	2006 US$
	(in thousands)			
Net cash provided by operating activities	589,608	234,770	634,146	92,452
Net cash used in investing activities	(753,367)	(669,311)	(1,289,944)	(188,063)
Net cash provided by financing activities	254,493	452,777	670,640	97,775
Effect of foreign currency exchange on cash and cash equivalents		(4,713)	(5,104)	(744)
Net increase in cash and cash equivalents	90,734	13,523	9,738	1,420

Net cash flow provided by operating activities increased by Rmb 399.4 million (US$58.2 million) in 2006 compared to 2005. The increase was principally caused by the increase in cash collections from customers due to increased sales, better management of working capital and a decrease in cash paid for income taxes due to the over-payment of tax in 2005, partially offset by increased cash payments to suppliers and employees due to increased operations and the increase in cash paid for interest because of higher borrowings from banks. Net cash used in investing activities increased by Rmb 620.6 million (US$90.5 million) in 2006 compared to 2005, principally due to the acquisition of equities and bonds in HLGE and further investment in TCL. See Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan for further details. Net cash provided by financing activities increased by Rmb 217.9 million (US$31.8 million) in 2006 compared to 2005, due mainly to a Rmb 114.4 million and Rmb 43.6 million decrease in dividends paid to shareholders and dividends paid by subsidiaries to minority stockholders, respectively, as well as an increase in net proceeds from bank term loans of Rmb 266.8 million.

Net cash flow provided by operating activities decreased by Rmb 354.8 million between 2004 and 2005. The decrease was principally caused by an increase in cash paid for inventories due to stocking up at the end 2005 to meet expected higher sales in 2006. Net cash used in investing activities decreased by Rmb 84.1 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. 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 1,238.2 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.

Other than with respect to the application of cash generated from operations for capital expenditures and dividend payments, we do not have a formal cash management policy.

Our working capital as of December 31, 2006 was Rmb 457.5 million (US$66.7 million) compared to Rmb 823.3 million as of December 31, 2005.

As of December 31, 2006, we had long-term debt, including current installments, totaling Rmb 675.4 million (US$98.5 million), of which Rmb 575.5 million (US$83.9 million) will mature in 2008 and Rmb 100 million (US$14.6 million) in 2010. We had current debt totaling Rmb 806.5 million (US$117.6 million) as of December 31, 2006.

In February 2005, we issued $25.0 million in principal amount of convertible bonds due 2012 in a private placement. The convertible bonds due 2012 carried interest at 2.0% per annum, unless redeemed earlier in accordance with their terms. The bonds were convertible by their holders into newly issued shares of Common Stock of the Company at a conversion price of $12.97 per share, subject to customary adjustments. The bonds were fully converted by their holders in June 2005. Upon conversion, we issued 1,927,673 shares of Common Stock, representing approximately 5.5% and 5.2% of the then existing and enlarged shares of Common Stock, respectively. The proceeds of this offering were fully utilized to partially finance the TCL ordinary share acquisitions described above.

As an additional source of funding for our business expansion and diversification related activities, in March 2005, September 2005, January 2006 and March 2006, we entered into credit facilities for US$25.0 million, US$50.0 million, S$60.0 million (approximately US$44.1 million) and S$110.0 million (approximately US$80.8 million), respectively, with various banks in Singapore. We have drawn down the first three facilities as of December 31, 2006 in connection with our acquisition of shares and bonds in TCL and HLGE described above. The fourth credit facility expired in October 2006.

As of December 31, 2006, US$113.4 million had been drawn down. The terms of these facilities require, among other things, that Hong Leong Asia retains ownership of our special share and that we remain a consolidated subsidiary of Hong Leong Asia. The terms of these facilities also include certain financial covenants with respect to our 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. See Note 18 to our consolidated financial statements for more information.

On March 30, 2007, we entered into an unsecured multi-currency revolving credit facility agreement with a bank in Singapore for an aggregate of US$40.0 million to refinance the S$60.0 million facility that was due to mature on July 26, 2007. The facility is available for three years from the date of the facility agreement and will be utilized by us to finance our long-term general working capital requirements. The terms of the facility require, among other things, that Hong Leong Asia Ltd. (Hong Leong Asia) retains ownership of the special share and that we remain a principal subsidiary (as defined in the facility agreement) of Hong Leong Asia. The terms of the facility also include certain financial covenants with respect to our tangible net worth (as defined in the agreement) as at June 30 and December 31 of each year not being less than US$120 million and the ratio of our total net debt (as defined in the agreement) to tangible net worth as at June 30 and December 31 of each year not exceeding 2.0 times, as well as negative pledge provisions and customary drawdown requirements. As of June 12, 2007, we have fully drawndown on the US$40.0 million facility. The Company has also undertaken to make available to the bank, within 180 days after the end of its financial year (beginning with financial year 2007), copies of its audited consolidated accounts as at the end of and for that financial year. A waiver from compliance with this undertaking in relation to the production of the 2007 audited consolidated accounts has been received from the bank granting an extension of time until September 30, 2008.

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On March 20, 2008, we entered into a facility agreement with the Bank of Tokyo Mitsubishi UFJ, Ltd., Singapore Branch (Bank of Tokyo-Mitsubishi), to re-finance the existing $25.0 million credit facility which matured on March 20, 2008. The new unsecured, multi-currency revolving credit facility has a committed aggregate value of S$21.5 million with a one year duration. The new facility will be used to finance the Company s long-term general working capital requirements.

As part of its business strategy, Yuchai seeks from time to time opportunities to invest in China 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.

The following table sets forth information on our material contractual obligation payments for the periods indicated as of December 31, 2006:

	Payments Due by Period				
Contractual Obligations	Total Rmb	Less than 1 Year Rmb	1 3 Years Rmb	4 5 Years Rmb	More than 5 Years Rmb
			(in millions)		
Short-term debt*	1,022.6	1,022.6			
Long-term debt*	728.1		604.7	123.4	
Purchase Obligations regarding capital expenditures	127.0	127.0			
Lease Commitments	8.1	4.4	3.7		
Total	1,885.8	1,154	608.4	123.4	

* Includes contractual interest payments

Capital Expenditures

Our capital expenditures for routine upgrades to, and replacement of, equipment, plant and property were Rmb 552.9 million, Rmb 515.4 million and Rmb 323.8 million (US$47.2 million) in 2004, 2005 and 2006, respectively. We funded our capital expenditures primarily from funds generated from operations and, when necessary, from bank loans obtained by Yuchai. Our 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, particularly the second foundry, production capacity upgrading and the second stage of construction of Yuchai heavy-duty engine project. Our capital expenditures for 2005 of Rmb 515.4 million were primarily used for production capacity upgrading, second stage construction of Yuchai heavy-duty engine project and the new 4F engine project. Our capital expenditures for 2006 were primarily used for general production capacity and technical center upgrading, construction of Yuchai heavy-duty engine project and the 4F engine project, and acquisition of leasehold land for future development.

As of December 31, 2006, we had authorized and contracted for capital expenditures for improvement to existing production facilities in the amount of Rmb 127.0 million (US$18.5 million). As our business continues to grow, we will also require additional funds for increased working capital requirements and to finance increased trade accounts receivable. We expect to fund our 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 us. 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 we contribute to Yuchai would require, among other things, the approval of the MOC which has broad discretion with respect to such approval.

Off-Balance Sheet Arrangements

As of December 31, 2005 and 2006, Yuchai had issued irrevocable letter of credits of Rmb 110.3 million and Rmb 34.8 million (US$5.1 million), respectively.

As of December 31, 2005 and 2006, outstanding bills receivable discounted with banks for which Yuchai had retained a recourse obligation totaled Rmb 1.4 billion and Rmb 1.8 billion (US$0.3 billion), respectively. Management has assessed the fair value of the recourse obligation arising from these discounted bank bills to be immaterial based on the Company s default experience and the credit status of the issuing banks.

Except for the above off-balance sheet arrangements and off balance sheet exposure of YEGCL as described under Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Provision for loss contingency for guarantee granted by YEGCL , we have no other outstanding derivative financial instruments, off-balance sheet arrangements or guarantees.

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Research and Development

See Item 4. Information on the Company Research and Development .

Recently Issued Accounting Standards

SAB No. 108

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108). Considering the Effect of Prior Year Misstatement when Quantifying Misstatements in Current Year Financial Statements which requires companies to evaluate the materiality of identified unadjusted errors on each financial statement and related financial statement disclosure using both the rollover approach and the iron curtain approach (dual approach). The rollover approach quantifies misstatements based on the amount of the error originating in the current year statement of operations whereas the iron curtain approach quantifies misstatements based on the effects of correcting the misstatements existing in the balance sheet at the end of the current year, irrespective of the misstatements year(s) of origin. Financial statements would require adjustment when either approach results in quantifying a misstatement that is material. We adopted SAB No. 108 effective January 1, 2006.

As a transition accommodation, SAB No. 108 permits accumulative effect adjustments, without restatement of previously issued financial statements, to be used for errors that are determined to be immaterial pursuant to the Company s previous method of quantification of unadjusted errors but are determined to be material under dual approach. Prior to the adoption of SAB No. 108, the Company had quantified unadjusted errors under the rollover approach and has assessed these unadjusted errors to be immaterial individually and in the aggregate. Upon initial adoption of SAB No. 108 for the fiscal year 2006, we quantified unadjusted errors under the dual approach and assessed that these unadjusted errors are not material. As such, the initial adoption of SAB No. 108, had no impact on our consolidated financial statements.

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 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. We adopted this statement on January 1, 2006 under the modified prospective method of application. Under that method, We 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 did not have any effect on our 2006 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 was effective and adopted by us for inventory costs incurred on or after January 1, 2006. The initial adoption of this statement had no effect on our 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 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 was effective and adopted by us for nonmonetary asset exchanges occurring on or after January 1, 2006. The adoption of this statement had no effect on our 2006 consolidated financial statements.

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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 was applied to new arrangements entered into, and modifications or renewals of existing arrangements beginning in the first interim or annual reporting periods beginning after March 15, 2006. The application of EITF 04-13 had no significant impact on our 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 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. We do not believe there will be any material impact resulting from the initial adoption of this statement to our 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. We are currently evaluating the impact of the statement to the Company s consolidated financial statements.

FIN No. 48

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. We are currently evaluating the impact of the provisions of FIN 48 to the Company s consolidated financial statements.

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expenses disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability.

In February 2008, the FASB Staff Position, or FSP, SFAS No. 157-1, Application of FASB SFAS No. 157 to SFAS No. 13 and its Related Interpretive Accounting Pronouncements That Address Leasing Transactions, and FSP SFAS No. 157-2, Effective Date of SFAS No. 157. FSP SFAS No. 157-1 excludes from the scope of SFAS No. 157 certain leasing transactions accounted for under SFAS No. 13, Accounting for Leases . FSP SFAS No. 157-2 delays the effective date of SFAS No. 157 from 2008 to 2009 for all non financial assets and non financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

The provisions of SFAS No. 157 will be applied prospectively to fair value measurements and disclosures for financial assets and financial liabilities and non financial assets and non financial liabilities recognized or disclosed at fair value in the financial statements on at least an annual basis beginning in the first quarter of 2008. We do not believe the initial adoption of SFAS No. 157 will have a material impact on the consolidated financial statements at this time and will monitor any additional implementation guidance that may be issued.

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SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities . Under SFAS No. 159, entities will be permitted to measure various financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option). SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We have elected not to adopt the fair value option for the eligible items as of January 1, 2008 the effective date of SFAS No. 159.

SFAS No. 141 (revised 2007)

In December 2007, the FASB issued SFAS No. 141 (revised 2007), or SFAS No. 141R, Business Combination which replaces FAS Statement No. 141. SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquiree and the goodwill acquired. The statement also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. This statement is effective as of the beginning of an entity s first fiscal year beginning after December 15, 2008. The impact of the adoption of SFAS No. 141R on our consolidated financial position and consolidated results of operations is dependent upon the specific terms of any applicable future business combinations.

SFAS No. 160

In December 2007, the FASB issued SFAS No. 160, Non Controlling Interests in Consolidated Financial Statements-Amendments of ARB No. 51 . SFAS No. 160 states that accounting and reporting for minority interests will be re-characterised as non controlling interests and classified as a component of equity. The statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non controlling owners. FAS No. 160 applies to all entities that prepare consolidated financial statements, except non-for-profit organizations, but will affect only those entities that have an outstanding non controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement is effective as of the beginning of an entity s first fiscal year beginning after December 15, 2008. We are required to adopt this statement in the first quarter of our fiscal year 2009 and we are currently assessing the impact of adopting SFAS No. 160.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.
Directors and Executive Officers of the Company

Our Articles of Association require that our Board of Directors shall consist of eleven members so long as the Special Share is outstanding. As of May 30, 2008, there are nine members elected to and serving on our Board of Directors, with two vacancies. Pursuant to the rights afforded to the holder of the special share, Hong Leong Asia has designated Messrs. Teo Tong Kooi, Gan Khai Choon, Gao Jia Lin and Kwek Leng Peck as its nominees. Messrs. Yan Ping and Zhang Shi Yong are nominees of Coomber Investments Limited. Our directors are appointed at the annual general meeting or at any special general meeting of shareholders and hold office until the next annual general meeting of shareholders or until their successors are appointed or their office is otherwise vacated.

Our directors and executive officers are identified below.

Name(1)	Position	Year First Elected or Appointed Director or Officer
TEO Tong Kooi(2)(3) (6)	President and Director	2004
GAO Jia Lin(2)	Vice President and Director	1995
GAN Khai Choon (2) (6)	Director	1995
KWEK Leng Peck(2)(4)	Director	1994
NEO Poh Kiat (2)(4)(5)	Director	2005
TAN Aik-Leang(2)(5)	Director	2005
Matthew RICHARDS(4)(5)	Director	2006

YAN Ping[(2)]	Director	2007
ZHANG Shi Yong[(2)]	Director	2007
TAN Wan Hong[(2)]	Group General Manager	2008

Name(1)	Position	Year First Elected or Appointed Director or Officer
HOH Weng Ming(3)	Chief Financial Officer	2008
FOO Shing Mei Deborah	General Counsel	2007
Ira Stuart OUTERBRIDGE III	Secretary	2001

(1) Mr. Raymond C.K. Ho ceased to be a director of the Company with effect from September 15, 2006 and resigned as a director of Yuchai on September 7, 2006. Mr. Wong Hong Ren resigned as a director of each of the Company and Yuchai with effect from July 5, 2007 and August 16, 2007, respectively. Mr. Philip Ting Sii Tien resigned as the Chief Financial Officer of the Company with effect from November 15, 2007. Mr. Ting also resigned as a director of each of the Company and Yuchai with effect from December 3, 2007 and March 28, 2008, respectively. Mr. Matthew Richards was appointed as a director of the Company on December 12, 2006. Mr. Yan Ping and Mr. Zhang Shi Yong were appointed as directors of the Company on August 3, 2007. Ms. Sheila Murugasu resigned as the General Counsel of the Company with effect from December 10, 2007. Mr. Ho Tuck Chuen was appointed as the Chief Financial Officer and Director of the Company with effect from November 15, 2007 and December 3, 2007, respectively. Mr. Ho subsequently resigned from both positions with effect from April 30, 2008.

(2) Also a Director of Yuchai.

(3) Also a Director/Alternate Director of TCL.

(4) Member of the Compensation Committee.

(5) Member of the Audit Committee.

(6) Also a Director of HLGE.

Mr. Teo Tong Kooi is the President and a Director of the Company. He is also a Director and Chief Executive Officer of Hong Leong Asia as well as a Director of Hong Leong China, Yuchai, HLGE, TCL and Isyoda Corporation Berhad. He is also an Executive Director of Tasek Corporation Berhad, where previously he held the position of 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 Program at the Stanford University Graduate School of Business and has a wealth of corporate and commercial banking experience with many years in senior management positions where he was Head of Corporate Banking, Deutsche Bank, Malaysia, and Chief Operating Officer of Hong Leong Bank Berhad, Malaysia.

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

Mr. Gan Khai Choon is a Director of the Company, Yuchai, Grace Star, Venture Lewis, Venture Delta and Safety Godown Company Limited. He is also the Chairman of HLGE, an Executive Director of City e-Solutions Limited and Managing Director of Hong Leong International (Hong Kong) Limited. He has extensive experience in banking, real estate investment and development sectors and has been involved in a number of international projects for the Hong Leong group of companies, which include the management and development of the Grand Hyatt Taipei. He holds a Bachelor of Art degree (Honors) in Economics from the University of Malaya.

Mr. Kwek Leng Peck is a Director of the Company. He is a member of the Kwek family which controls the Hong Leong Investment group. He serves as an Executive Director of Hong Leong Asia and sits on the boards of HL Technology, Hong Leong China, Yuchai, City Developments Limited, Hong Leong Finance Limited, City e-Solutions Limited, Millennium & Copthorne Hotels plc and Tasek Corporation Berhad. He holds a Diploma in Accountancy and has extensive experience in trading, manufacturing, property investment and development, hotel operations, corporate finance and management.

Mr. Neo Poh Kiat is a Director of the Company and Yuchai. He is Managing Director of Octagon Advisors Pte Ltd, a financial advisory firm in Singapore. Between 1976 and January 2005, he 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. Our Board of Directors has determined that Mr. Neo is independent within the meaning of the NYSE s 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 and Yuchai. 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

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Association, Hong Kong Chapter (headquartered in USA) 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. Our Board of Directors has determined that Mr. Tan is independent within the meaning of the NYSE s corporate governance standards, on the basis that the Company has no material relationship with him.

Mr. Matthew Richards is a Director of the Company. Mr. Richards is the General Counsel and a Director of Principia Management Pte Ltd, which provides advisory and management services related to corporate finance transactions and private equity investments. Previously, Mr. Richards was in private practice in Singapore as an international lawyer between 1999 and 2007, having worked on a variety of capital markets, mergers and acquisitions and other corporate finance transactions throughout the Asian region, particularly in Indonesia and India. From 2003 to mid 2006, Mr. Richards was an associate at Latham & Watkins LLP, the international law firm advising the Company on US law matters. Mr. Richards holds a Graduate Diploma in Legal Practice, Bachelor of Laws and Bachelor of Asian Studies from the Australian National University. Our Board of Directors has determined that Mr. Richards is independent within the meaning of the NYSE s corporate governance standards, on the basis that the Company has no material relationship with Mr. Richards.

Mr. Yan Ping is a Director of the Company and the Chairman of the Board of Directors of Yuchai. Mr. Yan is also the Chairman of the State Holding Company, Yuchai Machinery Co., Ltd and Yuchai Marketing Company since October 2005. The State Holding Company owns 22.1% of the shares of Yuchai, and is owned by the city government of Yulin in Guangxi Zhuang Autonomous Region, China. Prior to becoming Chairman of the State Holding Company, Mr. Yan held various China-government related positions, including most recently as Deputy Secretary-General, Yulin Municipal Government, as Director, Yulin Municipal Development and Reform Commission and as Deputy General Manager of Guangzhou Shenzhen Railway Company, Ltd. Mr. Yan holds a Bachelor of Engineering degree from Dalian Railway College and a Master of Economics degree from the East-North Financial and Economic University.

Mr. Zhang Shi Yong is a Director of the Company. He is also the Company Secretary of Yuchai and has been a Director of Yuchai since April 12, 2007. He also sits on the boards of the State Holding Company, Coomber and Goldman. Mr. Zhang was a director of City Construction Investment Company of Yulin. He holds a Bachelor of Traffic and Transportation degree from Xinan Jiaotong University and a Master of Business Administration degree from the Tsing Hua University.

Mr. Tan Wan Hong was appointed Group General Manager of the Company and a Director of Yuchai with effect from February 1, 2008 and March 28, 2008 respectively. Mr. Tan qualified with the Institute of Chartered Accountants (England & Wales) in 1980 and has extensive work experience in China.

Mr. Hoh Weng Ming was appointed Chief Financial Officer of the Company with effect from May 1, 2008. Prior to re-joining the Company, Mr. Hoh was the Group Controller of the Industrial Product Group division for Hong Kong-listed, Johnson Electric Industrial Manufactory Limited, a leading industrial electric motor producer. Before Johnson Electric, he was the Financial Controller for two of Hong Leong Asia s subsidiaries, namely Henan Xinfei Electric Co., Ltd. from 2003 to 2005 and the Company from 2002 to 2003. Mr. Hoh has a Bachelor of Commerce degree majoring in Accountancy from the University of Canterbury, Christchurch, New Zealand and an M.B.A. degree from Massey University, New Zealand. He is a Chartered Accountant in New Zealand and Malaysia and a Fellow Member of the Hong Kong Institute of Certified Public Accountants.

Ms. Foo Shing Mei Deborah was appointed the General Counsel of the Company with effect from December 10, 2007. Ms. Foo has more than 10 years of commercial and corporate experience gained from various in-house positions in Singapore and Hong Kong. Prior to joining the Company, she held the positions of Vice President of Group Legal and Company Secretary at Nasdaq listed Pacific Internet Limited. She holds a BA (Honors) in Law and History and a Masters of Law degree in Commercial and Corporate law from University of London. She is a Barrister-at-Law (Middle Temple) and is admitted as an Advocate and Solicitor in Singapore.

Mr. Ira Stuart Outerbridge III is the Secretary of the Company. He 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 since February 1996.

Audit Committee

The members of the Audit Committee are Messrs. Tan Aik-Leang (Chairman), Neo Poh Kiat and Matthew Richards. The Audit Committee oversees the performance of our internal audit function and our independent public accountants. It also reviews our quarterly financial statements and effectiveness of our financial reporting process and material internal controls including financial operational and compliance controls. The Board has designated Mr. Tan Aik-Leang as our Audit Committee Financial Expert.

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Compensation Committee

The members of the Compensation Committee are Messrs. Kwek Leng Peck (Chairman), Neo Poh Kiat and Matthew Richards. The Compensation Committee reviews our general compensation structure as well as reviews, recommends or approves executive appointments and remuneration, subject to ratification by our Board of Directors and supervise the administration of our employee benefit plans, including stock option plans, if any.

Special Committee

Effective April 13, 2007, the Board of Directors dissolved the Special Committee. The Special Committee was established in 2003 in response to the litigation-related and other difficulties that we faced at that time with respect to our investment in Yuchai.

Directors and Executive Officers of Yuchai

According to Yuchai s Articles of Association, the Board of Directors of Yuchai may consist of up to 13 members. Currently, there are 12 members elected to and serving on Yuchai s Board of Directors. Yuchai s Articles of Association entitle us (as the indirect holder of the Foreign Shares), through our six wholly-owned subsidiaries, 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 the terms of the Reorganization Agreement, Yuchai s board of directors has been reconstituted with the Company entitled to elect nine of Yuchai s 13 directors, again reaffirming the Company s right to effect all major decisions relating to Yuchai. Pursuant to and subject to the conditions in the Shareholders Agreement described under Item 7. Major Shareholders and Related Party Transactions Related Party Transactions, and by virtue of the special share, Hong Leong Asia is entitled to designate five of the nine Yuchai Directors designated by us.

Pursuant to the Shareholders Agreement and our Bye-laws, the Yuchai Directors designated by us 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 our continued rights, 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 May 30, 2008 are identified below.

Name	Position	Year First Elected or Appointed Director Position or Officer
YAN Ping[(1)]	Chairman of the Board of Directors	2005
GAO Jia Lin[(1)]	Director	1995
LI Tiansheng	General Manager and Director	2001
GAN Khai Choon [(1) (4)]	Director	2007
KWEK Leng Peck[(1)]	Director	2005
NEO Poh Kiat [(1) (5)]	Director	2008
TAN Aik-Leang[(1)]	Director	2005
TAN Wan Hong[(5) (6) (7)]	Director	2008
TEO Tong Kooi[(1)(2)(4)]	Director	2004
YUAN Xucheng	Director	2003
GU Tangsheng	Assistant to Chairman and Director	2005
ZHANG Shi Yong[(1) (3)]	Secretary and Director	2005
ZENG Shi Qiang	Assistant Director	1999
TAN Chai Huat[(7)]	Financial Controller	2006
LIANG He Ping	Executive Deputy General Manager	2000
WU Qiwei	Deputy General Manager	2005
YAN Jie	Deputy General Manager	2003
LI Cheng Jie	Deputy General Manager	2004
QIN Xiaohong	Chief Accountant	2007
SHEN Jie	General Engineer	2003
SI LIWO Yu Hok[(7)]	Senior Vice President of Business Controller	2005
LIM Kian Heng Benny [(7)]	Vice President, International Sales	2007

(1) Also a Director of the Company.
(2) Also a Director of TCL.

(3) Appointed a Director of Yuchai since April 12, 2007.
(4) Also a Director of HLGE.
(5) Appointed a Director of Yuchai since March 28, 2008.
(6) The Group General Manager of the Company.
(7) Secondees of the Company, whose salaries and expenses are paid by the Company.

For information about Messrs. Gao Jia Lin, Gan Khai Choon, Neo Poh Kiat, Tan Wan Hong, Teo Tong Kooi, Kwek Leng Peck, Tan Aik-Leang, Yan Ping and Zhang Shi Yong, 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. Li Tiansheng is a Director and General Manager of Yuchai. He previously served as the principal coordinator for liaison with Chinese government agencies, banks and tax department. Mr. Li holds a Bachelor s degree (foundry) from Guangxi University.

Mr. Yuan Xu Cheng is a Director of Yuchai. He previously served as a Director and Assistant General Manager of Guijiang Enterprise Co. Mr. Yuan holds a Master of Economics degree.

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. Zeng Shi Qiang has been an Assistant Director of Yuchai since May 1999. Mr. Zeng holds a Master s degree (Business Management) from Chinese Science and Technology University.

Mr. Tan Chai Huat is a Financial Controller in the employment of the Company. He has been assigned by us to assist Yuchai in its financial accounting, reporting and compliance with local and statutory requirements, and the implementation of financial policies, procedures, financial budgeting and review of investments. Mr. Tan holds a Bachelor of Commerce degree from the University of Western Australia and is a member of the Institute of Certified Public Accountants of Singapore.

Mr. Liang He Ping is the Executive Deputy General Manager since December 2000. He holds a Master of Business Administration from Qinghua University.

Mr. Wu Qiwei is the Deputy General Manager of Yuchai and is in charge of sales and marketing. He holds a Bachelor s degree (Inter-Combustion Engine, Vehicle and Mechanical Engineering) from Hunan University. He had also completed his MBA program from the Huazhong University of Science and Technology.

Mr. Yan Jie is the Deputy General Manager of Yuchai and is in charge of the manufacturing department. Until August 2003, Mr. Yan was the Deputy General Manager of the Yuchai group. He holds a Master s degree (Political Economy) from Guangxi University.

Mr. Li Cheng Jie is the Deputy General Manager of Yuchai since 2004. He holds a Master s degree (Philosophy of Science and Technology).

Miss Qin Xiaohong joined Yuchai in 1990 and became the Chief Accountant in July 2007. She holds a Bachelor s degree in Auditing from Nanjing Auditing Institute.

Mr. Shen Jie is the General Engineer of Yuchai and is responsible for all matters relating to engine design, testing and quality control. He joined Yuchai over 20 years ago as a technician in the assembly workshop of Yuchai. He holds a Master s degree (Inter-Combustion Engine) from Jilin Industrial University.

Mr. Si Liwo Yu Hok is the Senior Vice President of Business Control in the employment of the Company. He has been assigned by us to assist Yuchai in its management and operations. He holds a Master s degree (Industrial Engineering and Management) from the Asian Institute of Technology, Bangkok, and a Bachelor of Science (Electrical Engineering) degree from the National Taiwan University, Taipei.

Mr. Lim Kian Heng Benny is the Vice-President, International Sales in the employment of the Company. He has been assigned by us to the international sales department of Yuchai. Mr. Lim holds a Master of Business Administration from the Royal Melbourne

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Institute of Technology Australia, a Diploma in Mechanical Engineering from the Ngee Ann Polytechnic Singapore, a Diploma in Management Study from Singapore Institute of Management, and a Diploma in Motor Trade Management from the Institute of the Motor Industry, UK. Mr. Lim also completed a one-year International Executive Development Program in Germany.

Yuchai

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, operating budget and year-end financial statements of final accounts, balance sheet, profit and loss statements and other accounting statements; (iv) the issuance of new shares or other securities, the expansion of the scope of any subscription of shares, the conversion of Yuchai from a company with privately placed shares into a company with publicly offered shares, and the transfer procedures for Yuchai s share certificates; (v) the nomination, election, dismissal and compensation of members of the Board of Directors; (vi) significant sales or purchases of assets, or any division, merger, acquisition, termination, liquidation or other major corporate action of Yuchai; (vii) amendment to Yuchai s Articles of Association; (viii) motions presented by shareholders holding 10% or more of the outstanding shares of Yuchai; and (ix) other matters required to be resolved by the shareholders meeting. Yuchai s 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, mainly including (i) the execution of resolutions adopted by the shareholders; (ii) the formulation and review of Yuchai s development plans; (iii) the review of and decision on 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) to fill vacancies on the Board provided the selected replacement is nominated by and represents the same shareholders as his or her predecessor; (vi) the adoption of various corporate policies and rules; (vii) the appointment of senior executive officers as recommended by the Chief Executive Officer and their dismissals and the appointment of senior advisers to the Board; (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.