



# FUEL-EFFICIENT LOW-EMISSION ENGINES

THE NEW  
NATURAL  
GAS/DIESEL  
ENGINE

ENVIRONMENT-FRIENDLY  
HYBRIDES  
ENGINES

EURO IV & V CERTIFIED ENGINES

## Advancing towards a greener future

The World Brand Laboratory named the Yuchai brand “Chinese Brand of the Year” in the diesel engine category in 2008. Not resting on our laurels, our subsidiary Guangxi Yuchai Machinery Company Limited (GYMCL) continued to leverage on its R&D expertise and was the first to introduce diesel engines complying with the more stringent National IV and National V emission standards. China Yuchai is well positioned to continue to benefit from the demand for engines that comply with these standards. The 2008 Beijing Olympics has led to an early implementation of the National IV standard in Beijing in 2008 with a targeted implementation in Shanghai in November 2009 and nationwide in late 2010. The company has also prioritized the reduction of the environmental impact of our engines through the development and adoption of new technologies for the future.

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## Yuchai's Core Ideals

- Promote green development, harmonious partnership and mutual benefits
- Establish Yuchai as an international brand
- Propel Yuchai into multinational status
- Develop a caring professional workforce that possesses technical excellence and creativity
- Lead in the pursuit of business excellence, responsible corporate citizenship and respectable public integrity

## 玉柴的核心理念

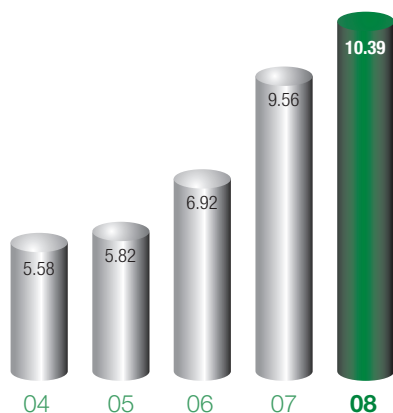
- 玉柴动力的核心理念是绿色发展，和谐共赢
- 打造玉柴世界知名品牌
- 成就大型跨国企业集团的企业愿景
- 建设高素质的干部队伍，打造创造性的劳动群体的人才观
- 引领企业追求卓越，享有优良的社会美誉度和公众诚信度



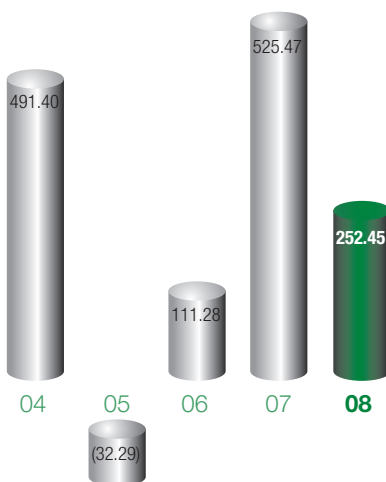
# Five-Year Financial Highlights

	2008	2007	2006	2005	2004
Net revenue	Rmb'000 10,384,022	Rmb'000 9,556,303	Rmb'000 6,920,528	Rmb'000 5,816,740	Rmb'000 5,582,095
Net income	252,450	525,469	111,284	(32,291)	491,397
Basic and diluted earnings per share	Rmb 6.77	Rmb 14.10	Rmb 2.99	(Rmb 0.89)	Rmb 13.90
Weighted average number of shares	37,267,673	37,267,673	37,267,673	36,459,635	35,340,000
Total assets	Rmb'000 9,712,678	Rmb'000 9,579,184	Rmb'000 7,961,357	Rmb'000 6,679,630	Rmb'000 5,384,248
Stockholders' equity	3,430,825	3,294,465	2,728,399	2,566,263	2,483,084

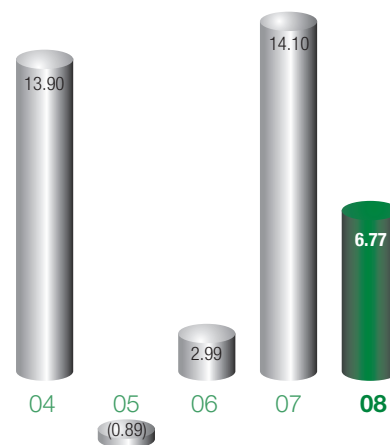
**Net Revenue**  
(in Rmb billions)



**Net Income**  
(in Rmb millions)



**Basic and Diluted Earnings Per Share**  
(in Rmb)







# Corporate Background

China Yuchai International Limited (“CYI”) is a Bermuda holding company established on April 29, 1993. We operate as an exempt company limited by shares under The Companies Act 1981 of Bermuda. On March 7, 2008, CYI registered a branch office in Singapore and has its principal operating office located at No 16 Raffles Quay #39-01A, Hong Leong Building, Singapore 048581.

CYI is a subsidiary of Hong Leong Asia Ltd (“HLA”) which indirectly holds 21.2% of its outstanding ordinary shares as well as one special share. The common stock of CYI is traded on the New York Stock Exchange under the symbol “CYD”.

The principal operating subsidiary of CYI is Guangxi Yuchai Machinery Company Limited (“GYMCL”) which is located in Yulin City, Guangxi Zhuang Autonomous Region in southern China. GYMCL is one of the largest medium-duty diesel engine manufacturers in China. It produces and provides a comprehensive range of products from light-duty diesel engines to heavy-duty diesel engines, parts and diesel-powered generators to meet the needs of different sectors. GYMCL has a strong reputation among vehicle manufacturers and customers for the performance and reliability of its products as well as its after-sales customer service. We currently own through six of our wholly-owned subsidiaries, 76.4% of the outstanding shares of GYMCL.

In February 2005, the Board of Directors of CYI announced its approval of the implementation of a business expansion and diversification plan. As a result, CYI acquired interests in Thakral Corporation Ltd (“TCL”) and HL Global Enterprises Limited (“HLGE”). Currently we hold 34.4% and 45.4% interests in the outstanding ordinary shares of TCL and HLGE respectively.

The TCL group is a distributor of consumer electronic products with operations mainly in the People’s Republic of China (including Hong Kong). TCL also has other business activities relating to contract manufacturing, property development and investment in the PRC.

The core businesses of HLGE are hospitality operations and property development.

TCL and HLGE are each listed on the Main Board of the Singapore Exchange Securities Trading Limited.





# 公司背景

中国玉柴国际有限公司（“玉柴国际”）于1993年4月29日在百慕达登记注册成立。依据百慕达1981年的公司法，玉柴国际是家享有豁免权的股份有限公司。在2008年3月7日，玉柴国际在新加坡登记成立分公司，该分公司的营运地址位于16号莱佛士码头、丰隆大厦、39楼01A室，新加坡邮政编号048581。

玉柴国际是丰隆亚洲有限公司（“丰隆亚洲”）的一家附属公司，丰隆亚洲间接持有玉柴国际的21.2%已发行普通股以及一股特别股。玉柴国际的普通股在纽约证券交易所上市交易，股票代码为“CYD”。

广西玉柴机器股份有限公司（“广西玉柴”）是玉柴国际的主要子公司。广西玉柴位于中国广西壮族自治区的玉林市。广西玉柴是中国最大的中型柴油发动机制造商之一。为了满足不同市场的需求，广西玉柴也同时生产和提供更广泛的产品类型，包括从轻型柴油发动机到重型柴油发动机、零部件和柴油驱动发动机等等。广西玉柴在汽车制造商及汽车消费者当中享有极佳的声誉和受到高度的评价，这是因为其产品具备高效可靠的性能及良好的售后服务。目前，玉柴国际通过其下的六家全资附属公司持有广西玉柴76.4%的已发行股份。

玉柴国际董事会在2005年2月宣布批准公司实施业务扩充和多元化的计划。鉴此，玉柴国际分别收购了Thakral Corporation Ltd（“TCL”）以及HL Global Enterprises Limited（“HLGE”）的股权。目前，玉柴国际分别持有TCL和HLGE的34.4%和45.4%的股权。

TCL是著名电子消费产品的经销商，其主要的营运地区是中国（包括香港），同时也在中国有其他的业务，包括提供和约性质制造服务、房地产开发及投资活动。

HLGE的核心业务是酒店的经营及房地产的开发。

TCL和HLGE均在新加坡证券交易有限公司主板上市。

# Past President's Statement



**“We would like to thank our shareholders for their patience and support during the past year. We have weathered the storm and resolved past historical issues and now look forward to growing the Company further.”**

Dear Shareholders,

As we entered 2008, we experienced continuing robust demand for our diesel engines as the Chinese economy remained strong, spending for the 2008 Beijing Olympics set new records and demand increased before the countrywide adoption of engines compliant with the mandated National III emission standards implemented progressively in China from July 1, 2008. However, the economies in North America, Europe and other markets suffered significant decline following from the global financial crisis in the second half of 2008 and automotive sales fell sharply in many markets. The Chinese economy fared better, but it was also affected by the global recession with gross domestic product growth rates falling to single digit ranges since 2003. While the overall Chinese automotive market continued to grow by 6.7% in 2008 to 9.34 million units, there was a pronounced slowdown in the second half of the year. Chinese commercial vehicle sales began to slow noticeably in the third quarter of 2008 and recorded an approximate 5.3% decline for 2008 compared to 2007 due to the global economic slowdown. However, our subsidiary, Guangxi Yuchai

Machinery Company Limited (“GYMCL”), remained the No.1 seller of domestic diesel engines for the 8th year in a row according to the China Association of Automobile Manufacturers, and the “Yuchai” brand was awarded the “Chinese Brand of the Year” in the diesel engine category by the World Brand Laboratory (“WBL”) in 2008.

## **Financial performance**

For fiscal year 2008, our net revenues grew 8.3% to RMB 10.4 billion (US\$1.5 billion) compared with RMB 9.6 billion in 2007. While our overall unit sales declined by 3%, our sales revenue increased due to the higher average selling price (“ASP”) as the new National III compliant engines sold were at higher prices than the engine models they replaced, and we experienced greater engine parts sales. Fourth quarter sales were especially affected by the global financial crisis. Gross margin in 2008 was impacted by higher raw material prices while SG&A expenses remained flat as a percentage of sales. Although our net income declined in 2008 as compared with 2007, there were a few one-time non-recurring charges during the year. We recorded an impairment charge of RMB 46.0 million



(\$6.7 million) in 2008 on the assets owned by Guangxi Yulin Hotel Company Ltd which was acquired by GYMCL in settlement of past loans. Another impairment in 2008 was related to other plant and equipment resulting in a charge of RMB 23.9 million (\$3.5 million) and goodwill was impaired by RMB 5.7 million (\$830,000). At December 31, 2008, our balance sheet showed RMB 693.4 million (\$101.5 million) in cash and cash equivalents.

### Developments

Our subsidiary GYMCL, continued to leverage on its R&D expertise to introduce a range of new engines compliant with both National III and IV emission standards with broad applications. In fact, GYMCL was the first to introduce diesel engines in China complying with the more stringent National IV and National V emission standards. The 2008 Beijing Olympics has led to an early implementation of the National IV standard in Beijing in 2008 with a targeted implementation in Shanghai in November 2009 and nationwide in late 2010. We are well positioned to continue to benefit from the demand for engines that comply with these stringent emission standards. We

believe we are one of the leaders producing advanced emission standard engines and we are also a leader in the municipal bus market in China. Furthermore, in 2008 we announced the entry into of an equity joint venture agreement between GYMCL with Zhejiang Geely Holding Co., Ltd. and Zhejiang Yinlun Machinery Company Limited to form two joint venture companies in Tiantai, Zhejiang Province and Jining, Shandong Province, to develop and produce proprietary diesel engines and parts targeting the passenger car market in China. Diesel cars have successfully penetrated into the passenger car markets in Europe, but only make up a small proportion of the China market today which presents a good future growth prospect for us.

### Reporting of results

Since May 2008, upon the conclusion of the independent investigation into the facts and circumstances of the potential accounting errors relating to the adjustment of GYMCL's accounts payable of approximately RMB 168 million, we restated year 2005 audited consolidated financial results and thereafter announced the audited consolidated financial results for 2006, 2007 and 2008. Mr. Hoh Weng Ming joined us as our new Chief Financial Officer and we also added more senior accounting personnel and provided more training to augment our internal controls and improve reporting processes. These actions have brought us current with our filing and reporting requirements and Ernst & Young LLP, Singapore, was appointed as our new principal independent auditors at the April 17, 2009 annual shareholders meeting. In July and August 2009, we announced our unaudited first quarter and second quarter 2009 financial results respectively.

### New President

On July 1, 2009, Mr. Saw Boo Guan was appointed to the Board of Directors and assumed the role of President on August 1, 2009. Mr. Saw brings over 23 years of outstanding track record in the automotive industry from the Cummins organization and General Motors Corp. As President of Cummins Westport Inc. joint venture, he was responsible for the company's worldwide natural gas engine business. Under his leadership from 2005 to 2008, revenue and profit increased 32% and 65% respectively on

## Past President's Statement

a compounded annual growth rate. From 1989 to 2005, Mr. Saw's responsibilities included general management and marketing and distribution management for specific Cummins operations in the U.S., Singapore, Hong Kong and China. His leadership, experience and especially his knowledge of alternative automotive technologies will be invaluable to China Yuchai.

### Outlook

In response to the global economic slowdown, the Chinese government had announced various stimulus measures to increase economic activity and encourage the sales of automotive vehicles. The measures include reduced sales taxes for certain automobiles, subsidies, low interest loans and tax benefit incentives for the large rural population to upgrade from their older vehicles and tractors with high exhaust emissions to fuel efficient, low emissions light-duty trucks, pickup trucks and mini vans. The GDP growth is expected to reach 7.9% in the second quarter of 2009 and passenger and light duty vehicle sales are expected to continue to grow strongly. The Chinese government has demonstrated its strong commitment to environmental improvement and pollution control to pave the way for sustainable long-term growth. A recently announced policy in the government new stimulus plan is to provide a subsidy of between RMB 3,000 and RMB 6,000 to replace vehicles which do not meet current emission standards or are between 8-12 years old, particularly targeting the commercial vehicle sector. More excitingly, a number of large infrastructure construction projects including high speed railroads, extended national highways, urban subways and large clean energy plants, are being implemented throughout China. We are hopeful these new measures will provide an impetus for greater spending and result in higher demand for the heavy duty commercial vehicles.

Our other investments in affiliate companies namely HL Global Enterprises Ltd ("HLGE") and Thakral Corporation Ltd ("TCL") faced tough & challenging business conditions in 2008. Strong competition in China's hospitality sector and the global financial turmoil adversely affected HLGE's operating performance in 2008 with lower hotel occupancy rates. Our Shanghai serviced apartments is currently undergoing a major refurbishment which is scheduled for completion shortly. The outlook on the hospitality sector in China remains cautious due to an increasing influx of new hotels which will lead to more competition for room occupancy.

TCL's consumer electronic division continued to be affected by the global economic slowdown which led to tighter gross margins. The closure of one business unit in China led to net attributable loss for 2008. However arising from the China government measures to provide liquidity to the business sector through the stimulus measures, there are some positive signs of higher consumer spending in electronic goods in China. TCL continues to identify new product lines to expand its consumer electronic business.

### Appreciation

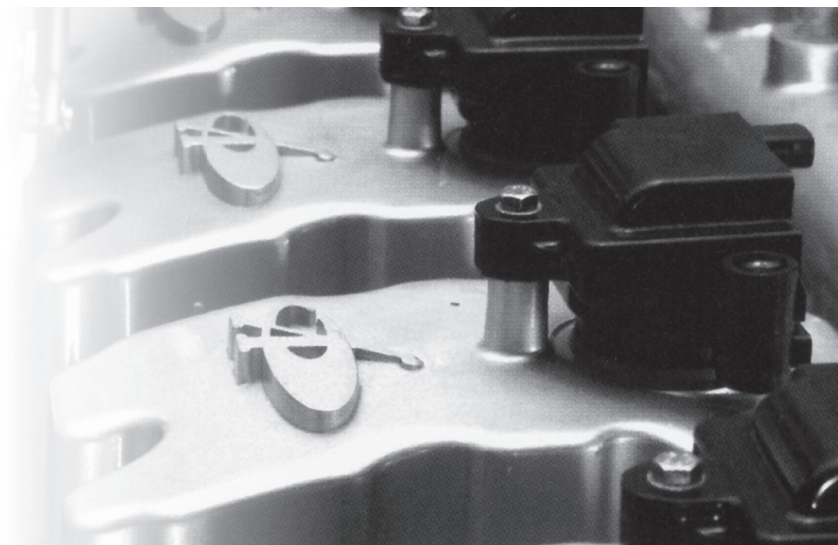
We would like to thank our shareholders for their patience and support during the past year. We have weathered the storm and resolved past historical issues and now look forward to growing the Company further. During my tenure as the President of China Yuchai, we have successfully grown our base line diesel engine business and continue to expand our market share in China. We have also formed a dedicated management team to further support the Company's growth and build shareholder value. I strongly believe that China Yuchai has a bright future ahead.

### Mr. Teo Tong Kooi

Past President  
China Yuchai International Limited  
August 31, 2009



# President's Statement



**“Equally important, we have made it a priority to reduce the environmental impact of our engines through developing and adopting new technologies for the future.”**

Dear Shareholders,

It is with great pleasure that I joined the board of directors of China Yuchai International Limited on July 1, 2009 and I look forward to my role as President. What attracted me to accept the position was the value and potential I see in China Yuchai. The “Yuchai” brand is highly admired and has acquired a good reputation throughout China and GYMCL is committed to excellence in its products with an emphasis on quality, innovation, and services. We are dedicated to providing a safe and stimulating environment to attract and retain the best workers taking pride in their accomplishments. Equally important, we have made it a priority to reduce the environmental impact of our engines through developing and adopting new technologies for the future.

I would like to take this opportunity to thank Mr. Teo Tong Kooi for his leadership, dedication and commitment which has positioned the Company for future growth.

As the new President of China Yuchai, it will be my job to further unlock growth and development potential in the Company. I am prepared for the challenges ahead and encouraged by the opportunities available, and I believe this Company has provided me with a great foundation to achieve our goals and enhance long-term shareholder value.

**Mr. Saw Boo Guan**

President  
China Yuchai International Limited  
August 31, 2009



# 前任总裁报告



“我们由衷地感谢各位股东在过去的一年里所给予公司的支持。我们渡过重重难关并解决了长久以来积累的一些历史问题。而今，让我们携手展望未来，将公司推向另一个高点及创造更美好的前景。”

## 敬爱的股东，

迈入2008年，我们的柴油发动机需求量继续攀升，这是因为中国的经济保持强劲发展、中国对北京奥运会的投入总额创历史新高及市场赶在2008年7月1日中国开始在全国推行实施使用国3排放标准规定前大量采购现有的柴油发动机的结果。然而，在北美以及欧洲等地却由于受到2008年下半年全球金融风暴的影响，经济受到严重的冲击，从而也导致了市场的汽车销售量急剧下降。虽然中国经济表现强劲，但也受到全球经济不景气的波及，国内生产总值自2003年以来首次出现个位数增长。在2008年里，中国汽车销售量为934万辆，增长了6.7%，但下半年却出现了明显的放缓趋势。由于全球经济疲软，相较于2007年，2008年中国商用汽车第三季度的销售量也明显减缓，下滑了5.3%。尽管如此，我们的子公司广西玉柴机器股份有限公司（“广西玉柴”）却依然连续八年被中国汽车制造商协会评选为同行柴油发动机销量第一的企业，而“玉柴”牌的柴油发动机也被世界品牌实验室（“WBL”）授予2008年“中国品牌年度大奖”。

## 财务业绩

在2008年财政年度里，我们的净营业收入为人民币104亿元（15亿美元），相较于2007年的人民币96亿元，增长了8.3%。此外，由于国3排放标准的新发动机比原有的发动机以更高的价格出售，加上发动机零件需求量的增加，因此虽然整体销售量下滑了3%，但较高的平均售价(ASP)却使得销售收入得到增长。而我们在第四季度的销售额也受到客观环境的影响，尤其是全球金融危机的影响。此外，2008年的毛利率也受到较高原料价格的影响，但作为占据销售额的一部分，营业开支却是持平不变。相较于2007年，虽然2008年的净营业收入下降，但在同一年里也增加了几笔非经常性开支。其中一笔费用是在2008年因作为债务抵偿，广西玉柴收购广西玉林宾馆有限公司后作的4600万元（670万美元）的固定资产减值损失。另外一笔是对其他厂房和设备所作的资产减值损失共人民币239万元（350万美元）。此外，还有一笔人民币570万元（83万美元）的商誉减值费用。截至2008年12月31日，我们资产负债表的现金和现金等价物为人民币6亿9340万元（1亿1500万美元）。



## 发展概况

我们的子公司广西玉柴持续通过其研发专业技术，推出了一系列国3和国4排放标准且具备广泛适用功能的新型发动机。实际上，广西玉柴也是首家在中国推出符合国4和国5排放标准柴油发动机的制造商。随着2008年北京奥运会的举行，国4排放标准也提早在2008年于北京开始实施，并将在2009年11月推及上海实行，预计2010年年底全国普及实施。与此同时，我们也准备就绪，足以应付市场对严格排放标准达标的发动机的需求，并将持续从中受惠。我们深信，我们是市场上生产先进排放标准发动机的主要主导生产制造商之一，同时在中国城市客运巴士的市场有着举足轻重的地位。此外，我们于2008年宣布了广西玉柴与浙江吉利控股集团有限公司和浙江银轮机械股份有限公司共同达成合资协议，并在浙江省天台县和山东省济宁市组建两家合资公司，为中国客车市场开发及生产专有的柴油发动机和零件。柴油轿车已成功打入欧洲市场，而目前在中国的市场渗透率虽然不高，但这也意味着公司在这块领域具有良好的未来发展前景。

## 成果报告

自2008年5月我们结束对广西玉柴针对一笔约人民币1.68亿元应付账款所作的财务调整而可能导致的潜在会计误差事宜的独立调查后，对2005年原来的财务报表重新决算并重申公布了经审计后的财务合并报表。其后，也披露公布了经审计的2006、2007及2008财务年度合并报表。同时公司也聘请了何永明先生担任公司新的首席财务总监公司并增添了高级会计人员的人数且提供更多的培训以增强我们的内部监控和改善现有的汇报程序流程。通过上述措施，我们目前已回归及达到到正常的披露报表的规定要求。同时，于2009年4月17日的公司常年股东大会上也正式批准委任新加坡安永会计师事务所作为公司的外部主要独立审计师。在2009年7月和8月，我们分别披露了2009年第一和第二季度未经审计的财务数据。

## 新总裁

苏武源先生于2009年7月1日被委任成为董事会成员，并于2009年8月1日担任总裁一职。苏先生在汽车工业领域里拥有超过23年的丰富经验，并曾在康明斯公司及通用汽车公司任职。身为康明斯西港公司合资企业的总裁，苏先生负责公司的全球天然气发动机业务。在他的领导下，该公司在2005年至2008年期间的收入和利润的复合年增长率分别为32%和65%。从1989年至2005年，苏先生的工作职责包括负责康明斯公司在美国、新加坡、香港和中国特定作业的综合管理和行销与流通分销管理。而苏先生的领导能力和经验，尤其是他对于汽车工业替代技术的知识，将为中国玉柴带来重大的贡献。

## 展望

为了应对全球经济放缓，中国政府已经宣布了一系列措施以刺激经济活动和鼓励提高汽车销售量。这些措施包括降低某些汽车类别的营业税、提供补贴、低息贷款以及为大量农村人口提供税务优惠奖励，协助他们将目前所拥有的旧高排放量车辆和拖拉机替换提升为高燃料效率、低排放量的轻型卡车、货车和小型厢式车。中国2009年第二季度的生产总值增长预计将达到7.9%，而轿车及轻型车辆的销售量预计也将继续强劲增长。为了长

期持续的增长铺路，中国政府已表明了关于加强环境保护和污染控制方面的坚定立场。在最新的振兴计划中，政府将拨款提供人民币3000元至6000元的补贴，协助车主替换不符合目前废气排放标准或车龄介于8年至12年的车辆，特别是针对商用汽车的替换补贴，更令人振奋的还包括在中国各地展开的大型基础设施建设项目，包括高速铁路、延长国家高速公路、城市地铁以及大型的清洁能源电厂。我们希望这些新措施将能推动刺激更大的消费并提高对重型商用车辆的需求。

我们其他的附属投资公司，即HL Global Enterprises Ltd (HLGE) 和 Thakral Corporation Ltd (TCL)在2008年经历了严峻的商业挑战及考验。竞争激烈的中国酒店业市场以及全球金融危机导致酒店入住率下滑，严重影响HLGE在2008年的经营业绩。我们于上海的酒店式公寓目前正在进行大型翻新工程，并计划在短期内完成。由于大量新酒店业者的涌入，这将形成更为激烈的竞争局面。因此，对于中国酒店业市场未来的展望，我们仍然保持谨慎的态度。

TCL方面，也因其电子产品部门持续受到全球经济放缓的影响而导致毛利率萎缩。TCL在中国的其中一个业务单位的关闭也导致了公司在2008年蒙受净亏损。然而，从中国政府为提高企业的资本流动性而实施的振兴措施中，也可察觉到中国消费者花在电子产品的消费有提高的迹象。因此，TCL将继续开发新的产品线路以开拓其消费电子业务。

## 感谢

我们由衷地感谢各位股东在过去的一年里所给予公司的支持。我们渡过重重难关并解决了长久以来积累的一些历史问题。而今，让我们携手展望未来，将公司推向另一个高点及创造更美好的前景。在我担任中国玉柴国际有限公司总裁期间，我们成功地开拓了公司基本的柴油发动机业务，并继续扩大公司产品在中国市场的占有率。同时，我们也建立了一个尽职专业的管理团队以协助共同扩展公司的业务及为公司的股东谋取更好的效益回报。我坚信中国玉柴国际有限公司将有一个更持续美好的前景。

## 张冬贵

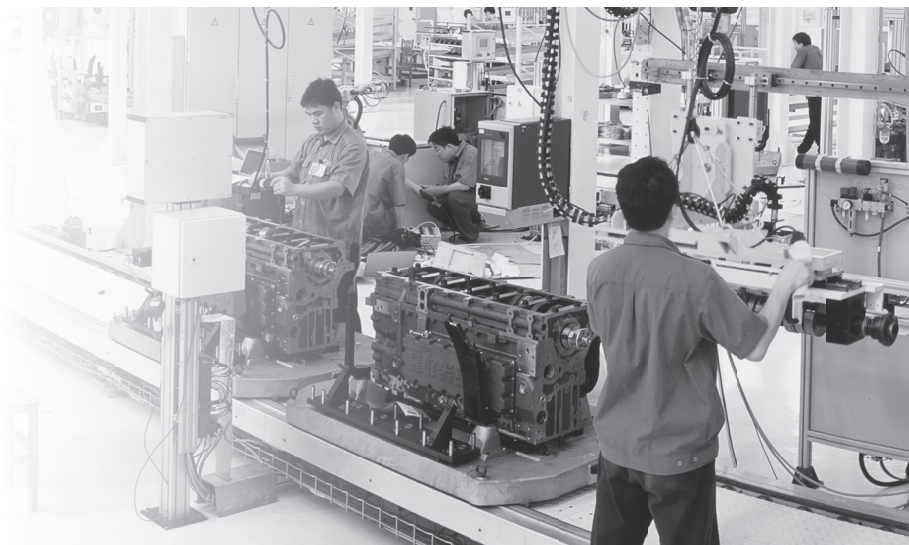
前任总裁

中国玉柴国际有限公司

August 31, 2009



# 总裁报告



“相对重要的是，我们也着重于通过不断地研发以及采用尖端科技，以减低所生产的发动机对于环境的影响。”

## 敬爱的股东，

本人非常荣幸能于2009年7月1日加入中国玉柴国际有限公司（“玉柴国际”）的董事会，同时也期待胜任总裁一职。我之所以会接受委任是因为我对玉柴国际所拥有的价值与潜力具有信心。作为一个品牌，“玉柴”一直备受推崇并在中国各地取得了良好的声誉。同时，中国广西玉柴机器股份有限公司（“广西玉柴”）致力于提供卓越的产品，并着重于质量、创新以及服务。我们将不遗余力地提供安全和具激发性的环境，以吸引和保留最佳的员工，并以他们的成就而自豪。相对重要的是，我们也着重于通过不断地研发以及采用尖端科技，以减低所生产的发动机对于环境的影响。

我借此机会由衷地感谢张冬贵先生多年来的领导、奉献以及敬业精神，为公司未来的增长奠定了良好的基础。

身为玉柴国际的新总裁，我的职责便是为公司开发更大的增长空间和发展潜力。我已经为将来所可能面对的挑战作好了准备，并为呈现于眼前的机会而感到鼓舞。同时，相信公司也已为我提供良好的基础，这让我们能更有效地实现公司未来的扩展目标，并为公司股东的长期回报效益增值。

**苏武源先生**

总裁

中国玉柴国际有限公司

August 31, 2009

# Corporate Governance

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

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

The following table compares our principal corporate governance practices, which are in compliance with Bermuda law, to those required of US companies.



<b>Standard for US Domestic Listed Companies</b>	<b>China Yuchai International Limited's Practice</b>
<p><b>Director Independence</b></p> <ul style="list-style-type: none"> <li>A majority of the board must consist of independent directors.</li> </ul>	<ul style="list-style-type: none"> <li>Three of our nine directors, Messrs. Neo Poh Kiat, Tan Aik-Leang and Matthew Richards are independent within the meaning of the NYSE standards.</li> </ul>
<p>Independence is defined by various criteria including the absence of a material relationship between director and the listed company. Directors who are employees, are immediate family of the chief executive officer or receive over \$120,000 per year in direct compensation from the listed company are not independent. Directors who are employees of or otherwise affiliated through immediate family with the listed company's independent auditor are also not independent.</p>	
<ul style="list-style-type: none"> <li>The non-management directors of each company must meet at regularly scheduled executive sessions without management.</li> </ul>	<ul style="list-style-type: none"> <li>Our non-management directors do not meet periodically without management directors.</li> </ul>
<p><b>Audit Committee</b></p>	
<ul style="list-style-type: none"> <li>Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Exchange Act. The rule requires that the audit committee (i) be comprised entirely of independent directors; (ii) be directly responsible for the appointment, compensation, retention and oversight of the independent auditor; (iii) adopt procedures for the receipt and treatment of complaints with respect to accounting, internal accounting controls or auditing matters; (iv) be authorized to engage independent counsel and other advisors it deems necessary in performing its duties; and (v) be given sufficient funding by the company to compensate the independent auditors and other advisors as well as for the payment of ordinary administrative expenses incurred by the committee.</li> </ul>	<ul style="list-style-type: none"> <li>Our audit committee meets the requirements of Rule 10A-3 under the Exchange Act.</li> </ul>
<ul style="list-style-type: none"> <li>The audit committee must consist of at least three members, and each member meets the independence requirements of both the NYSE rules and Rule 10A-3 under the Exchange Act.</li> </ul>	<ul style="list-style-type: none"> <li>Our audit committee currently consists of three members, each of whom meets the independence requirements of both the NYSE rules and Rule 10A-3 under the Exchange Act.</li> </ul>
<ul style="list-style-type: none"> <li>The audit committee must have a written charter that addresses the committee's purpose and responsibilities.</li> </ul>	<ul style="list-style-type: none"> <li>Our audit committee has a charter outlining the committee's purpose and responsibilities, which are similar in scope to those required of US companies.</li> </ul>

## Corporate Governance

Standard for US Domestic Listed Companies	China Yuchai International Limited's Practice
<p>At a minimum, the committee's purpose must be to assist the board in the oversight of the integrity of the company's financial statements, the company's compliance with legal and regulatory requirements, the independent auditor's qualifications and independence and the performance of the company's internal audit function and independent auditors. The audit committee is also required to review the independent auditing firm's annual report describing the firm's internal quality control procedures, any material issues raised by the most recent internal quality control review or peer review of the firm, or by any recent governmental inquiry or investigation, and any steps taken to address such issues.</p>	
<p>The audit committee is also required to assess the auditor's independence by reviewing all relationships between the company and its auditor. It must establish the company's hiring guidelines for employees and former employees of the independent auditor. The committee must also discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditors, the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies, and policies with respect to risk assessment and risk management. It must also meet separately, periodically, with management, the internal auditors and the independent auditors.</p>	
<ul style="list-style-type: none"> <li>Each listed company must disclose whether its board of directors has identified an Audit Committee Financial Expert, and if not the reasons why the board has not done so.</li> </ul>	<ul style="list-style-type: none"> <li>The Board of Directors has identified Mr. Tan Aik-Leang as our Audit Committee Financial Expert.</li> </ul>
<ul style="list-style-type: none"> <li>Each listed company must have an internal audit function.</li> </ul>	<ul style="list-style-type: none"> <li>We are a holding company and the majority of business is done at our main subsidiary, Guangxi Yuchai Machinery Company Limited ("Yuchai"). Our group transactions, fees and expenses are reviewed by the Internal Audit Department of Hong Leong Asia. In addition, Yuchai maintains an independent internal audit function, headed by an internal audit manager who reports to the Audit Committee of Yuchai's Board which approves the audit plans, reviews significant audit issues and monitors corrective actions taken by management.</li> </ul>
<p><b>Compensation Committee</b></p>	
<ul style="list-style-type: none"> <li>Listed companies must have a compensation committee composed entirely of independent board members as defined by the NYSE listing standards.</li> </ul>	<ul style="list-style-type: none"> <li>Our compensation committee currently has three members, two of whom are independent within the meaning of the NYSE standards.</li> </ul>

<b>Standard for US Domestic Listed Companies</b>	<b>China Yuchai International Limited's Practice</b>
<ul style="list-style-type: none"> <li>The committee must have a written charter that addresses its purpose and responsibilities.</li> </ul>	
<ul style="list-style-type: none"> <li>These responsibilities include (i) reviewing and approving corporate goals and objectives relevant to CEO compensation; (ii) evaluating CEO performance and compensation in light of such goals and objectives for the CEO; (iii) based on such evaluation, reviewing and approving CEO compensation levels; (iv) recommending to the board non-CEO compensation, incentive compensation plans and equity-based plans; and (v) producing a report on executive compensation as required by the SEC to be included in the company's annual proxy statement or annual report. The committee must also conduct an annual performance self-evaluation.</li> </ul>	<ul style="list-style-type: none"> <li>Our compensation committee reviews among other things the Company's general compensation structure, and reviews, recommends or approves executive appointments, compensation and benefits of directors and executive officers, subject to ratification by the Board of Directors, and supervises the administration of our employee benefit plans, if any.</li> </ul>
<b>Nominating/Corporate Governance Committee</b>	
<ul style="list-style-type: none"> <li>Listed companies must have a nominating/corporate governance committee composed entirely of independent board members.</li> </ul>	<ul style="list-style-type: none"> <li>We do not have a nominating/corporate governance committee. However, certain responsibilities of this committee are undertaken by our Compensation Committee, such as the review and approval of executive appointments and all other functions are performed by the Board of Directors.</li> </ul>
<ul style="list-style-type: none"> <li>The committee must have a written charter that addresses its purpose and responsibilities, which include (i) identifying qualified individuals to become board members; (ii) selecting, or recommending that the board select, the director nominees for the next annual meeting of shareholders; (iii) developing and recommending to the board a set of corporate governance principles applicable to the company; (iv) overseeing the evaluation of the board and management; and (v) conducting an annual performance evaluation of the committee.</li> </ul>	
<b>Equity-Compensation Plans</b>	
<ul style="list-style-type: none"> <li>Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions.</li> </ul>	<ul style="list-style-type: none"> <li>We intend to have our shareholders approve equity-compensation plans.</li> </ul>
<b>Corporate Governance Guidelines</b>	
<ul style="list-style-type: none"> <li>Listed companies must adopt and disclose corporate governance guidelines.</li> </ul>	<ul style="list-style-type: none"> <li>We have formally adopted various corporate governance guidelines, including Code of Business Conduct and Ethics (described below); Audit Committee Charter; Whistle-blowing Policy; Insider Trading Policy; and Disclosure Controls and Procedures.</li> </ul>
<b>Code of Business Conduct and Ethics</b>	
<ul style="list-style-type: none"> <li>All listed companies, US and foreign, must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any amendment to or waivers of the code for directors or executive officers.</li> </ul>	<ul style="list-style-type: none"> <li>We adopted a Code of Business Conduct and Ethics Policy in May 2004, which was revised on December 9, 2008. The text of the Code is posted on our internet website at <a href="http://www.cyilimited.com/invest_govt.asp">http://www.cyilimited.com/invest_govt.asp</a>. We intend to promptly disclose any amendment to or waivers of the Code for directors or executive officers.</li> </ul>

# Our China-Wide Presence



 Guangxi Yuchai Machinery Company Limited  
公司总部

 Regional Sales Offices  
玉柴办事处

 Customer Service Stations  
玉柴技术服务站

# Directors and Executive Officers of the Company

Our Board of Directors may consist of up to eleven members. As of July 1, 2009, 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, Saw Boo Guan, Gan Khai Choon and Kwek Leng Peck as its nominees. Messrs. Yan Ping and Zhang Shi Yong are nominees of Coomber Investments Limited.

Our directors and executive officers are identified below.

## Board of Directors

Name	Position	Year First Elected or Appointed Director or Officer
SAW Boo Guan <sup>(1)</sup>	President and Director	2009
TEO Tong Kooi <sup>(1) (2) (5)</sup>	Director	2004
GAN Khai Choon <sup>(1) (5)</sup>	Director	1995
KWEK Leng Peck <sup>(1) (3)</sup>	Director	1994
NEO Poh Kiat <sup>(1) (3) (4)</sup>	Director	2005
TAN Aik-Leang <sup>(1) (4)</sup>	Director	2005
Matthew RICHARDS <sup>(3) (4)</sup>	Director	2006
YAN Ping <sup>(1)</sup>	Director	2007
ZHANG Shi Yong <sup>(1)</sup>	Director	2007

## Management Team

Name	Position	Year First Elected or Appointed Director or Officer
SAW Boo Guan	President	2009
HOH Weng Ming	Chief Financial Officer	2008
FOO Shing Mei Deborah	General Counsel	2007
Ira Stuart OUTERBRIDGE III	Secretary	2001

<sup>(1)</sup> Also a Director of GYMCL.

<sup>(2)</sup> Also a Director of TCL.

<sup>(3)</sup> Member of the Compensation Committee.

<sup>(4)</sup> Member of the Audit Committee.

<sup>(5)</sup> Also a Director of HLGE.



## Directors and Executive Officers of the Company

**Mr. Saw Boo Guan** is the President and Director of the Company. He was appointed a Director of the Company on July 1, 2009. He has extensive experience in the automotive industry and his last position from 2005 to 2008 as President of Cummins Westport Inc., a joint venture company between Cummins, Inc. and Westport Innovations, Inc., a position based in Vancouver, Canada. From 1989 to 2005, Mr. Saw held various positions in a number of Cummins entities in the U.S., Singapore, Hong Kong and China and his responsibilities included general management, marketing and distribution management for various Cummins entities in the U.S., Singapore, Hong Kong and China. Mr. Saw is a Malaysian Federal Government Scholar and received a Master's degree in Public and Private Management from Yale University, U.S. in 1986 and a Bachelor of Engineering (Hons) in Mechanical Engineering from the University of Malaya, Malaysia in 1979.

**Mr. Teo Tong Kooi** is 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, GYMCL, HLGE, TCL and Isyoda Corporation Berhad. He is also the Vice-Chairman and Executive Director of Tasek Corporation Berhad, where he previously 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. Gan Khai Choon** is a Director of the Company, GYMCL 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 the 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 and the Beijing Riviera. He holds a Bachelor of Arts degree (Honors) in Economics from the University of Malaya. Mr. Gan is related to Mr. Kwek Leng Peck.

**Mr. Kwek Leng Peck** is a Director of the Company. He is a member of the Kwek family which controls the Hong Leong Investment Holdings group of companies. He serves as an Executive Director of Hong Leong Asia and is the non-executive Chairman of Tasek Corporation Berhad. He also sits on the boards of HL Technology, Hong Leong China, GYMCL, City Developments Limited, Hong Leong Finance Limited and Millennium & Copthorne Hotels plc. 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 GYMCL. He is Managing Director of Octagon Advisors (Shanghai) Co. Ltd. and a 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 Sing-Han Management Consulting (Shanghai) Limited and Asia Airfreight Terminal Co Ltd. He holds a Bachelor of Commerce degree (Honors) 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 GYMCL. He had held various senior executive and managerial positions for a total of over 25 years at the Dao Heng Bank Group in Hong Kong, the National Australia Bank Group in Australia and Asia, and The Bank of Nova Scotia in Canada. Mr. Tan is currently also a Director of the Risk Management Association, Hong Kong Chapter. He is a Fellow member of the Hong Kong Institute of Certified Public Accountants, CPA Australia, the Financial Services Institute of Australasia (formerly

## Directors and Executive Officers of the Company

known as 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 attorney 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 GYMCL. 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 which is owned by the City Government of Yulin in Guangxi Zhuang Autonomous Region, China is a 22.1 % shareholder in Yuchai. 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 and GYMCL. He also sits on the boards of the State Holding Company, Coomber Investments Limited and Goldman Industrial Limited. 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. Hoh Weng Ming** was appointed Chief Financial Officer of the Company with effect from May 1, 2008. He is also a Director of GYMCL with effect from December 26, 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 (Hons) in Law and History from the University of Keele, UK and a Masters of Law degree in Commercial and Corporate law from the University of London, UK. 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.

# Financial Report

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# Report of Independent Registered Public Accounting Firm

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## **The Board of Directors and Shareholders of China Yuchai International Limited**

We have audited China Yuchai International Limited's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). China Yuchai International Limited's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment. Management has identified material weaknesses in controls related to the company's (1) insufficient knowledge and resources on U.S. generally accepted accounting principles, (2) financial statement closing process and (3) segregation of duties in BOKE system.

These material weaknesses were considered in determining the nature, timing and extent of audit tests applied in our audit of the 2008 financial statements and this report does not affect our report dated July 15, 2009 on those financial statements.

# Report of Independent Registered Public Accounting Firm

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In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, China Yuchai International Limited has not maintained effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

/s/ Ernst & Young LLP  
Singapore  
July 15, 2009



# Report of Independent Registered Public Accounting Firm

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## **The Board of Directors and Shareholders of China Yuchai International Limited**

We have audited the accompanying consolidated balance sheet of China Yuchai International Limited and subsidiaries as of December 31, 2008, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of China Yuchai International Limited for the year ended December 31, 2007 and 2006, were audited by other auditors whose report dated January 30, 2009, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of China Yuchai International Limited and subsidiaries at December 31, 2008, and the consolidated results of their operations and their cash flows for the year ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), China Yuchai International Limited's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 15 2009 expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Ernst & Young LLP  
Singapore  
July 15, 2009

# Report of Independent Registered Public Accounting Firm

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## The Board of Directors and Shareholders

### China Yuchai International Limited

We have audited the accompanying consolidated balance sheet of China Yuchai International Limited and subsidiaries as of December 31, 2007, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for the years ended December 31, 2006 and 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Yuchai International Limited and subsidiaries at December 31, 2007, and the results of their operations and their cash flows for the years ended December 31, 2006 and 2007, in conformity with U.S. generally accepted accounting principles.

As more fully described in Note 5, Note 32 and Note 33(e) to the consolidated financial statements, on December 25, 2007 a subsidiary of the Company purchased a 100% equity interest in Guangxi Yulin Hotel Company Ltd ("Yulin Hotel Company") from certain related parties in contemplation of the settlement of loans due from Yuchai Marketing Company Limited ("YMCL"), which is also a related party. The recoverability of the loans due from YMCL was previously considered impaired and a loss provision and corresponding valuation allowance in the amount of Rmb 203 million was recognized during the year ended December 31, 2005. Although management of the Company has concluded the subsidiary of the Company is the legal owner of the shares in Yulin Hotel Company and the subsidiary also bears the risks and rewards of ownership in the corresponding operations of Yulin Hotel Company as of December 25, 2007, the transfer of the equity interest was subject to the approval of the appropriate government regulatory agency in the People's Republic of China. Consequently, no recovery for the previously recorded impairment loss on the loans due from YMCL has been recognized in the Company's consolidated financial statements as of December 31, 2007. The approval was subsequently obtained on January 13, 2009.

/s/ KPMG LLP  
Singapore  
January 30, 2009

# Consolidated Statements of Income

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

	Note	Years ended December 31,			
		2006	2007	2008	2008
		Rmb	Rmb	Rmb	US\$
Revenues, net(a)	3(k),27	6,920,528	9,556,303	10,384,022	1,519,398
Cost of goods sold(a)	4, 27	(5,648,407)	(7,611,585)	(8,561,520)	(1,252,728)
Gross profit		1,272,121	1,944,718	1,822,502	266,670
Research and development costs	3(m)	(167,653)	(153,146)	(177,370)	(25,953)
Selling, general and administrative expenses(a)	3(m), 3(n),4,14,27	(801,830)	(951,589)	(1,041,225)	(152,353)
Gain on transfer of land use rights to a related party	27	1,841	1,573	-	-
Operating income		304,479	841,556	603,907	88,364
Interest expense	6, 26	(117,491)	(125,244)	(146,973)	(21,505)
Equity in income/(loss) of affiliates, net of tax	17	(22,449)	14,048	(36,573)	(5,351)
Other income, net(a)	7	38,856	53,554	43,261	6,329
Earnings before income taxes and minority interests		203,395	783,914	463,622	67,837
Income taxes	8	(30,466)	(68,518)	(110,531)	(16,173)
Income before minority interests		172,929	715,396	353,091	51,664
Minority interests in income of consolidated subsidiaries		(61,645)	(189,927)	(100,641)	(14,726)
Net income	3(l)	111,284	525,469	252,450	36,938

	Note	Years ended December 31,			
		2006	2007	2008	2008
		Rmb	Rmb	Rmb	US\$
<b>Earnings per common share</b>					
Basic	3(l)	2.99	14.10	6.77	0.99
Diluted	3(l)	2.99	14.10	6.77	0.99
<b>Weighted average number of shares</b>					
Basic	3(l)	37,267,673	37,267,673	37,267,673	37,267,673
Diluted	3(l)	37,267,673	37,267,673	37,267,673	37,267,673

(a) Includes the following income and expenses resulting from transactions with related parties in addition to those indicated above (see Notes 5 and 26)

	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Revenues, net	86,652	94,901	215,064	31,468
Cost of goods sold	(592,535)	(573,926)	(1,030,887)	(150,840)
Selling, general and administrative expenses	(124,376)	(149,964)	(209,036)	(30,586)
Other income, net	10,622	11,664	4,224	618

See accompanying notes to consolidated financial statements.

# Consolidated Balance Sheets

**AS OF DECEMBER 31, 2007 AND 2008**

(Rmb and US\$ amounts expressed in thousands, except per share data)

	Note	As of December 31,		
		2007	2008	2008
		Rmb	Rmb	US\$
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents	31(g)	520,945	693,436	101,464
Trade accounts and bills receivable, net	9	3,107,785	2,537,681	371,315
Amounts due from related parties	10, 26	143,652	139,267	20,378
Loans receivable from a related party, net	5	2,050	–	–
Loans to customers, net	11	3,361	156	23
Inventories	12	1,647,025	2,250,030	329,226
Prepaid expenses		31,752	106,585	15,596
Other receivables, net	13	97,074	181,699	26,586
Income taxes recoverable		27,990	46,296	6,775
Deferred income taxes	8	114,361	125,788	18,405
<b>Total current assets</b>		<b>5,695,995</b>	<b>6,080,938</b>	<b>889,768</b>
Property, plant and equipment, net	14, 32	2,158,246	2,149,290	314,485
Construction in progress	15	184,921	252,872	37,000
Lease prepayments	16, 32	168,002	158,681	23,218
Investments in affiliates	17	505,009	392,386	57,414
Other investments	17	615,201	446,430	65,323
Goodwill	3(n)	218,311	212,636	31,113
Deferred income taxes	8	33,499	19,445	2,845
<b>Total assets</b>		<b>9,579,184</b>	<b>9,712,678</b>	<b>1,421,166</b>
<b>LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY</b>				
<b>Current liabilities</b>				
Short-term bank loans	18(a)	819,164	1,068,675	156,369
Amount due to holding company	26	5,278	451	66
Amounts due to related parties	5, 10, 26	380,521	204,910	29,983
Trade accounts payable		2,509,962	2,612,928	382,325
Income taxes payable		5,663	10,998	1,609
Deferred gain	5	–	202,950	29,696
Accrued expenses and other liabilities	19	946,675	937,084	137,115
Deferred income taxes liabilities	8	–	15,282	2,236
<b>Total current liabilities</b>		<b>4,667,263</b>	<b>5,053,278</b>	<b>739,399</b>
Long-term bank loans	18(b)	767,929	254,529	37,243
<b>Total liabilities</b>		<b>5,435,192</b>	<b>5,307,807</b>	<b>776,642</b>
<b>Total liabilities</b>		<b>5,435,192</b>	<b>5,307,807</b>	<b>776,642</b>
<b>Minority interests</b>		<b>849,527</b>	<b>974,046</b>	<b>142,524</b>

See accompanying notes to consolidated financial statements.

# Consolidated Balance Sheets

## AS OF DECEMBER 31, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

	Note	As of December 31,		
		2007 Rmb	2008 Rmb	2008 US\$
<b>Shareholders' equity</b>				
Common shares		31,945	31,945	4,674
Ordinary shares				
US\$0.10 par value:				
authorized 100,000,000 shares; issued and outstanding				
37,267,673 shares at December 31, 2007 and 2008				
Special share				
US\$0.10 par value: authorized 1 share; issued and				
outstanding 1 share at December 31, 2007 and 2008	1			
Contributed surplus		1,692,251	1,692,251	247,611
Statutory reserves	21	270,339	287,473	42,063
Accumulated other comprehensive income, net		154,580	49,335	7,219
Retained earnings		1,145,350	1,369,821	200,433
<b>Total shareholders' equity</b>		<b>3,294,465</b>	<b>3,430,825</b>	<b>502,000</b>
<b>Total liabilities, minority interests and shareholders' equity</b>		<b>9,579,184</b>	<b>9,712,678</b>	<b>1,421,166</b>

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Shareholders' Equity and Comprehensive Income/(Loss)

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

Note	Common shares	Contributed surplus	Statutory reserves	Retained earnings	Accumulated	Total
					other comprehensive income	
	Rmb	Rmb	Rmb	Rmb	Rmb	Rmb
	31,945	1,692,251	266,586	546,630	28,851	2,566,263
<b>2006</b>						
	-	-	-	111,284	-	111,284
	-	-	-	-	56,840	56,840
	-	-	-	-	3,201	3,201
	-	-	-	-	(3,249)	(3,249)
						168,076
21	-	-	1,000	(1,000)	-	-
	-	-	-	(5,940)	-	(5,940)
	31,945	1,692,251	267,586	650,974	85,643	2,728,399
<b>2007</b>						
	-	-	-	525,469	-	525,469
	-	-	-	-	80,612	80,612
	-	-	-	-	13,283	13,283
	-	-	-	-	(24,958)	(24,958)
						594,406
21	-	-	2,753	(2,753)	-	-
	-	-	-	(28,340)	-	(28,340)
	31,945	1,692,251	270,339	1,145,350	154,580	3,294,465

See accompanying notes to consolidated financial statements.



# Consolidated Statements of Shareholders' Equity and Comprehensive Income/(Loss)

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

	Note	Common shares	Contributed surplus	Statutory reserves	Retained earnings	Accumulated other comprehensive income	Total shareholders' equity
		Rmb	Rmb	Rmb	Rmb	Rmb	Rmb
<b>2008</b>							
Net income		–	–	–	252,450	–	252,450
Net unrealized loss on investment securities, net of nil tax (a)		–	–	–	–	(26,696)	(26,696)
Net unrealized loss on investment securities held by an affiliate, net of nil tax		–	–	–	–	(80,196)	(80,196)
Foreign currency translation adjustments, net of nil tax		–	–	–	–	1,647	1,647
Comprehensive income							147,205
Transfer to statutory reserves	21	–	–	17,134	(2,093)	–	15,041
Dividend declared (US\$0.10 per share)		–	–	–	(25,886)	–	(25,886)
Balance at December 31, 2008		31,945	1,692,251	287,473	1,369,821	49,335	3,430,825
Balance at December 31, 2008 (in US\$)		4,674	247,611	42,063	200,433	7,219	502,000

(a) Components of net unrealized gains on investment securities:

	2006	2007	2008
Unrealized holding gains arising during the year	97,332	98,090	10,235
Redemption of investment securities in an affiliate taken to net income	(19,550)	(17,478)	(36,931)
Investment in affiliate upon conversion (Note 17(b)(i))	(20,942)	–	–
Net unrealized gains/(loss) on investment securities	56,840	80,612	(26,696)

(b) Components of foreign currency translation adjustments

	2006	2007	2008
Balance as at January 1	(10,018)	(13,267)	(38,225)
Foreign currency translation adjustments, net of tax	(3,249)	(24,958)	1,647
Balance as at December 31	(13,267)	(38,225)	(36,578)

(c) Net unrealized gains/(loss) on investment securities

	2006	2007	2008
Balance as at January 1	–	56,840	137,452
Net unrealized gain/(loss) on investment securities, net of tax	56,840	80,612	(26,696)
Balance as at December 31	56,840	137,452	110,756

(d) Net unrealized gains/(loss) on investment securities held by an affiliate

	2006	2007	2008
Balance as at January 1	38,869	42,070	55,353
Net realized gains/(loss) on investment securities held by an affiliate, net of tax	3,201	13,283	(80,196)
Balance as at December 31	42,070	55,353	(24,843)
	85,643	154,580	49,335

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands)

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<b>Cash provided by operating activities</b>				
Net income	111,284	525,469	252,450	36,938
Adjustments to reconcile net income to net cash provided by operating activities:				
– Depreciation and amortization of property, plant and equipment	142,860	223,304	266,621	39,012
– Lease prepayment charged to expense	3,328	4,702	8,647	1,265
– Impairment of property, plant and equipment	2,346	781	69,931	10,232
– Impairment of goodwill	–	–	5,675	830
– Loss on disposal of property, plant and equipment	1,598	5,926	4,008	587
– Gain on transfer of land use rights to a related party	(1,841)	(1,573)	–	–
– Deferred income tax (benefit)/expenses	(19,996)	34,637	2,627	384
– Provision for losses/(recoveries) on guarantees	(7,410)	(4,237)	2,777	406
– Equity in losses/(income) of affiliates, net of tax	21,261	(14,048)	36,573	5,351
– Minority interests	61,645	189,927	100,641	14,726
– Gain on redemption of other investments	(28,457)	(17,478)	(19,198)	(2,809)
– Loss on dilution of investments in affiliates	1,188	2,591	–	–
– Net loss/(gain) on changes in fair value of embedded derivatives	3,617	(6,139)	5,519	808
– Exchange loss/(gain) on financing activities	38,388	38,622	(31,207)	(4,566)
– Bad debt expense/(credit)	21,582	(11,008)	33,487	4,900
Decrease/(increase) in assets				
– Inventories	103,252	(81,842)	(603,005)	(88,232)
– Amounts due from related parties, net	77,401	52,088	33,774	4,942
– Trade accounts and bills receivable, net	(323,647)	(1,615,859)	536,617	78,518
– Prepaid expenses	44,345	62,225	(74,833)	(10,950)
– Other receivables, net	(4,417)	50,804	(76,816)	(11,240)
– Loans to customers, net	(3,582)	8,125	3,205	469
– Income taxes recoverable/(payable), net	32,885	(13,366)	(12,971)	(1,898)
Increase/(decrease) in liabilities				
– Trade accounts payable	332,355	377,164	102,966	15,065
– Accrued expenses and other liabilities	25,236	271,687	(4,296)	(628)
– Amount due to holding company	(1,075)	2,052	(10,507)	(1,537)
<b>Net cash provided by operating activities</b>	<b>634,146</b>	<b>84,554</b>	<b>632,685</b>	<b>92,573</b>
<b>Cash flow from investing activities</b>				
Purchase of property, plant and equipment and construction in progress (includes interest capitalized)	(323,781)	(265,258)	(432,423)	(63,272)
Proceeds from disposal of property, plant and equipment	2,134	5,236	36,975	5,410
Proceeds from disposal of land use rights	2,394	2,125	–	–
Purchase of investments	(923,101)	–	–	–
Proceeds from disposal of other investments	–	773	5,025	735
Acquisition of subsidiaries	–	–	(870)	(127)
Prepayments for land use right	(59,497)	(31)	–	–
Proceeds from redemption of investment securities	11,907	88,652	129,517	18,951
<b>Net cash used in investing activities</b>	<b>(1,289,944)</b>	<b>(168,503)</b>	<b>(261,776)</b>	<b>(38,303)</b>

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands)

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<b>Cash flow from financing activities</b>				
Proceeds from short-term bank loans	974,978	649,164	1,093,528	160,006
Proceeds from long-term bank loans	687,473	197,044	–	–
Repayments of short-term and long term bank loans	(962,835)	(933,533)	(1,284,686)	(187,976)
Dividends paid by subsidiaries to minority shareholders	(23,036)	(22,316)	(33,471)	(4,898)
Dividends paid to shareholders	(5,940)	(28,340)	(25,886)	(3,788)
Capital contributions from minority interests	–	2,920	57,354	8,392
<b>Net cash provided by/(used in) financing activities</b>	<b>670,640</b>	<b>(135,061)</b>	<b>(193,161)</b>	<b>(28,264)</b>
<b>Effect of foreign currency exchange on cash and cash equivalents</b>	<b>(5,104)</b>	<b>(5,978)</b>	<b>(5,257)</b>	<b>(769)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>9,738</b>	<b>(224,988)</b>	<b>172,491</b>	<b>25,239</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>736,195</b>	<b>745,933</b>	<b>520,945</b>	<b>76,225</b>
<b>Cash and cash equivalents at end of year</b>	<b>745,933</b>	<b>520,945</b>	<b>693,436</b>	<b>101,464</b>

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<b>Supplemental disclosures of cash flow information</b>				
Cash paid during the year for:				
– Interest, net of amount capitalized	117,491	125,860	122,745	17,960
– Income taxes	21,012	47,247	106,335	15,559

## Significant non-cash investing and financing transactions

During 2006, the Company settled the amounts payable for the acquisitions of certain new debt and equity securities issued by an affiliated company and the amounts receivable from redemption of its existing investment in debt securities of the same affiliated company with a net cash payment of S\$5.3 million by the Company (see Note 17(b)).

On December 25, 2007, the Company acquired a 100% equity ownership interest in Yulin Hotel Company from a related party for Rmb245.6 million. As of December 31, 2007, the related purchase consideration had not yet been settled (see Notes 5 and 32).

On March 31, 2008, offset agreements were entered into by Yuchai to effect the settlement of the Rmb 205 million loans receivable against the liability of Rmb 245.6 million arising from the purchase of 100% equity interest in Yulin Hotel Company with the balance settled through offset of certain trade receivables due from YMCL, the Guarantors and other related parties (see Notes 5 and 32).

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 1 Background and principal activities

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

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

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

Yuchai established three direct subsidiaries, Yuchai Machinery Monopoly Company Limited (“YMMC”), Guangxi Yulin Yuchai Accessories Manufacturing Company Limited (“YAMC”) (previously known Guangxi Yulin Yuchai Machinery Spare Parts Manufacturing Company Limited) and Yuchai Express Guarantee Co., Ltd (“YEGCL”). YMMC and YAMC were established in 2000, and are involved in the manufacture and sale of spare parts and components for diesel engines in the PRC. YEGCL was established in 2004, and is involved in the provision of financial guarantees to mortgage loan applicants in favor of banks in connection with the applicants’ purchase of automobiles equipped with diesel engines produced by Yuchai. In 2006, YEGCL ceased granting new guarantees with the aim of servicing the remaining outstanding guarantee commitments to completion, expected to be in 2009. As at December 31, 2008, Yuchai held an equity interest of 71.83%, 97.14% and 76.92% respectively in these companies. As at December 31, 2007 and 2008, YMMC had direct controlling interests in twenty-five and thirty subsidiaries respectively, which are involved in the trading and distribution of spare parts of diesel engines and automobiles, all of which are established in the PRC. In December 2006, Yuchai established a wholly-owned subsidiary called Xiamen Yuchai Diesel Engines Co., Ltd. This new subsidiary was established to facilitate the construction of a new diesel engine assembly factory in Xiamen Fujian province in China. On April 10, 2007, Yuchai signed a Cooperation Framework Agreement with Zhejiang Geely Holding Group Co., Ltd or Geely and Zhejiang Yinlun Machinery Company Limited or Yinlun to consider establishing a proposed joint venture company to develop diesel engines for passenger cars 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”) are primarily engaged in the development, production and sales of a proprietary diesel engine and its parts for passenger vehicles. Yuchai is the controlling shareholder with 52% with Geely and Yinlun holding 30% and 18% shareholding respectively in both JV Cos. The two JV Cos have been duly incorporated. In December 2007, Yuchai purchased a subsidiary, Guangxi Yulin Hotel Company Ltd (“Yulin Hotel Company”) (see Note 32).

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 1 Background and principal activities (cont'd)

In March 2005, the Company, through Venture Delta Limited or Venture Delta acquired 14.99% of the ordinary shares of Thakral Corporation Ltd ("TCL"). TCL is a company listed on the main board of the Singapore Exchange Securities Trading Limited (the "Singapore Exchange") and is involved in the manufacture, assembly and distribution of high-end consumer electronic products and home entertainment products in the PRC. Three directors out of eleven directors on the board of TCL are appointed by the Company. Based on the Company's shareholdings and representation in the board of directors of TCL, management has concluded that the Company has the ability to exercise significant influence over the operating and financial policies of TCL. Consequently, the Company's consolidated financial statements include the Company's share of the results of TCL, accounted for under the equity method. The Company acquired an additional 1% of the ordinary shares of TCL in September 2005. As a result of the rights issue of 87,860,288 rights shares on February 16, 2006, the Company's equity interest in TCL increased to 19.4%. On August 15, 2006, the Company exercised its right to convert all of its 52,933,440 convertible bonds into 529,334,400 new ordinary shares in the capital of TCL. Upon the issue of the new shares, the Company's interest in TCL has increased to 36.6% of the total issued and outstanding ordinary shares. During the year ended December 31, 2007, the Company did not acquire new shares in TCL. However, as a result of conversion of convertible bonds into new ordinary shares by TCL's third party bondholders, the Company's interest in TCL was diluted to 34.4%. On September 2, 2008, Venture Delta transferred 1,000,000 ordinary shares, representing 0.04% interest in TCL to Grace Star Services Ltd. As of December 31, 2008, the Company's interest in TCL remained unchanged.

On February 7, 2006, the Company acquired 29.1% of the ordinary shares of HL Global Enterprises Limited (formerly known as HLG Enterprise Limited ("HLGE")). HLGE is a public company listed on the main board of the Singapore Exchange. HLGE is primarily engaged in investment holding, and through its group companies, invests in rental property, hospitality and property developments in Asia. On November 15, 2006, the Company exercised its right to convert all of its 196,201,374 non-redeemable convertible cumulative preference shares into 196,201,374 new ordinary shares in the capital of HLGE. Upon the issue of the new shares, the Company's equity interest in HLGE has increased to 45.4% of the enlarged total number of ordinary shares in issue. As at December 31, 2008, three directors out of seven directors on the board of HLGE are appointed by the Company. Based on the Company's shareholdings and representation in the board of directors of HLGE, management has concluded that the Company has the ability to exercise significant influence over the operating and financial policies of HLGE. Consequently, the Company's consolidated financial statements include the Company's share of the results of HLGE, accounted for under the equity method. During the year ended December 31, 2007, the Company did not acquire new shares in HLGE. However, new ordinary shares were issued by HLGE arising from the third party's conversion of non-redeemable convertible cumulative preference shares, and the Company's interest in HLGE was diluted to 45.4%. There was no change in shareholding in 2008.

## 2 General

### *Basis of presentation*

The accompanying consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP").

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices

### (a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company, its majority-owned subsidiaries and those entities that the Company has determined that it has a direct or indirect controlling financial interest in (collectively, referred to as the “Group”). All significant intercompany balances and transactions have been eliminated in consolidation. In addition, the Company evaluates the Group’s relationships with other entities to identify whether they are variable interest entities as defined by the Financial Accounting Standards Board (the “FASB”) Interpretation (“FIN”) No. 46 (R), “Consolidation of Variable Interest Entities” (“FIN 46(R)”) and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Group is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46(R). The Group was not the primary beneficiary of any variable interest entities during the three years ended December 31, 2008.

### (b) Cash and cash equivalents

Cash includes cash on hand and demand deposits with banks. For purposes of the consolidated statements of cash flows, management considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. None of the Group’s cash is restricted as to withdrawal. See Note 28 for discussion of restrictions on the Renminbi.

### (c) Trade accounts receivable, loans receivable and bills receivable, net

Trade accounts receivable are recorded at the invoiced value of goods sold after deduction of trade discounts and allowances, if any. The allowance for doubtful accounts is management’s best estimate of the amount of probable credit losses in the Group’s accounts receivable. Management determines the allowance based on specific account identification and historical write-off experience by industry and national economic data.

Management reviews the Group’s allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectability. All other balances are reviewed on a pooled basis by aging of such balances. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

The Group sells bills receivable to banks on an ongoing basis. The buyer is responsible for servicing the receivables upon maturity of the bills receivable. Sales of the bills receivable are accounted for under Statement of Financial Accounting Standards (“SFAS”) No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities”. Accordingly, where the derecognition criteria is met, bills receivable are derecognized, and a discount equal to the difference between the carrying value of the trade accounts and bills receivable and cash received is recorded. The Group received proceeds from the sales of the bills receivable of Rmb4,485,221, Rmb4,403,828 and Rmb4,775,590 (US\$698,768), for the years ended December 31, 2006, 2007 and 2008, respectively. The Group has recorded discounts totaling Rmb54,720, Rmb75,193 and Rmb90,977 (US\$13,312) in respect of the sold bills receivable for the years ended December 31, 2006, 2007 and 2008, respectively, which has been included in interest expense.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (c) *Trade accounts receivable, loans receivable and bills receivable, net (cont'd)*

For loans receivable, the Company recognises interest income on an accrual basis based on an effective interest method. The Company does not accrue interest when a loan is considered impaired and the Company recognises such interest income on a cash basis.

### (d) *Inventories*

Inventories are stated at the lower of cost and market. Cost is determined using the weighted average cost method. Cost of work in progress and finished goods comprises direct materials, direct labor and an attributable portion of production overheads. Management routinely reviews its inventory for salability and indications of obsolescence to determine if inventory carrying values are higher than market values. If market conditions or future product enhancements and developments change, inventories would be written down to reflect the estimated market value.

### (e) *Property, plant and equipment, net*

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

Buildings	30 to 40 years
Machinery and equipment	5 to 15 years
Office and computer equipment	4 to 5 years
Leasehold improvements	Shorter of estimated useful life or remaining lease term

The Group capitalizes interest with respect to major assets under installation or construction based on the average cost of the Group's borrowings. Repairs and maintenance of a routine nature are expensed while those that extend the life of assets are capitalized. Upon retirement or disposal of assets, the cost and related accumulated depreciation are removed from the consolidated balance sheets and any gain or loss is included in the consolidated statements of operations.

Construction in progress represents factories under construction and machinery and equipment pending installation. All direct costs relating to the acquisition or construction of buildings and machinery and equipment, including interest charges on borrowings, are capitalized as construction in progress. No depreciation is provided in respect of construction in progress. Construction of plant is considered to be completed on the date when the plant is substantially ready for its intended use notwithstanding whether the plant is capable of producing saleable output in commercial quantities.

### (f) *Lease prepayments*

Lease prepayments represent payments to the PRC land bureau for land use rights, which are charged to expense on a straight-line basis over the respective periods of the rights which are in the range of 15 to 50 years.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (g) *Guarantees*

The fair value of a guarantee provided by the Group for the obligation of others is recognized at fair value at inception as a liability in accordance with FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees including Indirect Guarantees of Indebtedness of Others". If the guarantee was issued in a stand-alone transaction for a fee, the fair value of the liability recognized generally would offset the cash received by the Group, which is included in "Accrued expenses and other liabilities" and amortized to revenue over the period of guarantee. After initial measurement and recognition of the liability for obligations under the guarantee, management periodically evaluates outstanding guarantees and accounts for potential loss contingencies associated with the guarantees based on estimated losses from default in accordance with SFAS No. 5, "Accounting for Contingencies," after considering the effect of any amounts that may possibly be recovered under recourse, under which the liability is adjusted for further loss that is probable and when the amount of the loss can be reasonably estimated.

### (h) *Investments*

#### Affiliates

An affiliate is an entity in which the Company or the Group has the ability to exercise significant influence in its financial and operating policy decisions, but does not have a controlling financial interest. Investments in affiliates are accounted for using the equity method. The Group's share of earnings and losses of affiliate, adjusted to eliminate intercompany gains and losses and to account for the difference between the cost of investment and the underlying equity in net assets of the affiliates, is included in the consolidated results.

Management assesses impairment of its investments in affiliates when adverse events or changes in circumstances indicate that the carrying amounts may not be recoverable. A loss in value of investments in affiliate which is considered other than a temporary decline is recognized as an impairment charge.

#### Other investments

Investments in available-for-sale securities, including convertible preference shares of an affiliate that are mandatorily redeemable, are carried at fair value. Unrealized holding gains and losses, net of related tax effect, on available-for-sale securities are included in accumulated other comprehensive income/(loss), a separate component of stockholders' equity, until realized. Realized gains and losses from the disposal of available-for-sale securities are determined on a specific-identification basis.

Investments in convertible preference shares of an affiliate that are neither mandatorily redeemable by the issuer nor redeemable at the option of the investor, and that do not have a readily determinable fair value are accounted for under the cost method.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (h) *Investments (cont'd)*

#### Other investments (cont'd)

The Group recognizes 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, management considers various factors including market price of underlying holdings when available, investment ratings, the financial conditions and near term prospect of the investees, 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.

Equity derivatives embedded in the available-for-sale debt securities are recorded at fair values through income.

### (i) *Foreign currency transactions and translation*

The Company's functional currency is the US dollar. The functional currency of the Company's subsidiaries and certain of its affiliated companies located in the PRC is the Renminbi. Transactions denominated in currencies other than Renminbi are recorded based on exchange rates at the time such transactions arise, such as the Renminbi exchange rates quoted by the People's Bank of China (the "PBOC") prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the applicable exchange rates at the balance sheet dates. The resulting exchange differences are recorded in the consolidated statements of income as part of "Other income, net".

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

For the US dollar convenience translation amounts included in the accompanying consolidated financial statements, the Renminbi equivalent amounts have been translated into U.S. dollars at the rate of Rmb 6.8343 = US\$1.00, the rate quoted by the PBOC at the close of business on June 15, 2009. 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 15, 2009 or any other date.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (j) *Income taxes*

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

Beginning with the adoption of FASB Interpretation No.48, "Accounting for Uncertainty in Income Taxes" ("FIN 48") as of January 1, 2007, the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Prior to the adoption of FIN 48, the Company recognized the effect of income tax positions only if such positions were probable of being sustained.

The Company records interest related to unrecognized tax benefits in interest expense, and penalties in selling, general and administrative expenses in the consolidated statements of income.

### (k) *Revenue recognition*

#### (i) *Product sales*

Revenue is recognized in accordance with the Securities and Exchange Commission ("SEC") Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB 104"). SAB 104 requires that, among other conditions, four basic criteria be met before revenue can be recognized:

(i) persuasive evidence of an arrangement exists; (ii) the price is fixed or determinable; (iii) collectability is reasonably assured; and (iv) product delivery has occurred. For the Group, these criteria are generally considered to be met upon delivery and acceptance of products at the customer site.

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

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (k) Revenue recognition (cont'd)

#### (ii) Guarantee fee income

Guarantee fees received or receivable for a guarantee issued are recorded in "Accrued expenses and other liabilities" based upon the estimated fair value at the inception of such guarantee obligations, and are recognized as revenue on a straight line basis over the respective terms of the guarantees.

### (l) Earnings per share

Basic earnings per share is computed by dividing income attributable to common shares by the weighted average number of common shares outstanding for the period. Diluted earnings per share is calculated by dividing net earnings by the weighted average number of common shares outstanding and the number of additional common shares that would be outstanding if any potential common shares that are dilutive are issued. The Company's basic and diluted earnings per share are as follows:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Net income attributable to common shares	111,284	525,469	252,450	36,938
Earnings per share				
– Weighted average common shares outstanding during the year				
Basic	37,267,673	37,267,673	37,267,673	37,267,673
Diluted	37,267,673	37,267,673	37,267,673	37,267,673
– Earnings per common share				
Basic	2.99	14.10	6.77	0.99
Diluted	2.99	14.10	6.77	0.99

There were no potentially dilutive common shares in any of the years ended December 31, 2006, 2007 and 2008.

### (m) Advertising, research and development costs

Advertising, research and development costs are expensed as incurred. Advertising costs included in "Selling, general and administrative expenses", amounted to Rmb42,636, Rmb17,248 and Rmb24,693 (US\$3,613) respectively, for the years ended December 31, 2006, 2007 and 2008.

Yuchai received research and development subsidies of Rmb7,858, Rmb4,730 and Rmb32,653 (US\$4,778) for the years ended December 31, 2006, 2007 and 2008, respectively. The subsidies received are recognized as deferred income and net off against research and development expenses when earned.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (n) *Goodwill*

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Goodwill of Rmb 212,636 and Rmb 5,675 were allocated as a result of the acquisitions of Yuchai (see note 1) and Yulin Hotel (see note 5 and 32) respectively. Goodwill is not amortized, but instead is tested for impairment at least annually or whenever certain circumstances indicate a possible impairment may exist. Management evaluates the recoverability of goodwill using a two-step impairment test approach at the reporting unit level at the end of each year. In the first step, the fair value of the reporting unit is compared to its carrying value including goodwill. The fair value of the reporting unit is determined based upon discounted future cash flows. In the case that the fair value of the reporting unit is less than its carrying value, a second step is performed which compares the implied fair value of the reporting unit's goodwill to the book value of the goodwill. In determining the implied fair value of the reporting unit goodwill, the fair values of the tangible net assets and recognized and unrecognized intangible assets are deducted from the fair value of the reporting unit. If the implied fair value of reporting unit's goodwill is lower than its carrying amount, goodwill is considered impaired and is written down to its implied fair value. In 2008, the goodwill of Rmb 5,675 pertaining to the Yulin Hotel acquisition in 2007 was fully impaired because the carrying amount is not recoverable from the expected future cash flows. The remaining goodwill of Rmb 212,636 pertains to the acquisition of Yuchai and there was no impairment of the Yuchai goodwill in 2006, 2007 and 2008.

### (o) *Product warranty*

The Group recognizes a liability at the time the product is sold, for the estimated future costs to be incurred under the lower of a warranty period or warranty mileage on various engine models, on which the Group provides free repair and replacement. Warranties extend for a duration (generally 12 months to 24 months) or mileage (generally 80,000 kilometers to 250,000 kilometers), whichever is the lower. Provisions for warranty are primarily determined based on historical warranty cost per unit of engines sold adjusted for specific conditions that may arise and the number of engines under warranty at each financial year. 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, the accrued liability for product warranty will be adjusted accordingly.

### (p) *Use of estimates*

The preparation of the consolidated financial statements in accordance with U.S. GAAP requires management of the Group to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the recoverability of the carrying amount of long-lived assets including goodwill, estimated fair value of investments and other financial instruments, realizable values for inventories, valuation allowances for receivables and loans to related parties, obligations for warranty costs, and probable losses on loan guarantees of YEGCL. Actual results could differ from those estimates.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

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

Long-lived assets to be held and used, such as property, plant and equipment and construction in progress 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 sum of the undiscounted cash flows expected to result from its use and eventual disposition. An impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset, if the carrying value is not recoverable from the expected future cash flows. Fair value is the price that would be received to sell the asset on the measurement date in an orderly transaction between market participants in the principal or most advantageous market for the asset. Assets to be disposed of would be separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

The Company periodically conducts an impairment review on the conditions of our property, plant and equipment. It was determined certain fixed assets of Yuchai were idle or other factors existed, such as decline in property values, which suggest that the recovery of their respective carrying values may have been impaired. An impairment loss of Rmb 2.3 million, Rmb 0.8 million and Rmb 69.9 million was charged to the consolidated statement of operations in 2006, 2007 and 2008 respectively under selling, general and administrative expense. The 2008 impairment charges were as follows:

- Yulin Hotel and Guilin office buildings (see Note 32) Rmb 46.0 million (US\$6.7 million)
- Other plants and equipments Rmb 23.9 million (US\$3.5 million)

### (r) *Fair value measurements*

Effective January 1, 2008, the Company adopted SFAS No. 157, which defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a three level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Observable inputs other than quoted prices included in level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (r) *Fair value measurements (cont'd)*

The Company's adoption of SFAS No. 157 did not have a material impact on our consolidated financial statements.

The fair value of long-lived assets is the price that would be received to sell the asset on the measurement date in an orderly transaction between market participants in the principal or most advantageous market for the asset.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. The carrying amount of cash and cash equivalents, trade accounts receivable, bills receivable, short term amounts due from related parties, prepaid expenses, other receivables, short-term bank loans, current instalments of long-term bank loans, trade accounts payable, amount due to the holding company and amounts due to related parties approximates their fair value because of the short maturity of these instruments. It was not practicable for management to estimate the fair value of its equity investments for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation is considered excessive in relation to the significance of the equity investments to the Group. Management does not believe the carrying value of the equity investments will be significantly different from their fair value. Management estimated the fair value of its financial investments by obtaining an independent valuation of the investments by a professional valuer who adopted the discounted cash flow methodology.

The carrying amount of long-term bank loans approximates their fair value based on the borrowing rates currently available for bank loans with similar terms and average maturities.

### (s) *Commitments and contingencies*

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

### (t) *Defined contribution plans*

The Group participates in and makes contributions to the national pension schemes as defined by the laws of the countries in which it has operations. The contributions are at a fixed proportion of the basic salary of the staff. Contributions are recognized as compensation expense in the period in which the related services are performed.

### (u) *Leases*

Where the Company has the use of assets under operating leases, payments made under the leases are recognized in the consolidated statement of income on a straight-line basis over the term of the lease. Lease incentives received are recognized in the consolidated statement of operations as an integral part of the total lease payments made. Contingent rentals are charged to the consolidated statement of income in the accounting period in which they are incurred.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (v) *Recently issued accounting standards*

In February 2008, FASB issued FASB Staff Position No. 157-2, or FSP FAS 157-2, to delay the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Management does not believe the adoption of this statement will have a material impact on the consolidated financial statements at this time and will monitor any additional implementation guidance that may be issued.

In June 2007, the Financial Accounting Standards Board (FASB) ratified EITF Issue No.07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities. The EITF requires non-refundable advance payments to acquire goods or pay for services that will be consumed or performed in a future period in conducting R&D activities should be recorded as an asset and recognized as an expense when the R&D activities are performed. The EITF is to be applied prospectively to new contractual arrangements entered into beginning in fiscal 2009. The Company currently recognizes these non-refundable advanced payments, if any, as an expense upon payment. The adoption of EITF 07-3 is not expected to have a significant effect on the Company's financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), or SFAS No. 141(R), "Business Combination" which replaces SFAS No. 141. SFAS No. 141(R) 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. 141(R) on the Company's consolidated financial positions and consolidated results of operations is dependent upon the specific terms of any applicable future business combinations.

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 recharacterised 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. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-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. The Company is required to adopt this statement in the first quarter of fiscal year 2009 and management is currently assessing the impact of adopting SFAS No. 160. Earlier adoption is prohibited. This Statement shall be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. Management is presently evaluating the impact of the newly required disclosures.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (v) Recently issued accounting standards (cont'd)

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP FAS 142-3 amends the factors that should be considered in developing a renewal or extension assumptions used for purposes of determining the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other GAAP. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier application is not permitted. We believe the impact of adopting FSP FAS 142-3 will not have a material effect on our consolidated financial condition or results of operations.

In May 2008, the FASB issued FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. This FSP clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*. Additionally, this FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Management will evaluate the impact of this FSP to the Company's consolidated financial statements if it applies.

In November 2008, the Emerging Issues Task Force issued EITF Issue No. 08-6, *Equity Method Investment Accounting Consideration*, that addresses how the initial carrying value of an equity method investment should be determined, how an impairment assessment of an underlying indefinite-lived intangible asset of an equity method investment should be performed, how an equity method investee's issuance of shares should be accounted for, and how to account for a change in an investment from the equity method to the cost method. EITF Issue No. 08-6 shall be effective in fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. EITF Issue No. 08-6 shall be applied prospectively with early application prohibited. The impact of adopting EITF 08-6 is not expected to have a material impact on our consolidated financial condition or results of operations.

In December 2008, the FSP FAS 140-4 and FSP FIN 46(R)-8 amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, and FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities (FIN 46(R))*. The FSP was issued by the FASB to expeditiously meet the need for enhanced information about transferred financial assets and about an enterprise's involvement with a variable interest entity (VIE). The FSP requires extensive additional disclosures by public entities with continuing involvement in transfers of financial assets to special-purpose entities and with VIEs, including sponsors that have a variable interest in a VIE. Additionally, the FSP requires certain disclosures to be provided by a public entity. This FSP is effective for fiscal periods ending after December 15, 2008 (i.e., fiscal year 2008 for calendar year companies). The Company intends to provide the additional disclosures under this FSP if it applies.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (v) *Recently issued accounting standards (cont'd)*

In January 2009, the FASB ratified EITF Issue No. 08-10, Selected Statement 160 Implementation Questions. The Issue is to clarify the accounting for certain transactions involving a transfer of an interest in a subsidiary after the effective date of SFAS No. 160. Specifically, i) accounting for the transfer of an interest in a subsidiary that is in-substance real estate; ii) accounting for the transfer of an interest in a subsidiary to an equity method investee that results in deconsolidation of the subsidiary; iii) accounting for the transfer of an interest in a subsidiary in exchange for a joint venture interest that results in deconsolidation of the subsidiary. This Issue shall be effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. This Issue shall be applied prospectively. Management will evaluate the impact of this Issue to the Company's consolidated financial statements if it applies.

In January 2009, the FASB issued FSP EITF 99-20-1 that amends EITF Issue No. 99-20, "Recognition of Interest Income and Impairment of Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets." The FSP eliminates the requirement that a holder's best estimate of cash flows be based upon those that "a market participant" would use. Instead, the FSP requires that an other-than-temporary impairment (OTTI) be recognized as a realized loss through earnings when it is "probable" there has been an adverse change in the holder's estimated cash flows from the cash flows previously projected, which is consistent with the impairment model in FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (Statement 115). The FSP is effective for interim and annual reporting periods ending after December 15, 2008 (e.g., December 31, 2008, for a calendar year-end entity), and should be applied prospectively. Retrospective application to a prior interim or annual reporting period is not permitted. Management will evaluate the impact of this FSP to the Company's consolidated financial statements if it applies.

In April 2009, the FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies. The FSP amends SFAS No. 141(R), Business Combinations, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies (hereinafter referred to as "pre-acquisition contingencies") be recognized at fair value, in accordance with SFAS No. 157, Fair Value Measurements, if the fair value can be determined during the measurement period. FSP FAS 141(R)-1 has the same effective date as SFAS No. 141(R), which is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (i.e., on or after January 1, 2009 for a calendar year end company). Management will evaluate the impact of this FSP to the Company's consolidated financial statements if it applies.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (v) Recently issued accounting standards (cont'd)

In April 2009, the FASB released FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2). FSP FAS 115-2 was issued contemporaneously with FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly (FSP FAS 157-4) and FSP FAS 107-1 and APB 28-1, Interim Disclosures About Fair Value of Financial Instruments (FSP FAS 107-1). The three FSPs were approved by the FASB at its meeting on April 2, 2009. FSP FAS 115-2 changes existing accounting requirements for other-than-temporary-impairment (OTTI). FSP FAS 157-4 amends SFAS No. 157, Fair Value Measurements (Statement 157) to provide additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. The FSP FAS 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. FSP FAS 157-4, as well as the related FSP issued on the same day, FSP FAS 107-1, also require additional disclosures about fair value measurements in annual and interim reporting periods. FSP FAS 157-4 supersedes FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active. The FSP FAS 107-1 extends the disclosure requirements of SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to interim financial statements of publicly traded companies as defined in APB Opinion No. 28, Interim Financial Reporting. The three FSPs are effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. If an entity elects to early-adopt either FSP FAS 157-4 or FSP FAS 107-1, that entity is required to early-adopt FSP FAS 115-2. Likewise, if an entity early-adopts FSP FAS 115-2 or FSP FAS 107-1, it is also required to early-adopt FSP FAS 157-4. However, early adoption of FSP FAS 107-1 is permitted only if the entity also elects to early adopt FSP FAS 157-4 and FSP FAS 115-2. FSP FAS 157-4 must be applied prospectively and does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, comparative disclosures are required only for periods ending after initial adoption. However, in the period of adoption a reporting entity must disclose a change, if any, in valuation technique and related inputs resulting from the application of the FSP FAS 157-4, and quantify the total effect of the change in valuation technique and related inputs, if practicable, by major category. Management is presently evaluating the impact of FSP FAS 115-2 and FSP FAS 157-4 to the Company's consolidated financial statements. FSP FAS 107-1 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP FAS 107-1 requires comparative disclosures only for periods ending after initial adoption. The Company intends to provide the additional disclosures under FSP FAS 107-1 in fiscal 2009 if it applies.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. The Statement establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This Statement introduces the concept of financial statements being available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. In accordance with this Statement, an entity should apply the requirements to interim or annual financial periods ending after June 15, 2009. The Company intends to provide the additional disclosures under this Statement when it applies.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 3 Summary of significant accounting policies and practices (cont'd)

### (v) Recently issued accounting standards (cont'd)

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 166, Accounting for Transfers of Financial Assets, an amendment of SFAS No. 140 (Statement 166). The most significant amendments resulting from Statement 166 consist of the removal of the concept of a qualifying special-purpose entity (SPE) from SFAS No. 140, and the elimination of the exception for qualifying SPEs from the consolidation guidance of FIN 46(R), Consolidation of Variable Interest Entities. The statement also amends and clarifies certain transfers of financial assets that should not qualify as sales under SFAS No. 140. The disclosures required by Statement 166 are similar to those included in FSP FAS 140-4 and FIN 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets (FSP FAS 140-4/FIN 46(R)), which is superseded by SFAS No. 166. SFAS No. 166 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. That is, SFAS No. 166 is effective January 1, 2010 for calendar-year reporting entities. Earlier application is prohibited. Management will evaluate the impact of the statement to the Company's consolidated financial statements if it applies.

In June 2009, the SFAS No. 167, Amendments to FIN 46(R) (Statement 167), which (1) addresses the effects of eliminating the qualifying special-purpose entity (QSPE) concept from SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and (2) responds to concerns about the application of certain key provisions of FIN 46(R), Consolidation of Variable Interest Entities (FIN 46(R)), including concerns over the transparency of enterprises' involvement with variable interest entities (VIEs). SFAS No. 167 is effective as of the beginning of an enterprise's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. That is, Statement 167 is effective for calendar year-end companies beginning on January 1, 2010. The amendments to FIN 46(R) are applicable to all enterprises and to all entities with which those enterprises are involved, regardless of when that involvement arose. Therefore, upon adoption of SFAS No. 167, all enterprises must reconsider their consolidation conclusions for all entities with which they are involved. Management will evaluate the impact of the statement to the Company's consolidated financial statements when it applies.

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

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

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Cost of goods sold	94,215	163,909	193,062	28,249
Selling, general and administrative expenses	48,645	59,395	73,559	10,763
	142,860	223,304	266,621	39,012

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 4 Depreciation and amortization, sales commissions, and shipping and handling expenses (cont'd)

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

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Selling, general and administrative expenses	32,172	58,719	59,129	8,652

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

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Selling, general and administrative expenses	116,570	154,807	156,100	22,841

## 5 Provision for uncollectible loans to a related party and subsequent contingent recovery

The amount represents the recognition of specific impairment provisions totaling Rmb202,950 on the loans with an aggregate principal amount of Rmb205 million due from Yuchai Marketing Company Limited ("YMCL") as of December 31, 2005. YMCL is wholly owned by Coomber Investment Limited ("Coomber"), a shareholder of the Company and State Holding Company (collectively, the "Chinese Shareholders").

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

On December 2, 2004, these advances were converted into formal loans and written agreements and were executed between Yuchai and YMCL through an authorized financial institution in the PRC. Under the terms of the loan agreements, the loans were payable in their entirety on December 2, 2005 and interest, at the rate of 5.58% per annum, was payable on a monthly basis. Further, the loans were secured by guarantees given by the Chinese Shareholders. Interest income of Rmb10,512, Rmb11,548 and Rmb4,224 (US\$618) was received and recognized in 2006, 2007 and 2008, respectively.

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

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 5 Provision for uncollectible loans to a related party and subsequent contingent recovery (cont'd)

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

When the loans became due in December 2005, Yuchai was requested to extend the maturity date for the loans. However, the Company and Yuchai had been unable to access the financial statements of YMCL. Consequently, the Directors from the Company's and Yuchai's boards had doubts about YMCL's ability to repay the loans. However, the Company's and Yuchai's board of directors considered the request to extend the loans based on representations received from the Chinese Shareholders and management of YMCL concerning their respective abilities and intentions to repay the loans and honor their guarantees, and therefore agreed to extend the repayment date of the loans for an additional year. The extension of the loans was approved by the Board of Directors of Yuchai on December 2, 2005. An agency bank was appointed under PRC requirements to administer the Rmb205 million loans and the legal method requires such loans to be repaid and the funds re-disbursed. The new loans carry the same terms, including scheduled maturity on December 1, 2006. New guarantees were also granted by the Chinese Shareholders for these loans. The maturity date of the loans was subsequently extended to June 1, 2007 and further extended to May 30, 2008.

The Company discussed this matter with the Chinese Shareholders and management of YMCL and also considered the financial position and financial resources of the State Holding Company and Coomber. CYI management made an assessment of the future cash flows of the State Holding Company and Coomber and concluded that it was likely they will not be able to honor their respective guarantees in the event YMCL is unable to repay the loans when they become due.

Consequently, at that time, CYI management identified a number of possible courses of action in the event YMCL is unable to repay the loans when they become due. These actions included:

- Taking actions to force YMCL to liquidate;
- Retaining portions of future dividends declared by Yuchai and payable to State Holding Company until the guarantee obligations are fulfilled; and
- Commencing legal action against YMCL and possibly the Chinese Shareholders.

The Company's management ruled out any form of legal or other enforcement action against the Chinese Shareholders as management believed that Yuchai may not be the first preferred creditor entitled to receive payment of the judgment debt. Moreover, management believed that the process for enforcement of a judgment in China is complex and not as effective when compared with other jurisdictions. In addition, management believed that the commencement of legal or other enforcement actions would likely lead to a deterioration in relations with the Chinese Shareholders which could have a materially adverse impact on the Company's investment in Yuchai and could lead to the impairment of shareholder value of the Company. Consequently, management believed that it was beneficial to the Company's shareholders for management to continue their dialogue and seek other possible arrangements with YMCL, Coomber and State Holding Company to resolve the repayment of the Rmb205 million loans rather than for it to resort to legal and enforcement actions described above.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 5 Provision for uncollectible loans to a related party and subsequent contingent recovery (cont'd)

In July 2007, Yuchai's Board of Directors agreed in principle to a proposal by the State Holding Company to settle the loans due from YMCL, along with various other accounts receivable from YMCL (collectively, the "receivables"), by forgiving the receivables in exchange for the transfer of 100% of the equity ownership in a hotel in Yulin, PRC and YMCL's central office building in Guilin, PRC. On December 25, 2007, Yuchai, pursuant to the execution of a share transfer contract with YMCL, Coomber and State Holding Company, acquired all the outstanding share capital of Guangxi Yulin Hotel Company Ltd ("Yulin Hotel Company") for Rmb245.6 million. As of December 31, 2007 the purchase consideration for this acquisition had not been settled and is included in "Amounts due to related parties" on the consolidated balance sheet. Agreements were entered into by Yuchai on March 31, 2008 to effect the repayment of the Rmb205 million loans against the liability of Rmb245.6 million arising from the purchase of 100% equity interest in Yulin Hotel Company with the balance settled through offset of certain trade receivables due from YMCL, the Guarantors and other related parties. Under the terms of these agreements, Yuchai's purchase price obligation of Rmb245.6 million was legally extinguished through the offsetting of this liability.

As of December 31, 2007 and 2008, the transfer of the 100% equity interest in Yulin Hotel Company was subject to approval from the provincial government regulatory agency in charge of state-owned assets administration in China. Yuchai's Board of Directors and shareholders had approved an extension of time for obtaining of approval from November 30, 2008 to June 30, 2009 failing which, Yuchai would have had the right to sell to the State Holding Company, who would have been obligated to buy, 100% of the equity in Yulin Hotel Company at the original purchase price of Rmb245.6 million. This condition is contained in a guarantee letter provided by the original shareholders of Yulin Hotel Company. However, management of the Company was uncertain whether State Holding Company had the financial ability to purchase Yulin Hotel Company for the full contractual amount of Rmb245.6 million. Consequently, no recovery of the previously recorded impairment loss on the loans due from YMCL has been recognized in the Company's consolidated financial statements as of December 31, 2008 and the provision against the loan was reclassified as a deferred gain in the balance sheet. Such recovery will only be recognized in the Company's consolidated financial statements in the period when a) approval is obtained from the provincial government regulatory agency in charge of state-owned assets administration in China for its acquisition of the 100% equity interest in Yulin Hotel Company, or b) the Company is able to resolve the uncertainty about the recovery through other means. On January 13, 2009, Yuchai received approval from the provincial government regulatory agency in charge of state-owned assets administration in China for its acquisition of the 100% equity interest in Yulin Hotel Company. The gain will be recognized in the Statement of Income in 2009 upon receipt of approval from the provincial government.

An analysis of the allowance for doubtful loans for 2006, 2007 and 2008 is as follows:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Balance at beginning of year	202,950	202,950	202,950	29,696
Less: Reclassified to deferred gain	-	-	(202,950)	(29,696)
Balance at end of year	202,950	202,950	-	-



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 6 Interest cost

The Group capitalizes interest charges as a component of the cost of construction in progress. The following is a summary of interest cost incurred during 2006, 2007 and 2008:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Interest cost capitalized	18,057	12,367	11,500	1,683
Interest cost charged to consolidated statements of operations	117,491	125,244	146,973	21,505
Total interest cost incurred	135,548	137,611	158,473	23,188

## 7 Other income, net

Other income, net consists of:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Interest income	47,124	54,205	37,784	5,529
Foreign exchange (loss)/gain, net	(41,940)	(37,172)	10,412	1,523
Dividend income from other investments	–	4,897	–	–
Rental income	1,766	1,499	188	27
Loss on dilution of equity interests in affiliates	(1,188)	(2,591)	–	–
Gain on redemption of other investments (Note 17(b)(ii))	28,457	17,478	19,198	2,809
Net gain/(loss) on changes in fair value of embedded derivatives (Note 17(b))	(3,617)	6,139	(5,366)	(785)
Others, net	8,254	9,099	(18,955)	(2,774)
	38,856	53,554	43,261	6,329

## 8 Income taxes

### *Bermuda tax*

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

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

# Notes to Consolidated Financial Statements

**FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008**

(Rmb and US\$ amounts expressed in thousands, except per share data)

## **8 Income taxes (cont'd)**

### ***PRC income tax***

As Yuchai is a sino-foreign enterprise in the Western Region of the PRC that is engaged in an encouraged industry, its PRC statutory income tax rate is 15% in 2006, 2007 and 2008 under the relevant PRC income tax laws.

The PRC income tax rates of Yuchai's subsidiaries under the relevant PRC income tax laws are 15% to 33% in 2006 and 2007, 15% to 25% in 2008.

Pursuant to the income tax law of the PRC concerning foreign investment and foreign enterprises (the "FEIT Law"), the applicable income tax rate through December 31, 2008 of Yuchai was 15%. Since January 1, 2002, Yuchai was subject to tax at a rate of 15% so long as it continued to qualify as a foreign-invested enterprise eligible for tax reductions under PRC income tax law.

In 2007, the National People's Congress approved and promulgated a new tax law, China's Unified Enterprise Income Tax Law ("CIT law"), which became effective January 1, 2008. Under the CIT law, foreign invested enterprises and domestic companies are subject to a uniform tax rate of 25%. The CIT law provides a five-year transition period from its effective date for those enterprises which were established before the promulgation date of the CIT law and which were entitled to a preferential lower tax rate under the then-effective tax laws or regulations. In accordance with a grandfathering provision, the CIT law also provides for a graduated tax rate increase over a five-year period from an existing reduced tax rate to the uniform tax rate of 25%.

In 2008, Yuchai has continued to fulfill the requirements to qualify for an extension to the reduced tax rate of 15% which will continue to 2010 in accordance with transitional arrangements in the CIT law. Subsequent to this, Yuchai can apply for other programs which may be available to provide a reduced rate. In the event that Yuchai is ineligible for either an extension to the existing tax rate reduction or the transitional graduated rates noted above, Yuchai would be subject to tax at a rate of 25%. For all of Yuchai's subsidiaries that were previously subjected to tax at a rate of 33%, the rate has been lowered to 25% following the CIT law.

The CIT law also provides for a tax of 10% to be withheld from dividends expected to be paid from earnings made in the PRC to foreign investors of PRC enterprises. This withholding tax provision does not apply to dividends paid out of profits earned prior to January 1, 2008. Beginning on January 1, 2008, a 10% withholding tax will be imposed on dividends expected to be paid to CYI, a non-PRC resident enterprise, unless an applicable tax treaty provides for a lower tax rate and the Company will recognize withholding taxes payable for profits accumulated after December 31, 2007 for the earnings that the Company does not plan to indefinitely reinvest in the PRC enterprises. The Company recognise withholding tax expense and a corresponding deferred tax liability of Rmb 15,282 in 2008.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 8 Income taxes (cont'd)

Earnings before income taxes and minority interests comprise the following:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
PRC	292,359	845,239	495,408	72,489
Non-PRC	(88,964)	(61,325)	(31,786)	(4,652)
Total	203,395	783,914	463,622	67,837

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

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
PRC				
Current tax expense	50,462	33,881	92,622	13,552
Deferred tax expense/(benefit)	(19,996)	34,637	17,909	2,621
	30,466	68,518	110,531	16,173

Income tax expense reported in the consolidated statements of income differs from the amount computed by applying the PRC income tax rate of 15% for the three years ended December 31, 2008 for the following reasons:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Computed tax expense	30,509	117,587	69,543	10,175
Adjustments resulting from:				
– Non-deductible expenses related to errors correction	7,795	–	–	–
– Non-deductible expenses	4,053	8,411	17,861	2,614
– Effect of change in tax law on allowance for doubtful loans to a related party (see Note (ii))	–	27,650	–	–
– Tax credits on purchase of property, plant and equipment	(6,895)	(70,877)	–	–
– Tax credits on purchase of property, plant and equipment forfeited	–	8,861	–	–
– Tax credits for R& D expense (see Note (i))	(10,386)	(11,877)	(10,169)	(1,488)
– Change in valuation allowance	(6,492)	(34,699)	739	108
– Tax rate differential	11,882	18,314	2,048	300
– Underprovision in respect of prior years	–	–	4,683	685
– Withholding tax expense	–	–	15,282	2,236
– Other	–	5,148	10,544	1,543
Actual tax expense	30,466	68,518	110,531	16,173

# Notes to Consolidated Financial Statements

**FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008**

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 8 Income taxes (cont'd)

Notes:

- (i) In 2006 and 2007, amounts mainly represent tax credits relating to the purchase of domestic equipment for approved research and development costs. For 2008, amounts represent tax credits relating to 50% super deduction for approved research and development costs.
- (ii) Amount pertains to the elimination of the deferred tax asset previously recognized on a loan loss provision to a related party (see Note 5), which is no longer considered to be deductible temporary difference due to a change in the CIT law in 2007.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at December 31, 2007 and 2008 are presented below:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Trade accounts receivable	31,836	23,953	3,505
Inventories	19,124	30,203	4,419
Property, plant and equipment	31,407	8,483	1,241
Accrued expenses and other liabilities	68,381	83,689	12,245
Tax losses carried forward	1,152	3,685	539
Total gross deferred tax assets	151,900	150,013	21,949
Less: Valuation allowance (see Note (i))	4,040	4,780	699
Net deferred tax assets	147,860	145,233	21,250

Note: (i) An analysis of the valuation allowance for 2007 and 2008 is as follows:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Balance at beginning of year	38,739	4,040	591
Less:			
Reduction in valuation allowance for forfeited unused tax credits	(8,861)	-	-
Realization of deferred tax assets in the current year	(25,838)	-	-
Allowance made during the year	-	740	108
Balance at end of year	4,040	4,780	699

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 8 Income taxes (cont'd)

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

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Net deferred tax assets comprise:			
Current portion	114,361	125,788	18,405
Non-current portion	33,499	19,445	2,845
	147,860	145,233	21,250

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Current deferred tax liability	–	15,282	2,236

Under the new CIT law, Yuchai is entitled to claim 50% super-deduction for approved research and development costs and the tax benefits of such claims amount to Rmb 10,169 (US\$1,488).

As at December 31, 2008, one of the subsidiaries of the Company had tax loss carry forwards for PRC income tax purposes of Rmb1,362 (US\$199), which are available to offset future taxable income, if any, and will expire if unused by 2010. This subsidiary has been loss making since its commencement of operations in 2004 and management deems it more likely than not that the deferred tax assets relating to the tax loss carry forwards as well as other deductible temporary differences of this subsidiary will not be realized. A total valuation allowance of Rmb4,780 (US\$699) has been provided for all of its deferred tax assets as at December 31, 2008. Management believes that it is more likely than not that the results of future operations in the next four years will generate sufficient taxable income to allow the realization of the tax benefit of the deferred tax assets at December 31, 2008.

During the year ended December 31, 2008, in accordance with the provisions of FIN 48, the Company and its subsidiaries did not have any material unrecognized tax benefits and thus, no significant interest and penalties related to unrecognized tax benefits were recognized.

In the event of under-reporting of taxable income as a result of filing method, that is based on management accounts instead of the audited financial statements, the tax bureau can claw back the underpaid taxes within three years and impose late payment surcharges. If the accumulative underpaid tax would be more than Rmb100, the claw back period could be extended to five years.

The PRC tax authorities had completed an examination of Yuchai's PRC income tax returns through 2008. The tax bureau did not make any adjustment to Yuchai's tax positions, and no surcharge or penalty was imposed.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 9 Trade accounts and bills receivable, net

Trade accounts and bills receivable, net comprise:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Trade accounts receivable	732,682	492,876	72,118
Less: Allowance for doubtful accounts	(64,893)	(96,034)	(14,052)
	667,789	396,842	58,066
Bills receivable	2,439,996	2,140,839	313,249
	<u>3,107,785</u>	<u>2,537,681</u>	<u>371,315</u>

An analysis of the allowance for doubtful accounts for 2006, 2007 and 2008 is as follows:

	December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Balance at beginning of year	69,047	90,365	64,893	9,495
Add:				
Charge (credit) to consolidated statements of income	21,582	(11,008)	33,487	4,900
Less:				
Written off	(264)	(14,464)	(2,346)	(343)
Balance at end of year	<u>90,365</u>	<u>64,893</u>	<u>96,034</u>	<u>14,052</u>

At December 31, 2007 and 2008, gross trade accounts receivable due from a major customer, Dongfeng Automobile Company and its affiliates ("the Dongfeng companies") were Rmb117,728 and Rmb119,513 (US\$17,487), respectively. See Note 31(a) for further discussion of customer concentration risk.

As of December 31, 2007 and 2008, no trade accounts receivable was pledged as security under secured loan arrangements (see Note 18(a)).

## 10 Amounts due from/(to) related parties

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Amounts due from: SHC & subsidiaries	88,207	48,163	7,047
YMCL & subsidiaries	10,992	52	8
Automobile Accessories Company	16,467	81,276	11,892
Others	27,986	9,776	1,431
Due within one year	<u>143,652</u>	<u>139,267</u>	<u>20,378</u>



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 10 Amounts due from/(to) related parties

An analysis of the allowance for doubtful accounts due from related parties for 2006, 2007 and 2008 is as follows:

	December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Balance at beginning of year	–	33,170	29,307	4,288
Add:				
Charge to consolidated statements of income in current year	33,170	–	–	–
Less:				
Written off	–	(3,863)	(4,699)	(688)
Balance at end of year	33,170	29,307	24,608	3,600

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Amounts due to:			
SHC & subsidiaries	183,595	140,980	20,628
YMCL & subsidiaries	191,184	20,070	2,937
Others	5,742	43,860	6,418
Due within one year	380,521	204,910	29,983

Related parties include HLA affiliates, TCL, HLGE, YMCL (excluding YMCL loans disclosed in Note 5), State Holding Company (“SHC”) and their subsidiaries and affiliates. At December 31, 2008, the amounts due from/to related parties are unsecured, interest free and arose principally from transactions as disclosed in Note 26. All amounts due from/to related parties are payable on demand.

In June 2006, YMCL and State Holding Company entered into an agreement with Yuchai to enable Yuchai and its subsidiaries to settle the amounts due from/to YMCL, State Holding Company and their subsidiaries on a net basis, i.e. the balance due from/to YMCL, State Holding Company, their subsidiaries and affiliates as of December 31, 2006 and 2007 were offset for settlement purposes only.

## 11 Loans to customers, net

Loans to customers, net refers to the designated loans lent by YEGCL through financial institutions to customers. The terms of the loan agreements were designated by the Group. The financial institutions assist the Group to release the principal to the borrowers and collect the repayment on behalf of the Group without bearing the risk of default by customers, if any. The loans carried interest rates ranging from 7.24% to 7.25% per annum and are repayable in installments within one year. The loans are secured and guaranteed by independent third parties.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 12 Inventories

Inventories are comprised of:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Raw materials	942,798	1,653,267	241,907
Work in progress	17,647	17,072	2,498
Finished goods	686,580	579,691	84,821
	<u>1,647,025</u>	<u>2,250,030</u>	<u>329,226</u>

As at December 31, 2008, YMMC had consigned finished goods inventory balance of Rmb 3,627 (2007: nil) with the customers.

## 13 Other receivables, net

Other receivables, net comprise:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
VAT recoverable	8,063	70,390	10,300
Staff loans	3,406	2,044	299
Staff advances	4,665	(454)	(66)
Amounts due under guarantee contracts, net (see Note 23(d))	10,440	3,173	464
Land deposit	5,000	5,000	732
Interest receivable from affiliates	50,599	61,422	8,987
Other deposits	–	10,000	1,463
Others	14,901	30,124	4,407
	<u>97,074</u>	<u>181,699</u>	<u>26,586</u>

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 14 Property, plant and equipment, net

Property, plant and equipment, net comprise:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Buildings, including leasehold improvements	1,096,622	1,191,037	174,273
Machinery and equipment	2,426,938	2,525,240	369,495
Office and computer equipment	106,995	103,458	15,138
	<u>3,630,555</u>	<u>3,819,735</u>	<u>558,906</u>
Less: Accumulated depreciation	(1,471,528)	(1,647,755)	(241,101)
Less: Impairment loss	(781)	(22,690)	(3,320)
Property, plant and equipment, net	<u>2,158,246</u>	<u>2,149,290</u>	<u>314,485</u>

Loss on disposal of property, plant and equipment for the years ended December 31, 2006, 2007 and 2008 is included in "Selling, general and administrative expenses" as follows:

	December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Loss on disposal of property, plant and equipment	1,598	5,926	4,008	587

## 15 Construction in progress

Construction in progress consists of capital expenditures and capitalized interest charges relating to the construction of facilities and assembly lines projects as follows:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Diesel engine production line and facilities projects	86,543	91,241	13,350
Factories auxiliary facilities	47,068	55,918	8,182
Second foundry	12,034	78,536	11,491
Others	39,276	48,152	7,046
Less: Impairment loss	–	(20,975)	(3,069)
	<u>184,921</u>	<u>252,872</u>	<u>37,000</u>

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 16 Lease prepayments

The lease prepayments are summarized as follows:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Gross payments for land use rights	203,127	228,720	33,466
Less: Amounts charged to expense	(35,125)	(43,773)	(6,405)
Less: Impairment loss	–	(26,266)	(3,843)
Lease prepayments	168,002	158,681	23,218

The land on which the Group's buildings are erected is owned by the PRC Government. Yuchai and its subsidiaries are granted the land use rights of 15 to 50 years in respect of such land. Lease prepayment represents those amounts paid for land use rights to the PRC government. The prepayments are charged ratably to expense over the term of the land use agreement. In the event that land use rights are sold or transferred, the remaining balance of the prepayment is derecognized and any resulting gain or loss is recorded. Lease prepayments charged to expense were Rmb3,328, Rmb4,702 and Rmb8,647 (US\$1,265) for the years ended December 31, 2006, 2007 and 2008, respectively.

## 17 Investments

(a) *Investments as of December 31, 2007 and 2008 are summarized as follows:*

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Investments in affiliates under the equity method (see Note 17(b))	505,009	392,386	57,414
Other investments in debt and equity securities of affiliates(see Note 17 (e))	615,201	446,430	65,323
	1,120,210	838,816	122,737

(b) *Investments in affiliates accounted for using the equity method as of December 31, 2007 and 2008 are as follows:*

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Listed:			
TCL (see Note (i))	387,930	265,811	38,894
HLGE (see Note (ii))	112,648	119,314	17,458
Unlisted:			
Others (see Note (iii))	4,431	7,261	1,062
	505,009	392,386	57,414

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

### (b) *Investments in affiliates accounted for using the equity method as of December 31, 2007 and 2008 are as follows: (cont'd)*

The retained earnings of the Company included accumulated losses of Rmb17,098 and Rmb53,671 (US\$7,853) attributable from affiliates as of December 31, 2007 and 2008, respectively.

Notes:

- (i) The Company acquired 264,000,000 shares and 17,795,664 shares of TCL's ordinary shares on March 23, 2005 and September 5, 2005, representing 15.0% and 1.0% interests of the enlarged share capital of TCL at a consideration of Singapore dollars ("S\$") 30,880,000 (Rmb152,133) and S\$1,400,000 (Rmb6,890) respectively. As a result, the Company held a 16.0% equity interest in TCL as of December 31, 2005.

In February 2006, the Company acquired an additional 3.4% interest in TCL and S\$52,933,440 principal amount of convertible bonds of TCL pursuant to a rights issue by TCL for an aggregate cash consideration of S\$49.4 million (Rmb243,230). The total purchase consideration has been allocated to the ordinary shares, the bond host instrument and the embedded conversion option based on their respective fair values of S\$7 million (Rmb34,626), S\$33.3 million (Rmb163,924) and S\$9.1 million (Rmb44,680). The Company has separately accounted for the conversion option as an embedded derivative instrument subject to fair value adjustment through earnings. The remaining host instrument of the convertible bonds has been accounted for as an available-for-sale debt security through August 2006, at which time the Company exercised its option and converted the bonds into 529,334,400 ordinary shares of TCL.

Immediately prior to the conversion, the fair value of the bond host instrument had increased by S\$3.3 million (Rmb20,942), which was reclassified from "Accumulated other comprehensive income/(loss)" and included as a part of the cost of the additional equity interest in TCL acquired as a result of the conversion. The decrease in fair value of the embedded conversion option of S\$1.2 million (Rmb5,662) has been recorded as a charge in the 2006 consolidated statement of operations. The fair value of the embedded conversion option immediately prior to the conversion of S\$7.9 million (Rmb39,984) has also been included in the cost of the additional interest in TCL. The conversion resulted in CYI increasing its interest in TCL by a further 17.2%. As of December 31, 2006, the Company's equity interest in TCL was 36.6%.

During the year ended 2007, the Company did not acquire new shares in TCL. However, as a result of the conversion of convertible bonds into new ordinary shares by TCL's third party bondholders, the Company's interest in TCL has been diluted to 34.4%. The loss in dilution was Rmb2,591 (US\$379).

During the year ended 2008, the Company did not acquire new shares in TCL. As of December 31, 2008, the Company held 898,990,352 shares (2007: 898,990,352 shares) of TCL's ordinary shares. As of December 31, 2007 and 2008, the Company's underlying equity in net assets of TCL exceeded the carrying amount of its investment in TCL by Rmb66,063 and Rmb67,856 (US\$9,929), respectively, primarily related to the differences between the fair value and book value of certain assets of TCL at the time of the respective acquisitions.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

### (b) *Investments in affiliates accounted for using the equity method as of December 31, 2007 and 2008 are as follows: (cont'd)*

The fair value, based on the quoted market price, of the TCL shares held by the Company was S\$80.9 million (Rmb405,560), S\$49.4 million (Rmb 235,047) and S\$53.9 million (Rmb255,033) as of December 31, 2007, December 31, 2008 and June 30, 2009 respectively.

The Company did not recognize an impairment charge pertaining to its investment in TCL in 2008 because the reduced fair value is believed to be not other-than-temporary as a result of general market conditions and the equity price increased subsequent to year end.

(ii) On February 3, 2006, the Company acquired a portfolio of debt and equity securities of HLGE for an aggregate purchase consideration of approximately S\$132 million (Rmb653,178) from several unrelated parties. The portfolio consisted of:

- 191,413,465 ordinary shares, representing 29.13% of the total issued and outstanding ordinary shares of HLGE;
- S\$129,428,256 in principal amount of secured bonds (the "Secured Bonds");
- 15,376,318 Series A mandatorily redeemable convertible preference shares of par value S\$0.05 each ("RCPS A"); and
- 107,634,237 Series B redeemable convertible preference shares of par value S\$0.05 each ("RCPS B").

With the investments in the ordinary shares of HLGE, the Company is able to exercise significant influence over the operating and financing policies of HLGE. The investment in the ordinary shares of HLGE has been accounted for under the equity method.

The Secured Bonds were accounted for as available-for-sale securities. The Secured Bonds were due to mature in March 2010, and the interest payable on the bonds was calculated based on the actual net cashflows derived from the assets on which the bonds are secured. The secured bonds were redeemed on July 4, 2006, as described below.

The RCPS A are mandatorily redeemable by HLGE and are more akin to a debt instrument. As such, the conversion option is not clearly and closely related to the host instrument and is therefore accounted for separately as an embedded derivative instrument, subject to the fair value adjustment through earnings. The RCPS A host instrument, other than the embedded conversion option, has been accounted for as an available-for-sale debt security.

RCPS A is 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 RCPS A. Any outstanding RCPS A will be mandatorily redeemed in March 2015. 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 the RCPS A any time prior to March 2015.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

### (b) Investments in affiliates accounted for using the equity method as of December 31, 2007 and 2008 are as follows: (cont'd)

The RCPS B are neither mandatorily redeemable nor redeemable at the option of the Company and are akin to an equity instrument. The embedded conversion option is deemed to be clearly and closely related to the host instrument and as the RCPS B's fair value is not readily determinable, the instrument in its entirety has been accounted for under the cost method. RCPS B is 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 RCPS B.

RCPS B which are not redeemed prior to March 2010, shall be mandatorily converted to ordinary shares at the conversion ratio of 1:1 in March 2010. 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 the RCPS B any time prior to March 2010.

The aggregate purchase consideration of S\$132 million was allocated to the above instruments based on their respective fair values as follows:

	<u>Fair value</u> <u>S\$'000</u>
Secured bonds	109,543
RCPS A	1,948
RCPS A-Embedded equity derivatives	137
RCPS B	7,221
Ordinary shares	12,766
	<u>131,615</u>

In June and December of 2006, HLGE partially redeemed a portion of RCPS A and 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 (Rmb11,907), resulting in a gain of S\$1.7 million (Rmb8,907).

On February 28, 2006, HLGE announced a proposed renounceable rights issue of zero coupon unsecured non-convertible bonds due in July 2009 (the "New Bonds") and non-redeemable convertible cumulative preference shares in the capital of HLGE (the "NCCPS") to raise funds for the purpose of redeeming existing Secured Bonds and for working capital purposes. On July 4, 2006, in connection with the rights issue, the Company was allotted 196,201,374 of NCCPS and S\$130,800,917 in principal amount of the New Bonds at a total consideration of S\$135 million (Rmb677,010). In conjunction with the allotment, the Secured Bonds were redeemed at their principal value of S\$129.4 million.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

### (b) *Investments in affiliates accounted for using the equity method as of December 31, 2007 and 2008 are as follows: (cont'd)*

At the date of settlement, the fair value of the newly acquired NCCPS and New Bonds was S\$8 million and S\$109.3 million, respectively, the sum of which exceeded the aggregate of the S\$5.3 million cash payment by the Company and the fair value of the Secured Bonds of S\$109 million, resulting in a net gain of approximately S\$3 million. The gain primarily related to an unrealized gain of S\$2.3 million (Rmb19,550) immediately prior to the redemption of the Secured Bonds, which had been included in "Accumulated other comprehensive income/ (loss)" and was reclassified and included in "Other income, net" upon redemption.

The New Bonds have been accounted for as available-for-sale debt securities. The investment in NCCPS, which does not have a readily determinable fair value, was accounted for using the cost method. On November 15, 2006, the Company exercised its right to convert all of its 196,201,374 NCCPS into 196,201,374 new ordinary shares of HLGE. As a result of the conversion of the NCCPS, the Company's interest in HLGE increased to 45.42% of the total issued and outstanding ordinary shares of HLGE.

On June 19, 2007, HLGE partially redeemed the New Bonds. The proceeds from the partial redemption amounted to S\$18.7 million (Rmb88,652), resulting in a gain of Rmb17,478 (US\$2,557), from the reclassification into earnings of previously unrealized gains that were included in Accumulated Other Comprehensive Income. The principal amount of the New Bonds was S\$130,800,917 before redemption and S\$112,886,727 after redemption.

During the year ended 2007, the Company did not acquire new shares in HLGE. However, new ordinary shares were issued by HLGE arising from the third party's conversion of the NCCPS, and the Company's interest in HLGE has been diluted to 45.39% (2006: 45.42%). There was an insignificant loss recognized in earnings in 2007 resulting from this dilution.

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

In June 2008, HLGE partially redeemed the New Bonds resulting in a gain of Rmb 19,198 (US\$2,809) (see Note 7). The principal amount redeemed was approximately S\$25.9 million (US\$18.0 million) and resulted in a reduction in the principal amount of the New HLGE Bonds held by the Company from S\$112.9 million (US\$78.5 million) to S\$87.0 million (US\$60.5 million). The proceeds from the partial redemption amounted to S\$28.5 million (US\$19.8 million).

As of December 31, 2008, the Company held 387,614,839 shares (2007: 387,614,839 shares) of HLGE's ordinary shares. Assuming full conversion of the existing Preference Shares held by the Company which would trigger the full conversion of the existing preference shares held by the other holders, and assuming that none of the other holders of the NCCPS convert their NCCPS, the Company's equity interest in HLGE would increase from 45.39% to 51.68%.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

### (b) Investments in affiliates accounted for using the equity method as of December 31, 2007 and 2008 are as follows: (cont'd)

As of December 31, 2007 and 2008, the Company's carrying value of its investments in HLGE exceeded its underlying equity in HLGE's net assets by Rmb139,937 and Rmb140,859 (US\$20,611), respectively, primarily related to the differences between the fair value and book value of the certain assets and liabilities of HLGE. These differences will be amortized over the respective periods consistent with the manner in which the underlying assets and liabilities are depreciated or otherwise accreted to HLGE's earnings, as adjustments to the Company's share of earnings or loss of HLGE.

The fair value, based on the quoted market price, of the HLGE ordinary shares held by the Company was S\$89.2 million (Rmb446,874), S\$21.3 million (Rmb101,344) and S\$44.6 million (Rmb210,760) as of December 31, 2007, December 31, 2008 and June 30, 2009 respectively.

The Company did not recognize impairment charge pertaining to its investment in HLGE in 2008 because the reduced fair value is believed to be not other-than-temporary as a result of general market conditions and the equity price increased subsequent to year end.

- (iii) Represents the Company's interests in certain entities in the PRC in which the Company has the ability to exercise significant influence in its financial and operating policy decisions, but do not have the controlling financial interests. The Company's equity in net income of these PRC entities amounts to Rmb1,761 (US\$258).

### (c) Summarized consolidated financial information of TCL as of December 31, 2007 and 2008, and the years ended December 31, 2006, 2007 and 2008 is as follows:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
<i>Financial position</i>			
Current assets	941,398	847,905	124,066
Property, plant and equipment, net	96,405	51,040	7,468
Other assets	407,627	157,749	23,082
Total assets	1,445,430	1,056,694	154,616
Current liabilities	102,736	87,296	12,773
Long term debt	1,549	–	–
Total liabilities	104,285	87,296	12,773
Minority interests	22,165	18,561	2,716
Stockholders' equity	1,318,980	950,837	139,127
Total liabilities, minority interests and stockholders' equity	1,445,430	1,056,694	154,616

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

(c) **Summarized consolidated financial information of TCL as of December 31, 2007 and 2008, and the years ended December 31, 2006, 2007 and 2008 is as follows: (cont'd)**

	Year ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<i>Statement of operations</i>				
Revenue	1,225,028	1,451,188	1,898,730	277,824
Gross profit	62,796	88,446	65,558	9,592
Operating profit/(loss)	(97,426)	25,915	(102,480)	(14,995)
Income tax credit/(expense)	(9,089)	(9,011)	4,645	680
Income/(loss) before minority interest	(88,337)	16,904	(97,835)	(14,315)
Minority interests in income of consolidated subsidiaries	4,997	(2,367)	1,980	290
Net income/(loss)	(83,340)	14,537	(95,855)	(14,025)
The Company's equity in income/(loss) of TCL, net of tax	(23,923)	5,925	(31,788)	(4,651)

(d) **Summarized consolidated financial information of HLGE as of December 31, 2006, 2007 and 2008, and for the years ended December 31, 2007 and 2008 is as follows:**

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
<i>Financial position</i>			
Current assets	356,135	210,322	30,774
Property, plant and equipment, net	86,331	85,683	12,537
Other assets	303,193	296,401	43,370
Total assets	745,659	592,406	86,681
Current liabilities	51,850	518,690	75,895
Non-current liabilities	753,930	121,182	17,731
Total liabilities	805,780	639,872	93,626
Stockholders' deficit	(60,121)	(47,466)	(6,945)
Total liabilities and stockholders' deficit	745,659	592,406	86,681

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

(d) **Summarized consolidated financial information of HLGE as of December 31, 2006, 2007 and 2008, and for the years ended December 31, 2007 and 2008 is as follows: (cont'd)**

	Period from February 3, 2006 to			
	December 31,		Year ended December 31,	
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<i>Statement of operations</i>				
Revenue	37,110	30,065	20,766	3,038
Gross profit	19,133	18,009	11,091	1,623
Operating profit/(loss)	(2,556)	22,502	(20,020)	(2,929)
Income tax credit/(expense)	(265)	(2,376)	5	1
Income before minority interest	(2,821)	20,126	(20,015)	(2,928)
Equity in income/(loss) of affiliates, net of tax	(18,853)	8,751	14,648	2,143
Net income	(21,674)	28,877	(5,367)	(785)
Income from discontinued operations	44,213	–	–	–
The Company's equity in income/(loss) of HLGE, net of tax	1,395	8,321	(6,546)	(958)

(e) **Other investments as of December 31, 2007 and 2008 not described above are summarized as follows:**

Following is a description of the valuation methodologies we used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

### Securities

The Company classify our securities within Level 3 of the valuation hierarchy where there is limited activity or less observable inputs to the valuation. Inputs to the Level 3 security fair value measurements consider various assumptions, including time value, credit spread, risk-free rate, current market prices for underlying financial instruments as well as other relevant economic measures. Securities classified within Level 3 include corporate debt securities.

The following table summarizes the financial instruments measured at fair value on a recurring basis:

	Fair Value Measurements on a Recurring Basis at December 31, 2008			
	Level 1	Level 2	Level 3	Level 3
	Rmb	Rmb	Rmb	US\$
Unsecured bonds of HLGE	–	–	398,916	58,371
RCPS A of HLGE	–	–	17,216	2,519

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

**(e) Other investments as of December 31, 2007 and 2008 not described above are summarized as follows: (cont'd)**

The tables below summarize the activity in our balance sheet accounts for financial instruments classified within Level 3 of the valuation hierarchy. When a determination is made to classify a financial instrument within Level 3, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components which are validated to external sources.

	Level 3 Financial Assets			
	December 31, 2008			
	Unsecured bonds of HLGE	RCPS A of HLGE	Unsecured bonds of HLGE	RCPS A of HLGE
	Rmb	Rmb	USb	US\$
Balance at January 1	558,852	20,119	81,772	2,944
Total realized/unrealized gains/(losses)				
Included in earnings	9,865	(6,372)	1,443	(933)
Included in other comprehensive income	(40,235)	3,469	(5,887)	508
Redemptions	(129,566)	–	(18,597)	–
Balance at December 31	398,916	17,216	58,371	2,519

The following table summarizes the financial instruments measured at fair value on a nonrecurring basis in periods subsequent to initial recognition:

	Fair Value Measurements using			
	Level 1	Level 2	Level 3	Level 3
	Rmb	Rmb	Rmb	US\$
RCPS B of HLGE	–	–	24,243	3,547

The Company review the carrying value of our equity and cost method investments when events and circumstances warrant. This review requires the comparison of the fair value of our investments to their respective carrying values. The fair value of our investments is determined based on valuation techniques using the best information that is available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded whenever a decline in fair value below the carrying value is determined to be other-than-temporary.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 17 Investments (cont'd)

(e) *Other investments as of December 31, 2007 and 2008 not described above are summarized as follows: (cont'd)*

	2007	2008	2008
	Rmb	Rmb	US\$
Available for sale securities, at fair value:			
Unsecured bonds	558,852	398,916	58,371
RCPS A	12,736	16,678	2,440
Embedded derivatives			
RCPS A - Embedded equity derivatives	7,383	538	79
Investment securities, at cost:			
Unquoted equity			
Securities (see Note 3(r))	6,255	6,055	886
RCPS B	29,975	24,243	3,547
	615,201	446,430	65,323

The maximum loss that would be incurred arising from all financial instruments in the event that HLGE failed to perform according to terms of the contracts, would be represented by their fair values of Rmb440,375 (US\$64,436) (2007: Rmb608,946).

Initial fair value, gross unrealized holding gain, and period-end fair value of available-for-sale securities as of December 31, 2008, were as follows:

	Initial fair value	Gross unrealized holding gains	Carrying value (Fair value)	Carrying value (Fair value)
	Rmb	Rmb	Rmb	US\$
Unsecured bonds of HLGE	355,830	43,086	398,916	58,371
RCPS A of HLGE	8,513	8,165	16,678	2,440
	364,343	51,251	415,594	60,811

The fair values of available-for-sale securities are estimated using the discounted cash flow methodology. Maturities of securities classified as available-for-sale were as follows as of December 31, 2007 and 2008:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Due after one year through five years	558,852	398,916	58,371
Due after five years through ten years	12,736	16,678	2,440

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 18 Bank debt

### (a) Short-term bank loans

Short-term bank loans are denominated as follows:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Renminbi denominated loans	819,164	833,000	121,885
Singapore dollars denominated loans	–	235,675 (d)	34,484
	819,164	1,068,675	156,369

The weighted average interest rate of short-term bank loans at December 31, 2007 and 2008 was 4.03% and 4.82% per annum, respectively.

As of December 31, 2007, short-term bank loans consist of unsecured loans of Rmb170,000 (US\$24,873) and unsecured bonds of Rmb649,164 (US\$94,982).

As of December 31, 2008, short-term bank loans consist of secured loans of Rmb133,000 (US\$19,461) and unsecured loans of Rmb935,675 (US\$136,909). The unsecured bonds that were outstanding as at December 31, 2007 had matured and were fully repaid in April, 2008.

### (b) Long-term bank loans

Long-term bank loans comprise:

	Interest rate at December 31, 2008 (per annum)	December 31,		
		2007	2008	2008
		Rmb	Rmb	US\$
US\$ denominated loans (unless otherwise stated):				
Due in 2008 (multi-currency)	–	457,787 <sup>(a)</sup>	– <sup>(c)</sup>	–
Due in 2009 (multi-currency)	2.13%	–	77,773 <sup>(a)&amp;(e)</sup>	11,380
Due in 2010 (multi-currency)	1.38%	225,142	176,756 <sup>(f)</sup>	25,863
Due in 2010 (RMB denominated loans)	–	85,000	–	–
Total long-term bank loans outstanding		767,929	254,529	37,243
Less: Amounts due within one year included under current liabilities		–	–	–
Amounts due after one year		767,929	254,529	37,243

All long-term bank loans are unsecured. The carrying amount of long-term bank loans approximates their fair value based on the borrowing rates currently available for bank loans with similar terms and average maturities.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 18 Bank debt (cont'd)

### (b) Long-term bank loans (cont'd)

Notes:

- (a) The debt is classified as long term because the Company has entered into a financing agreement that clearly permits the Company to refinance the short-term obligation on a long term basis.
- (b) Unused commitments for total bank facilities was Rmb3,639,724 (US\$532,567) as at December 31, 2008. The commitment fee incurred was Rmb138 (US\$20).
- (c) US\$50.0 million credit facility with Sumitomo Mitsui Banking Corporation, Singapore Branch ("Sumitomo"):

On September 7, 2005, in order to fund its business expansion plans, the Company entered into a revolving credit facility agreement with Sumitomo with a committed aggregate value of US\$50.0 million for a three years duration. Among other things, the terms of the facility require that Hong Leong Asia Ltd. ("HLA") retains ownership of the Company's special share and that the Company remains a consolidated subsidiary of HLA. The terms of the facility also include certain financial covenants with respect to the Company's tangible net worth (as defined in the agreement) as at June 30 and December 31 of each year not being less than US\$120,000 and the ratio of the Company's 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. At all times during the year ended December 31, 2007, the Company was in compliance with these financial covenants. The Company has also undertaken to make available to Sumitomo, within 180 days after the end of its financial year (beginning with financial year 2005), 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 2006 and 2007 audited consolidated accounts has been received from Sumitomo granting an extension of time until July 18, 2008 and September 30, 2008 respectively. On September 6, 2008, this credit facility with Sumitomo expired and the bridging loan as stated in note (d) below was used to partially refinance this facility which was fully repaid.

- (d) DBS S\$50.0 million bridging loan:

On August 28, 2008, the Company entered into a bridging loan agreement of up to S\$50 million for a 12 months duration, with DBS Bank Ltd., ("DBS") of Singapore, to partially re-finance the US\$50m revolving credit facility with Sumitomo Mitsui Banking Corporation, Singapore Branch which expired on 6 September 2008. The new facility will also be used to finance the Company's long-term general working capital requirements. The terms of the facility include certain financial covenants as well as negative pledge and default provisions. The Company has also undertaken to make available to DBS, within 180 days after the end of its financial year, copies of its audited consolidated accounts as at the end of each financial year. A waiver from compliance with this undertaking in relation to the production of 2008 audited consolidated accounts has been received from the bank granting an extension of time until August 31, 2009.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 18 Bank debt (cont'd)

### (b) Long-term bank loans (cont'd)

- (e) S\$21.5 million credit facility with Bank of Tokyo-Mitsubishi, UFJ Ltd, Singapore Branch ("BOTM"):

On March 20, 2008, the Company entered into a new facility agreement with BOTM to re-finance the existing revolving credit facility. The new unsecured, multi-currency revolving credit facility has a committed aggregated 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. Among other things, the terms of the facility require that Hong Leong Asia Ltd. ("HLA") retains ownership of the Company's special share and that the Company remains a consolidated subsidiary of HLA. The terms of the facility also include certain financial covenants with respect to the Company's 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 the Company's 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. On March 19, 2009, this credit facility expired and the new facility with same bank as stated in note 33(a) was used to refinance this facility which was fully repaid. The Company has also undertaken to make available to the bank, within 180 days after the end of its financial year, 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 2008 audited consolidated accounts has been received from the bank granting an extension of time until August 31, 2009.

- (f) US\$40.0 million credit facility with Sumitomo:

On March 30, 2007, the Company entered into an unsecured multi-currency revolving credit facility agreement with Sumitomo for an aggregate of US\$40.0 million to refinance the S\$60.0 million facility with Oversea - Chinese Banking Corporation Limited ("OCBC") 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 the Company to finance its long-term general working capital requirements. The terms of the facility require, among other things, that HLA retains ownership of the special share and that the Company remains a principal subsidiary (as defined in the facility agreement) of HLA. The terms of the facility also include certain financial covenants with respect to the Company's 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. 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 2008 audited consolidated accounts has been received from the bank granting an extension of time until August 31, 2009.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 19 Accrued expenses and other liabilities

Accrued expenses and other liabilities comprise:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Deposits from customers	32,951	58,161	8,510
Staff welfare payable (see Note (i))	15,041	–	–
Accrued product warranty (see Note 20)	194,898	188,599	27,596
Wages payable	153,270	157,645	23,067
Management bonus payable (see Note (ii))	94,312	51,658	7,559
Payable for construction in progress	67,707	53,947	7,894
Accrued research and development expenses	8,559	7,707	1,128
Accrued advertising expense	13,096	9,447	1,383
Accrued legal fee and other professional fees	14,298	9,035	1,322
Accrued expenses for litigation (see Notes 23(c))	7,102	7,247	1,060
Individual income tax withholding	10,124	6,481	948
VAT payable	13,816	4,847	709
Guarantee deposit	10,000	2,596	380
Accrued sales discount	94,055	142,800	20,894
Accrued interest	2,133	1,834	268
Other payables	628	588	86
Accrued retirement benefits	5,747	5,748	841
Other accruals and liabilities	208,938	228,744	33,470
	<u>946,675</u>	<u>937,084</u>	<u>137,115</u>

Notes:

- (i): Staff welfare payable is determined by Yuchai's Board of Directors. The payable can be applied towards the payment of special bonuses or collective welfare benefits to staff and workers of Yuchai, such as staff dormitories and staff welfare facilities. In 2008, the payable was transferred back to the statutory Public Welfare Fund as the payable is no longer required (see Note 21)
- (ii): Yuchai has a management bonus plan for its executives under which annual incentive bonuses in an aggregate amount of 3.5% to 10% of Yuchai's after-tax profit will be paid upon Yuchai achieving the required budgeted after-tax profit as approved by Yuchai's Board of Directors. There are no benefits provided to the directors of the Company or Yuchai upon their termination of employment.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 20 Accrued product warranty

An analysis of the accrued product warranty for 2006, 2007 and 2008 is as follows:

	December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Balance at beginning of year	142,126	163,701	194,898	28,518
Allowance charged to consolidated statements of income	200,892	233,838	215,544	31,538
Less: Amounts utilized	(179,317)	(202,641)	(221,843)	(32,460)
Balance at end of year	163,701	194,898	188,599	27,596

## 21 Statutory reserves

The Company's attributable share in the statutory reserves of Yuchai and its subsidiaries for the three years ended December 31, 2008 is as follows:

	December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<b>Statutory general reserve (see Note (ii))</b>				
Balance at January 1	170,280	171,280	174,033	25,465
Transfer from retained earnings	1,000	2,753	2,093	306
Balance at December 31	171,280	174,033	176,126	25,771
<b>Statutory public welfare fund (see Note (iii))</b>				
Balance at January 1	70,600	70,600	70,600	10,330
Transfer of unutilized welfare fund back to reserve (see Note (iv))	–	–	15,041	2,201
Balance at December 31	70,600	70,600	85,641	12,531
<b>General surplus reserve</b>				
Balance at January 1 and December 31	25,706	25,706	25,706	3,761
<b>Total</b>	267,586	270,339	287,473	42,063

Notes:

- (i) In accordance with the relevant regulations in the PRC, Yuchai and its subsidiaries are required to provide certain statutory reserves which are designated for specific purposes based on the net income reported in the PRC GAAP financial statements. The reserves are not distributable in the form of cash dividends (see Note 29).



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 21 Statutory reserves (cont'd)

- (ii) In accordance with the relevant regulations in the PRC, a 10% appropriation to the statutory general reserve based on the net income reported in the PRC financial statements is required until the balance reaches 50% of the authorized share capital of Yuchai and its subsidiaries. Statutory general reserve can be used to make good previous years' losses, if any, and may be converted into share capital by the issue of new shares to stockholders in proportion to their existing shareholdings, or by increasing the par value of the shares currently held by them, provided that the reserve balance after such issue is not less than 25% of the authorized share capital.
- (iii) Yuchai and its subsidiaries shall determine to transfer 5% to 10% of its net income reported in the PRC financial statements to the statutory public welfare fund. There is no limit on the amount that may be allocated to this fund. This fund can only be utilized on capital expenditure for the collective welfare of Yuchai and its subsidiaries' employees, such as the construction of dormitories, canteen and other welfare facilities, and cannot be utilized to pay staff welfare expenses. The transfer to this fund must be made before the distribution of a dividend to stockholders. Since January 1, 2006, in accordance with the amended Company's policy, the contribution to the fund ceased.
- (iv) In 2008, an amount of Rmb 15,041 was transferred back to the Statutory Public Welfare Fund as the payable was no longer required (see Note 19).

## 22 Commitments

At December 31, 2008, the Group had the following commitments:

	December 31,	
	2008	2008
	Rmb	US\$
<b>Authorized and contracted for:</b>		
Improvement to existing production facilities	1,524,526	223,070

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

Future minimum lease payments under non-cancellable operating leases (with initial or remaining lease terms in excess of one year) as of December 31, 2008 are:

	Rmb	US\$
2009	9,318	1,363
2010	5,137	752
2011	3,283	480
2012 and thereafter	2,945	431
	<u>20,683</u>	<u>3,026</u>

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 22 Commitments (cont'd)

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

	December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Rental expense	10,113	10,780	22,568	3,302

## 23 Contingencies

### (a) *Product liability*

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

### (b) *Environmental liability*

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.

In addition, the manufacture and sales of Euro I engines in major urban area became unlawful after August 31, 2004. After that date, the engines equipped with Euro I engines cannot be sold and used in major urban area. The manufacture and sale of Euro II engines is expected to be progressively phased out starting June 30, 2008 and the PRC emission standard equivalent to Euro III has been implemented progressively throughout China from July 1, 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.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 23 Contingencies (cont'd)

### (b) *Environmental liability (cont'd)*

Yuchai is 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 Yuchai to cease or improve upon certain activities causing environmental damage. Due to the nature of its business, Yuchai produces certain amounts of waste water, gas, and solid waste materials during the course of its production. Yuchai believes its environmental protection facilities and systems are adequate for it 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.

### (c) *Dispute with Bank of China*

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

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

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

In 2006, 2007 and 2008, there were no new developments in this case.

### (d) *Guarantees*

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, 2005 and 2006, YEGCL guaranteed new borrowings of Rmb153,538 and Rmb88,991, respectively. YEGCL ceased issuing guarantees on new borrowings from late 2006. 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 individual 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.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 23 Contingencies (cont'd)

### (d) Guarantees (cont'd)

In return for issuing the guarantee, YEGCL receives a premium fee ranging from 1% to 3% of the loan amount for the years ending December 31, 2006, 2007 and 2008, 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. The Group received Rmb4,250, Rmb nil and Rmb nil of premium fees in 2006, 2007 and 2008, respectively, which are included in "Accrued expenses and other liabilities" and recognized as revenue on a straight line basis over the terms of the respective guarantee. Guarantee fees recognized as revenue in 2006, 2007 and 2008 amounted to Rmb4,718, Rmb2,176 and Rmb628 (US\$92), respectively. As of December 31, 2006, 2007 and 2008, deferred guarantee fee revenue amounted to Rmb2,858, Rmb682 and Rmb54 (US\$8), respectively.

Subsequent to initial measurement and recognition of the liability for YEGCL's obligations under with 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. Each guarantee is secured by a cash deposit from the borrower and a security interest in the automobile purchased by the borrower. As of December 31, 2007 and 2008, YEGCL had gross receivables of Rmb20,162 and Rmb15,382 (US\$2,251), respectively, relating to payments made by YEGCL to the banks in conjunction with loans that had been defaulted and to be recovered from the individual borrowers. YEGCL recorded a bad debt allowance in the amount of Rmb9,722 and Rmb12,209 (US\$1,787) for other receivables, and Rmb1,119 and Rmb1,409 for potential losses associated with the guarantee at December 31, 2007 and 2008 respectively. The net receivable amount of Rmb10,440 and Rmb3,173 (US\$464), is included in "Other receivables, net" in the accompanying consolidated balance sheets (See Note 13).

As of December 31, 2007 and 2008, the maximum potential amount future undiscounted payments YEGCL could be required to make under the guarantees was Rmb43,701 and Rmb16,643 (US\$2,435), respectively. YEGCL held cash deposits of Rmb9,999 and Rmb2,596 as of December 31, 2007 and 2008 and security interests in automobiles with an aggregate initial purchase value of Rmb380,080 and Rmb351,566 as of December 31, 2007 and 2008, respectively. If, in the event of default the cash deposits and the amount of recoveries, if any, from repossession of the automobiles may not entirely mitigate YEGCL's losses then, YEGCL accumulates the total expected risk against the total expected recoverable amount and provides for any expected shortfall. Accordingly, management recorded an accrual for potential losses associated with the guarantees in the amount of Rmb1,119 and Rmb1,409 (US\$206) as of December 31, 2007 and 2008, respectively, included in "Accrued expenses and other liabilities".

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 23 Contingencies (cont'd)

### (d) Guarantees (cont'd)

An analysis of reserves for potential losses associated with the guarantees including amounts paid to banks in connection with guarantees issued by YEGCL is as follows:

	December 31,		
	2007	2008	2008
	Rmb	Rmb	US\$
Balance at beginning of year	15,078	10,841	1,587
Charged/(credited) to consolidated statements of operations	(4,237)	2,777	406
Balance at end of year	10,841	13,618	1,993
Balance allocated to:			
Allowance for uncollectible other receivables	9,722	12,209	1,787
Potential losses associated with the guarantees	1,119	1,409	206
	10,841	13,618	1,993

### (e) Outstanding bills receivables discounted

As of December 31, 2008, outstanding bills receivable discounted with banks for which the Group has retained a recourse obligation totaled Rmb1,214,497 (US\$177,706).

### (f) Outstanding letters of credit

As of December 31, 2008, the Group issued irrevocable letters of credit totaling Rmb64,904 (US\$9,497).

### (g) Other outstanding litigation

In addition to the matters disclosed in Note 23(c), the Group is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

## 24 Dispute with State Holding Company

The Company has from time to time in the period up to 2006 encountered difficulties in obtaining the cooperation of the State Holding Company, and its former Chairman, Mr. Wang Jianming, in the daily management and operation of Yuchai, including obtaining payments of the Company's share of the final 2001 dividend declared in August 2002. Mr. Wang Jianming ceased to serve as the Chairman, legal representative and chief executive officer of Yuchai, as well as the Chairman and legal representative of the State Holding Company, the principal Chinese shareholder of Yuchai with effect from October 28, 2005.

# Notes to Consolidated Financial Statements

**FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008**

(Rmb and US\$ amounts expressed in thousands, except per share data)

## **24 Dispute with State Holding Company (cont'd)**

The new Chairman and legal representative of these companies is Mr. Yan Ping whose appointment was confirmed on December 2, 2005. The Chinese stakeholders had previously asserted that the transfer of ownership of shares with respect to Yuchai in November 1994, in connection with the Company's initial public offering ("IPO"), was not validly approved by the Chinese authorities, and that as a result the Company's exercise of control over Yuchai has been improper.

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

On April 7, 2005, the Company entered into a Reorganization Agreement ("Reorganization Agreement") with Yuchai and Coomber in furtherance of the terms of the July 2003 Agreement, and the terms of this agreement were acknowledged and agreed to by the State Holding Company. The Reorganization Agreement was extended to December 31, 2006 by way of the Reorganization Agreement Amendment No.1 dated December 2, 2005 and then extended to June 30, 2007 by way of the Reorganization Agreement Amendment No.2 dated November 30, 2006. The Reorganization Agreement Amendments No.1 and No.2 were similarly acknowledged and agreed to by the State Holding Company.

On June 30, 2007, the Company 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 terminated on June 30, 2007. 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.

The principal terms contained in the Reorganization Agreement Amendments No.1 and No. 2 and the Cooperation Agreement relating to governance related issues are being adhered to by Yuchai.

## **25 Retirement and other postretirement benefits**

As stipulated by the regulations of the PRC, Yuchai and its subsidiaries participate in defined contribution retirement plans organized by the Guangxi Regional Government and Beijing City Government for its staff. All staff are entitled to an annual pension equal to a fixed proportion of their final basic salary amount at their retirement date. For the years ended December 31, 2006, 2007 and 2008, Yuchai and its subsidiaries were required to make contributions to the retirement plan at a rate of 20.0% of the basic salary of their staff. The Guangxi Regional Government and Beijing City Government are responsible for the entire obligations of all Yuchai and its subsidiaries' retirees. Expenses incurred in connection with the plan were Rmb42,254, Rmb48,107 and Rmb106,062 (US\$15,519), respectively, for the years ended December 31, 2006, 2007 and 2008.

Yuchai and its subsidiaries have no obligation for the payment of pension benefits or any other postretirement benefits beyond the annual contributions described above.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 25 Retirement and other postretirement benefits (cont'd)

In 2008, certain employees of Yuchai were eligible for early retirement. As part of this plan, Yuchai will compensate these employees with a base salary and the relevant social insurances, until they formally retire according to the statutory retirement age. Yuchai accrued the statutory termination benefits at the time management determined it was probable that benefits would be paid and the amount was reasonably estimated. The liability of Rmb10,800 is measured based on the fair value of the liability as of the respective termination dates, taking into consideration the impact of discounting and interest premiums.

## 26 Other related party transactions

In addition to the loans to and interest income from YMCL and the purchase of 100% of the share capital of Yulin Hotel Company (as discussed in Notes 5 and 32), the Group has undertaken other significant business transactions with related parties during the three years ended December 31, 2008. The following is a summary of these transactions:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Sales of diesel engines to State Holding Company, its subsidiaries and affiliates (see Note (i))	20,923	59,521	215,064	31,468
Sales of raw materials to YMCL (see Note (i))	65,729	35,380	–	–
Purchase of raw materials and supplies from subsidiaries and affiliates of State Holding Company (see Note (i))	(377,129)	(571,393)	(1,030,887)	(150,840)
Purchase of raw materials and supplies from YMCL (see Note (ii))	(201,802)	–	–	–
Processing fee to a subsidiary of YMCL (see Note (iii))	(13,604)	(2,533)	–	–
Delivery expense charged by a subsidiary of YMCL (see Note (iii))	(90,840)	(115,500)	(161,036)	(23,563)
General and administrative expenses				
– charged by State Holding Company (see Note (iv))	(19,821)	(21,447)	(34,934)	(5,112)
– charged by HLA (see Note (v))	(4,061)	(12,471)	(6,414)	(939)
– charged by an affiliate of HLA (see Note (vi))	(9,654)	(546)	(6,652)	(973)
Interest earned from balance due from an affiliate of HLA	110	116	–	–
Gain on disposal of land use rights to a subsidiary of State Holding Company (See Note (vii))	1,841	1,573	–	–

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 26 Other related party transactions (cont'd)

Note:

- (i) Sale and purchase of raw materials, supplies, scraps and diesel engines to/from State Holding Company, its subsidiaries and affiliates. Certain subsidiaries and affiliates of State Holding Company have acted as suppliers of raw materials and supplies to the Company and certain subsidiaries of State Holding Company have acted as sales agents of the Group. The State Holding Company also purchased scraps from the Group. Management considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.
- (ii) Purchase of raw materials, supplies and trucks from YMCL. From January 2005 to April 2006, subsidiaries of YMMC engaged in the sale of trucks which were mainly supplied by and purchased from YMCL. YMCL has also become a supplier of raw materials and supplies to the Group since 2005. Management considers that these transactions were entered into in the normal course of business. In April 2006, the above procurement and distribution arrangement between Yuchai and YMCL was stopped and YMCL sold the remaining inventory and some ancillary fixed assets back to YMMC.
- (iii) Processing fee and delivery expense charged by YMCL and its subsidiaries. The fee is for the packaging and delivery of spare parts charged by YMCL, which were recorded in "Cost of goods sold" and "Selling, general and administrative expenses" respectively. Management considers that these transactions were entered into in the normal course of business and these transactions continued on normal commercial terms. The packaging contract was terminated in April 2006.
- (iv) General and administrative expenses charged by State Holding Company. State Holding Company charges Yuchai for certain general and administrative expenses in respect of rental of certain office premises, property management services rendered by State Holding Company. The expenses are charged to Yuchai and its subsidiaries by State Holding Company on an actual incurred basis. Management believes that the expenses charged to Yuchai by State Holding Company would not have been materially different on a stand-alone basis because Yuchai could provide these services for itself at approximately the same amount.
- (v) Management fees, general and administrative expenses charged by HLA.
- (vi) General and administrative expenses charged by affiliates of HLA. The fees mainly relate to office rental, secretarial fees, insurance fees, professional and consultancy fees, and miscellaneous office expenses.
- (vii) Gain on disposal of land use rights to a subsidiary of State Holding Company. The Group has disposed of certain land use rights with net book value of Rmb552 and Rmb552 (US\$81) to a subsidiary of the State Holding Company for a consideration of Rmb2,394 and Rmb2,125 (US\$311) in the years ended December 31, 2006 and 2007 respectively.

In addition to the above, Yuchai also entered into transactions with other PRC Government owned enterprises. Management considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms. Balances with other PRC entities are excluded from this caption.

Amounts due to the holding company comprise mainly general and administrative expenses charged by the holding company in relation to the management, financial planning and control and other services provided to Yuchai. The balance is unsecured, interest free and repayable on demand.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 27 Segment information

SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information”, establishes standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company’s operating segments are Yuchai, TCL and HLGE for the years ended December 31, 2006, 2007 and 2008. The Yulin Hotel results are reviewed by the Chief Operating Decision Maker as part of the Yuchai segment.

The segment result for Yuchai is based on earnings after income taxes and before minority interests. The segment result for TCL and HLGE is the Company’s equity in the net income or losses of these affiliates. Segment assets for Yuchai are based on total assets of Yuchai. Segment assets for TCL and HLGE are based on the Company’s net investment in the affiliates. Substantially all of the Company’s operations including TCL are in the PRC. Further segment information about TCL and HLGE is included in Note 17(c) and Note 17(d).

Following is the segment information for the years ended December 31, 2006, 2007 and 2008:

	2006			2007			2008		
	Yuchai	TCL	HLGE	Yuchai	TCL	HLGE	Yuchai	TCL	HLGE
	Rmb	Rmb	Rmb	Rmb	Rmb	Rmb	Rmb	Rmb	Rmb
Segment revenue from external customers	6,920,528	–	–	9,556,303	–	–	10,384,022	–	–
Interest income	16,329	–	–	3,139	–	–	8,623	–	–
Interest expense	89,119	–	–	99,504	–	–	134,245	–	–
Depreciation and amortization	146,188	–	–	227,960	–	–	275,268	–	–
Impairment loss of property, plant & equipment and goodwill	2,346	–	–	781	–	–	75,605	–	–
Equity in income/(losses) of affiliates, net of tax	79	–	–	(198)	–	–	1,761	–	–
Income tax (expense)/credit	(30,466)	(9,089)	(265)	(68,518)	(9,011)	(2,376)	(95,249)	4,645	5
Segment profit / (loss)	292,359	(23,923)	1,395	845,239	5,925	8,321	511,839	(31,788)	(6,546)
Significant non-cash items:									
– Other adjustments to provisions and allowances	98,352	–	–	4,726	–	–	88,467	–	–
Segment assets	6,479,886	385,583	117,360	7,843,056	387,930	112,648	8,525,205	265,811	119,315
Total expenditures for additions to long-lived assets	323,781	–	–	536,660	–	–	361,491	–	–

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 27 Segment information (cont'd)

Reconciliation of segment information to the consolidated financial statements for the years ended December 2006, 2007 and 2008.

	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Total segment profit	269,831	859,485	473,505	69,284
Service fee to an affiliate of HLA (see Note 26)	(9,654)	(546)	(6,652)	(973)
Other corporate general and administrative expenses	(56,782)	(75,025)	(3,231)	(474)
Consolidated earnings/(loss) before income taxes and minority interests	203,395	783,914	463,622	67,837
Total segment assets	6,982,829	8,343,634	8,910,331	1,303,766
Corporate cash and cash equivalents	100,990	81,257	77,764	11,379
Other investments (long-term) (a)	633,837	608,946	440,375	64,436
Assets acquired from Yulin Hotel Company (Note 32)	–	272,397	–	–
Other corporate assets (b)	243,701	272,950	284,208	41,585
Consolidated total assets	7,961,357	9,579,184	9,712,678	1,421,166

Note (a): includes HLGE unsecured bonds (Rmb398,916), RCPS A (Rmb17,216), RCPS B (Rmb24,243) (see Note 17(e)).

Note (b): includes corporate's property, plant and equipment, goodwill and other receivables.

Revenues from external customers by product category are summarized as follows:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
<b>Revenues, net</b>				
4F Light-Duty Diesel Engines	264,335	380,601	583,978	85,448
4108 Light-Duty Diesel Engines	941,657	1,218,838	1,213,907	177,620
4110 Light-Duty Diesel Engines	644,116	1,189,995	1,218,097	178,233
4112 Light-Duty Diesel Engines	372,423	469,015	518,263	75,833
6105 Medium-Duty Diesel Engines	1,705,399	2,132,590	2,202,856	322,324
6108 Medium-Duty Diesel Engines	991,190	1,424,391	1,491,211	218,195
6112 Heavy-Duty Diesel Engines	725,288	643,373	623,459	91,225
6113 Heavy-Duty Diesel Engines	365,717	877,177	1,031,965	150,998
Others	910,403	1,220,323	1,500,286	219,522
	6,920,528	9,556,303	10,384,022	1,519,398

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 27 Segment information (cont'd)

Revenues from customers based on their geographical location for the years ended December 31, 2006, 2007 and 2008 (in Rmb thousands) are as follows:

	2006	2007	2008	2008
	Sales	Sales	Sales	Sales
	Revenue	Revenue	Revenue	Revenue
	Rmb	Rmb	Rmb	US\$
	(in thousands)	(in thousands)	(in thousands)	(in thousands)
China	6,893,551	9,533,767	10,352,114	1,514,729
Other countries	26,977	22,536	31,908	4,669
	6,920,528	9,556,303	10,384,022	1,519,398

## 28 Foreign currency exchange

The Renminbi is not fully convertible into foreign currencies. All foreign exchange transactions involving Renminbi must take place either through the PBOC or other institutions authorized to buy and sell foreign exchange. The exchange rate adopted for the foreign exchange transactions is the rate of exchange quoted by the PBOC which are determined largely by supply and demand.

Foreign currency payments, including the remittance of earnings outside of the PRC, must be arranged through banks authorized to conduct foreign exchange business.

## 29 Distribution of profits

The Company's sources of cash flow for the purposes of distribution of profits to its shareholders are its share of the dividends, if any, paid by Yuchai, HLGE and TCL to the Company. With respect to dividends by Yuchai, applicable PRC laws and regulations require that, before it can distribute profit to its stockholders it must satisfy all tax liabilities, recover losses in previous years and make contributions to certain statutory reserves as discussed in Note 21. Such dividends may be paid partly in Renminbi and partly in foreign currency. In the event that dividends are distributed in Renminbi, the dividends may be converted into foreign currency and remitted in accordance with relevant PRC laws, regulations and policies and to the extent permitted by PRC market conditions. Dividends of Yuchai are determined based on distributable profits reported in its PRC GAAP financial statements, after appropriation to statutory reserves. Such distributable profits differ from the amounts reported under U.S. GAAP. No similar provisions were imposed with respect to dividends by TCL and HLGE.

Under the Companies Act of 1981 of Bermuda (as amended), the Company's contributed surplus is available for distribution to stockholders.

## 30 Derivative instrument and hedging activities

For the periods presented, the Company and its subsidiaries did not enter into transactions with respect to derivative instruments. The Company and its subsidiaries do not hedge risk exposures or speculate using derivative instruments.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 31 Significant concentrations and risks

### (a) Customer concentration

Substantially all of the Group's customers are located in the PRC. The following are the customers that individually comprise 10% or more of gross revenue in any of the relevant periods:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb	Rmb	Rmb	US\$
Liuzhou Dongfeng Automobile (see Note (i))	453,090	658,585	574,236	84,023
Hubei Dongfeng Automobile (see Note (ii))	238,400	333,612	233,151	34,115

Notes:

- (i): Sales to Liuzhou Dongfeng Automobile for the year ended December 31, 2006, 2007 and 2008 was approximately 6.5%, 6.9% and 5.5% of total sales.
- (ii): Sales to Hubei Dongfeng Automobile for the year ended December 31, 2006, 2007 and 2008 was approximately 3.4%, 3.5% and 2.2% of total sales.

Both customers are controlled by or affiliated with Dongfeng Automobile Company. At December 31, 2007 and 2008, approximately 16.1% and 30.1% of gross trade accounts receivable, respectively, were due from these customers. Management considers its relationships with these major customers to be good; however, the loss of one or more of the Group's major customers would have a material adverse effect on the Company's consolidated financial position, results of operations and cash flows.

### (b) Product concentration

See note 27 "Revenues from external customers by product category".

### (c) Supplier concentration

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.



# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 31 Significant concentrations and risks (cont'd)

### (d) *Material supply concentration*

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. A large portion of its engine blocks used in production were casted and molded internally, and contingent supply came from a long term domestic supplier. Raw materials, principally steel and cast iron, were purchased from domestic suppliers.

### (e) *Nature of operations*

During periods of economic expansion, the demand of trucks, construction machinery and other application of diesel engines generally increases. Conversely, during economic slowdowns the diesel engine industry is generally adversely affected by a decline in demand. As a result, the performance of Chinese economy will affect the Group's business and prospects to a significant degree.

### (f) *Transactions involving Yuchai's Chinese shareholders*

Although the Company has proper legal ownership over and a controlling financial interest of 76.41% interest in Yuchai, the Company has from time to time encountered difficulties in obtaining the cooperation of the State Holding Company and Coomber. As part of the terms of the Reorganization Agreement as described in Note 23, Yuchai and State Holding Company acknowledged and reaffirmed the Company's continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai's board of directors. However, no assurance can be given that disagreements or difficulties with Yuchai's management of State Holding Company and Coomber will not recur. In addition, as described in Note 5, Yuchai has entered into transactions that involved the Chinese Shareholders that have resulted in losses. No assurance can be given that future transactions involving the State Holding Company, Coomber and their related parties will be conducted on an arm-length basis or otherwise be beneficial to the Company. Consequently, such disagreements, or difficulties and transactions involving State Holding Company, Coomber and their related parties could have a material adverse impact on the Company's consolidated financial position, results of operations and cash flows.

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 terminated on June 30, 2007.

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.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 31 Significant concentrations and risks (cont'd)

### (g) Cash and cash equivalents

Cash and cash equivalents denominated in various currencies are held in bank accounts in the following countries:

	Years ended December 31,			
	2006	2007	2008	2008
	Rmb PRC	Rmb Singapore	Rmb PRC	US\$ Singapore
Rmb	439,689	–	615,672	–
USD	–	79,872	–	76,987
SGD	–	1,384	–	777
	<u>439,689</u>	<u>81,256</u>	<u>615,672</u>	<u>77,764</u>

## 32 Acquisitions

### Acquisition of Yulin Hotel Company

As previously described in Note 5 to these consolidated financial statements, on December 25, 2007, Yuchai, pursuant to the execution of a share transfer contract with YMCL, Coomber and State Holding Company, acquired all the outstanding share capital of Yulin Hotel Company for Rmb245.6 million. On January 13, 2009, Yuchai received approval from the provincial government regulatory agency in charge of state owned assets administration in China for its acquisition of 100% equity in Yulin Hotel Company. Prior to this approval, management of the Company has concluded that Yuchai is the legal owner of the shares in Yulin Hotel Company and hence Yuchai also bears the risks and rewards of the ownership in the corresponding operations of Yulin Hotel Company as of December 25, 2007. Consequently, the acquisition has been accounted for under the purchase method as of December 25, 2007. The results of operations and cash flows of Yulin Hotel Company were immaterial during the period December 25, 2007 to December 31, 2007, and therefore are not included in the Company's consolidated statements of income or cash flows. The Yulin Hotel Company, whose results were consolidated beginning in 2008, was included in Yuchai's operating segment in 2008.

Assets acquired and liabilities assumed have been recorded in the consolidated balance sheet at their estimated fair values as of December 25, 2007, and the Company recognized goodwill of Rmb 5,675 at acquisition. The principal assets of Yulin Hotel Company were the Yulin Hotel and YMCL's central office building in Guilin. The Company has finalized through internal studies and third-party valuations, the fair values of the property and equipment. Consequently, the final purchase price allocation is set forth below.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 32 Acquisitions (cont'd)

	<u>Fair value</u> <u>Rmb'000</u>
Current assets	7,809
Property and equipment	210,502
Construction in progress	130
Lease prepayments	48,281
Goodwill	5,675
Total assets acquired	<u>272,397</u>
Amounts due to related parties	19,782
Other current liabilities	7,015
Total liabilities assumed	<u>26,797</u>
Net assets acquired	<u>245,600</u>

During 2008, as disclosed in Notes 3(n), 3(q) and 5, the Company recorded an impairment charge of Rmb 46.0 million (US\$6.7 million) relating to the Yulin Hotel and Guilin Office buildings. In addition, the goodwill of Rmb5.7 million (US\$0.8 million) arising from the acquisition of the Yulin Hotel Company was fully impaired during the year.

### **Acquisition of Guangxi Yuchai Anda Gearbox Company Limited (“Anda”)**

Anda was established by Yuchai Group Company and Guangzhou Anda Crankshaft Company Limited (“Anda”) on July 2005 as a limited liability company in Yulin with a registered capital of Rmb20 million. It was mainly engaged in the manufacturing and sales of automobile accessories. Upon establishment, Yuchai Group Company and Anda held 25% and 75% interests in Anda, respectively. In current year, to expand the business, YMMC entered into an agreement with Anda to acquire 75% interests in Anda at a consideration of Rmb12 million (US\$1.8 million). The consideration was paid to Anda in June 2008. On May 6, 2008, YMMC appointed the executive director and general manager to take over the operations of Anda. Anda has been included in the Yuchai’s operating segment in 2008.

Consequently, the net assets of Anda acquired as at May 6, 2008 were Rmb32.5 million (US\$4.8 million). A negative goodwill amounting to Rmb12.4 million (US\$1.8 million) arose as a result of the difference between the net assets acquired and the cost of acquisition. The negative goodwill was allocated as a pro rata reduction to the qualifying assets acquired.

# Notes to Consolidated Financial Statements

FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008

(Rmb and US\$ amounts expressed in thousands, except per share data)

## 33 Subsequent events

### (a) *Multi-currency Revolving Credit Facility*

On March 19, 2009, the Company entered into a new facility agreement with BOTM to re-finance the existing revolving credit facility. The new unsecured, multi-currency revolving credit facility has a committed aggregated value of S\$16.5 million with a one year duration. The new facility will be used to finance the Company's long-term general working capital requirements. Among other things, the terms of the facility require that Hong Leong Asia Ltd. ("HLA") retains ownership of the Company's special share and that the Company remains a consolidated subsidiary of HLA. The terms of the facility also include certain financial covenants with respect to the Company's 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 the Company's 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.

### (b) *HLGE S\$93 million Loan Agreement*

On February 18, 2009, we announced the entry into of a loan agreement by our wholly owned subsidiary, Venture Lewis with HLGE to refinance the outstanding zero coupon unsecured non-convertible bonds previously issued by HLGE and due to mature on July 3, 2009. Under the terms of the loan agreement, on the maturity date of the bonds, HLGE will redeem fully the bonds held by all minority bondholders and pay to Venture Lewis a portion of the principal and gross redemption yield. The remaining amount due to Venture Lewis on maturity date would be refinanced through an unsecured loan arrangement with a one-year term, renewable by mutual agreement on an annual basis. An option for HLGE to undertake a partial redemption of the bonds on a pro-rata basis prior to the maturity date was included in the loan agreement. On February 19, 2009, HLGE announced an early partial redemption on a pro-rata basis of up to S\$9.0 million in principal amount of the outstanding bonds.

### (c) *Partial Redemption of New Bonds by HLGE*

On March 23, 2009, HLGE partially redeemed the New Bonds. The principal amount redeemed was approximately S\$9.0 million (US\$5.9 million) and resulted in a reduction in the principal amount of the New HLGE Bonds held by the Company from S\$87.0 million (US\$57.6 million) to S\$78.0 million (US\$51.6 million). The proceeds from the partial redemption amounted to S\$10.5 million (US\$7.0 million).

### (d) *Full Redemption of New Bonds by HLGE*

On July 3, 2009, HLGE fully redeemed all the outstanding New Bonds. The principal amount redeemed was approximately S\$78.0 million (US\$53.6 million) and resulted in a reduction in the principal amount of the New HLGE Bonds held by the Company from S\$78.0 million (US\$53.6 million) to nil. As mentioned in Note 33 (b), HLGE would pay to Venture Lewis a portion of the principal and gross redemption yield which amounted to S\$0.2 million (US\$0.1 million), and the remaining amount due to Venture Lewis would be refinanced through the S\$93.0 million unsecured loan arrangement.

# Notes to Consolidated Financial Statements

**FOR YEARS ENDED DECEMBER 31, 2006, 2007 AND 2008**

(Rmb and US\$ amounts expressed in thousands, except per share data)

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## **33 Subsequent events (cont'd)**

### **(e) *Provincial Government Approval for Acquisition of Yulin Hotel Company***

On January 13, 2009, Yuchai received approval from the provincial government regulatory agency in charge of state owned assets administration in China for its acquisition of 100% equity in Yulin Hotel Company.

## **34 Comparative figures**

Certain comparative figures have been reclassified to conform with current year's presentation.

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## Reference Information

### **US Transfer Agent and Registrar**

BNY Mellon Shareowner Services  
480 Washington Boulevard 29<sup>th</sup> Floor  
Jersey City, NJ 07310  
United States of America

### **Investor Relations**

Grayling  
22 Cortlandt St, 14th Floor  
New York, NY 10007

### **Common Stock**

China Yuchai International Limited  
Stock is listed on the New York Stock Exchange  
(NYSE: CYD)

### **Auditors**

Ernst & Young LLP  
One Raffles Quay  
North Tower, Level 18,  
Singapore 048583

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China Yuchai International Limited

**Operating Office:**

China Yuchai International Limited  
16 Raffles Quay, #39-01A Hong Leong Building  
Singapore 048581

**Manufacturing Location:**

Guangxi Yuchai Machinery Company Limited  
88 Tianqiao West Road, Yulin, Guangxi  
537005 People's Republic of China