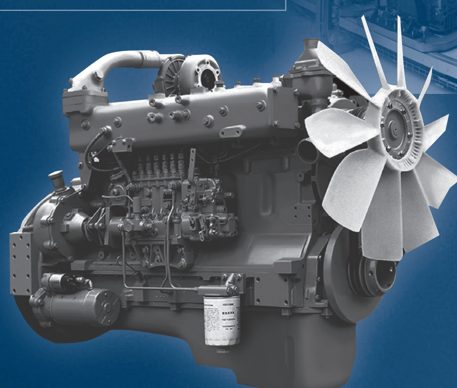
China Yuchai International Limited

# ANNUAL REPORT 2007



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# The Yuchai Spirit

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# Yuchai's core ideals are to:

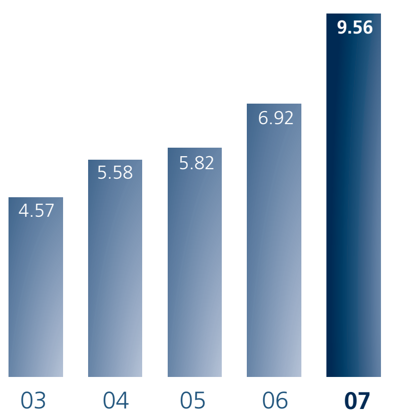
- Promote green development, harmonious partnership and mutual benefits
- Establish Yuchai as an international brand and propel Yuchai into multinational status
- Develop a caring professional workforce that possesses technical excellence and creativity
- Lead in the pursuit of business excellence, responsible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


The mark of
quality
quality

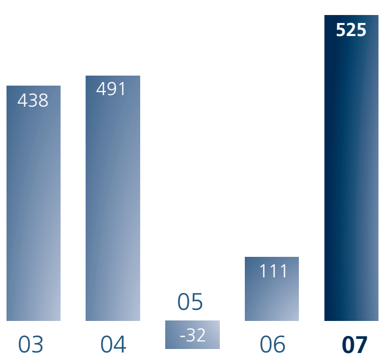
# Five-Year Financial Highlights

| | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| | Rmb'000 | Rmb'000 | Rmb'000 | Rmb'000 | Rmb'000 |
| Net revenue | 9,556,303 | 6,920,528 | 5,816,740 | 5,582,095 | 4,569,950 |
| Net income | 525,469 | 111,284 | (32,291) | 491,397 | 438,182 |
| Basic and diluted earnings per share | Rmb 14.10 | Rmb 2.99 | (Rmb 0.89) | Rmb 13.90 | Rmb 12.40 |
| Weighted average number of shares | 37,267,673 | 37,267,673 | 36,459,635 | 35,340,000 | 35,340,000 |
| | Rmb'000 | Rmb'000 | Rmb'000 | Rmb'000 | Rmb'000 |
| Total assets | 9,579,184 | 7,961,357 | 6,679,630 | 5,384,248 | 4,033,632 |
| Stockholders' equity | 3,294,465 | 2,728,399 | 2,566,263 | 2,483,084 | 1,991,687 |

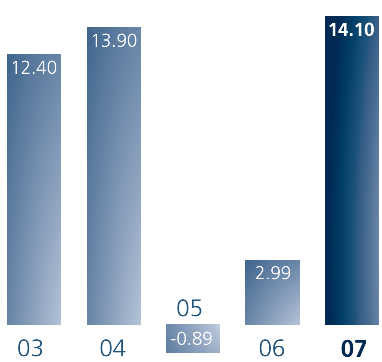
**Net Revenue**
*(in Rmb billions)*




**Net Income**
*(in Rmb millions)*




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




The mark of
success

# 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. CYI currently owns 76.4% of the outstanding shares of GYMCL through six of its wholly-owned subsidiaries.

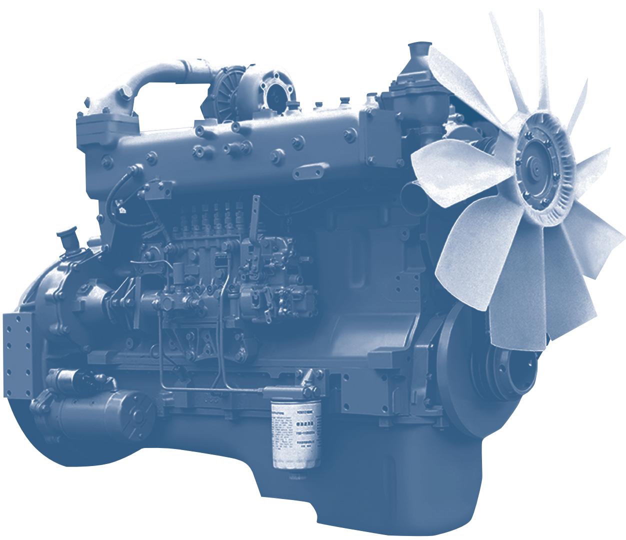
In February 2005, the Board of Directors of CYI announced its approval of the implementation of a business expansion and diversification plan. As a result, CYI acquired indirect interests in Thakral Corporation Ltd ("TCL") and HL Global Enterprises Limited ("HLGE"). Currently we hold 34.42% and 45.39% 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). In May 2008, TCL announced that it plans to reposition its principal business from consumer electronics distribution to real estate and related infrastructure investment in the pan-Asian region.

The core businesses of the HLGE group are hospitality operations and property development in mainland China and Malaysia.

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

CYI, on an ongoing basis continues to explore and assess new business opportunities.




成功的足迹

# 公司背景

中国玉柴国际有限公司(“CYI”)是一家于1993年4月29日在百慕达注册成立的控股公司。我们是依据百慕达公司法（1981）享有豁免权的股份有限公司。CYI于2008年3月7日在新加坡注册了其分公司，主要营业办事处位于No 16 Raffles Quay #39-01A, Hong Leong Building, Singapore 048581。

CYI是丰隆亚洲有限公司（“HLA”）的一家附属公司，HLA间接持有其21.2%的已发行普通股以及一股特别股份。CYI的普通股在纽约证券交易所上市交易，股票代号为“CYD”。

广西玉柴机器有限公司（“广西玉柴”）是CYI的主要营业子公司，它位于中国南部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。它同时也生产和提供广泛的产品类型，从轻型柴油发动机到重型柴油发动机、零件和柴油驱动发电机，以满足不同市场的需求。也因其产品的性能和可靠性高及良好的售后服务，广西玉柴在车辆制造商和顾客当中享有极佳声誉。目前，CYI通过其六家全资拥有的附属公司持有广西玉柴76.4%的已发行股份。

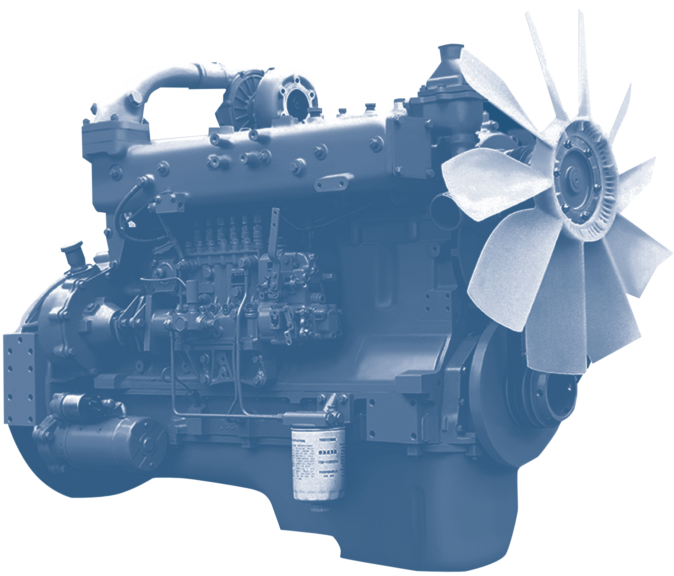
在2005年2月，CYI董事会宣布批准实施业务扩充和多元化计划。因此，CYI通过间接方式分别收购了Thakral有限公司（“TCL”）以及HLG企业有限公司（“HLGE”）的股权，目前，我们分别拥有TCL和HLGE的34.42%和45.394%的股权。

TCL集团是著名品牌电子消费产品的经销商，其主要的营运地为中国大陆（包括香港）。在2008年5月间,TCL宣布其计划将主要的业务从电子消费产品经销转向房地产和亚太区域的基础设施相关投资的领域。

HLGE的核心业务是在中国大陆和马来西亚的酒店经营和房地产开发。

TCL和HLGE均在新加坡证券交易有限公司主板上市。

CYI将持续探寻和评估一些新的商业机会 。



# President's Statement

The 2007 year was another solid period for China Yuchai International as our revenues demonstrated accelerated growth. In 2007, the Chinese auto industry grew unit sales by 21.8% and commercial vehicles recorded 22.3% year-over-year unit sales growth. It is noteworthy that diesel engines continue to play an important part in the commercial vehicle sector. Commercial vehicles powered by diesel engines grew 23.3% year-over-year in unit sales. We are very proud that our 2007 unit sales outpaced the industry as our diesel engine unit sales were 383,677, a 35.3% increase from the 283,583 units we sold in 2006.

We continued to extend our reach in the Chinese diesel engine market in 2007 as the Chinese economy experienced robust GDP growth at 11.4%. Our net revenues grew by 38.1% to RMB 9.556 billion from RMB 6.921 billion in 2006, and compared with RMB 5.817 billion in 2005. Of particular importance propelling commercial vehicle growth has been the Chinese infrastructure build out, including new highways and the needs of the increasing population in many urban centers, as well as preparations for the 2008 Olympics. All of these factors enhanced the demand for trucks and buses. The second half of 2007 also experienced strong growth due to the government mandate for the adoption of National III (equivalent to Euro III) emission standards for vehicles, originally scheduled for January 2008. However, the National III emission standards deadline was revised to July 2008, which also positively impacted sales in the first half of 2008. We continued to achieve success during 2008, especially in the market for National III and IV engines in the municipal bus market.

With their relatively greater power, fuel efficiency and reliability, governmental policies favor diesel engines until emerging technologies can be proven and commercialized to produce better performance and improved environmental results. Most of these new technologies are targeted in the near term for the passenger market, not the commercial and heavy-duty market where diesel engines dominate. Further, China Yuchai is seeking to expand its markets for diesel engines through increased exports and exploring new ventures that focus on the much larger Chinese passenger car markets.

While we achieved strong top line growth, we also improved our gross margin from 18.4% in 2006 to 20.4% in 2007. The increase was accomplished in the midst of a more competitive environment and higher raw material costs. The product mix had a positive impact on gross profit and margin as we introduced more heavy-duty products to the marketplace. The revenues from our light-duty engines grew 46.6%, medium-duty revenues were 31.9% higher, and the higher-margin, heavy-duty engine revenues grew by 39.4% compared with the same period a year ago. These factors, plus enhanced cost controls which lowered the production cost per unit, resulted in gross profit growth exceeding the rise in our revenues.

As an industry leader in technology and new products, we continue to focus on R&D. During 2007, we completed our National IV emissions technology, upgraded a variety of products and launched a number of new products. We continued to build on our reputation as a technology leader with commercial production of the 4-cylinder ISG (single-axle parallel ISG) hybrid bus engine and China's first LNG engine. In 2007, we proudly accomplished another "first" as we rolled out China's first National V emission compliant, electric control diesel engine in early December 2007. Our history of technology advancement has not gone unnoticed as GYMCL won three major awards at the China International Summit Forum on the Auto Parts Industry in Beijing. GYMCL was the only engine manufacturer to be selected and its YC6L-40, National IV diesel engine was designated as one of the "Best 10 New Technology Products". We have developed a large number of models from one-cylinder to multi-cylinder diesel engines to meet the specific needs of our customers and we will continue this trend of market innovation. In addition to diesel engine performance, our R& D is also focused on the development of environmentally sound diesel engine technology as this will enhance our market leadership.

Equally noteworthy, during 2007 we successfully demonstrated our ability to further control costs at all levels. Selling, general and administrative expenses (SG&A) represented almost 10.0% of 2007 revenues versus 11.5% of revenues in 2006. As a result, our operating income in 2007 climbed 176% to RMB 841.6 million (US$ 123.1 million) from RMB 304.5 million a year ago. Our operating margin doubled to 8.8% of revenues in 2007 versus 4.4% of revenues in 2006. The increase in operating income and margin reflected our strong revenues, higher gross margin and strict cost controls.

Our net income for 2007 of RMB 525.5 million, or RMB 14.10 per diluted share (US$ 76.9 million, or US$ 2.06 per diluted share) was 372% above the RMB 111.3 million, or RMB 2.99 per diluted share, in 2006.

At the end of 2007, net trade accounts receivable rose as revenues increased, and net inventories were higher as we positioned the Company for more sales in the future. Our net property, plant and equipment also was higher as we expanded our production facilities. In September 2008, the Company paid an interim cash dividend of US$0.10 per share for FY 2007 .

In 2007, we also focused on creating greater value and service for our customers. We realize that high-quality products and competitive prices are only part of the value we offer customers. To improve our customer service, we computerized our customer relations management system at key service centers and local branches. We also enhanced our information systems to improve our on-time product deliveries, customer claims processing and repair systems to higher levels.

The global financial crisis has affected the Chinese economy with a slowdown in demand for diesel engines in the later part of 2008 and we expect 2009 to be a difficult year. On behalf of the Board of Directors and management team, we thank our shareholders for their continued support.

**Teo Tong Kooi**
President
January 30, 2009

The production line-testing division

# 主席报告

对中国玉柴国际有限公司而言，2007年又是稳定发展的一年，我们的收入加速增长。2007年，中国汽车工业的单位销售量增长21.8%，商用车辆的单位销售量比去年同期增长22.3%。值得注意的是，柴油发动机继续在商用车辆领域占据举足轻重的地位。装配有柴油发动机的商用车辆单位销售量比去年同期增长23.3%。而让我们倍感自豪的是，2007年我们的单位销售量超过行业水平，我们的柴油发动机单位销售量为383,677台，相比2006年售出的283,583台增长35.3%。

由于中国经济发展迅猛，国内生产总值增长11.4%，我们继续寻求在中国柴油发动机市场有所突破。我们的净收入从2006年的人民币69.21亿元增至人民币95.56亿元，增长率为38.1%，而2005年为人民币58.17亿元。包括新公路在内的中国基础设施建设，许多城市中心人口日益增长的需求，以及2008年奥运会筹备工作，成为推动商用车辆销售量增长尤为重要的因素。上述所有因素增强了卡车和公共汽车的需求。2007年下半年，由于政府要求车辆采用国III（相当于欧III）排放标准（原定于2008年1月起开始实行），本公司收入大幅增长。然而，国III排放标准实施的最后期限经调整延后至2008年7月，这也对本公司于2008年上半年的销售量产生积极影响。由于我们的国III和国IV型号能为使用率较高的车辆节约燃料且提高其可靠性，并符合日益严格的环境标准，我们在2007年的公共汽车市场获得极大的成功。2008年，我们将继续努力实现成功的目标，尤其是在采用国III和国IV排放标准的发动机的市营公交市场。

由于其功率，燃油效率和可靠性相对较高，因此在性能更佳或更环保的新兴技术得到认可及商业化之前，政府政策都支持柴油发动机。这些新技术中的大多数着眼于短期内的客运市场，而不是柴油占主导地位的商业发动机和重型发动机市场。此外，中国玉柴正寻求通过增加出口量和针对中国大型客车市场推出的新举措，来拓展柴油发动机市场。

在实现稳固顶线增长的同时，我们还将毛利率从2006年的18.4%提高至2007年的20.4%。这一增长是我们克服市场环境竞争加剧和原材料成本上升得以实现的。由于我们将更多重型产品引入市场，因此产品组合对毛利润和利率具有积极的影响。与去年同期相比，我们的轻型发动机收入增长46.6%，中型发动机收入增长31.9%，而利润较高的重型发动机增长39.4%。鉴于这些因素，再加上成本控制增强，单位生产成本降低，毛利增长超过了我们的收入增长。

作为技术和新产品的行业领导者，我们持续投资于研究和开发。2007年，我们完成了达标国IV排放标准的技术革新，改良了多种产品并推出许多新产品。在这基础上，我们投入商业生产了4缸启动发电一体（单轴并联式启动发电一体）的混合公共汽车发动机以及中国首台液化天然气发动机，而这也为我们赢得行业技术领导者的美誉，我们会继续努力，争取将这一美誉加予发扬光大。2007年，我们实现又一个“首台”，即我们于2007年12月初推出中国首台达标国V排放标准的电控柴油发动机。广西玉柴在汽车零部件行业于北京举办的中国国际高峰论坛上获得三项大奖，这说明我们过去在技术革新方面取得的成就并未曾被遗忘。广西玉柴是此次唯一入选的发动机生厂商，其达标国Ⅳ柴油发动机YC6L-40荣获“十佳新技术推广产品”称号。为满足客户的特定需求，我们开发出涵盖从单缸到多缸的多种型号的柴油发动机，并将继续以市场创新为导向。除注重柴油发动机的性能外，我们的研发部门还致力于开发环保型柴油发动机技术，从而巩固我们的市场领导地位。

同样值得关注的是，2007年我们成功的展示了进一步控制各级成本的能力。2007年的销售及行政开支占收入10%，而2006年这一比例为11.5%。2007年我们的营

业收入为人民币8.416亿元（1.231亿美元），比上年的人民币3.045亿元增加了176%，营业利润相比2006年的4.4%翻了一番还多，达到8.8%。营业收入和利润的上升反映我们的收入强劲、毛利率较高及成本控制严格。

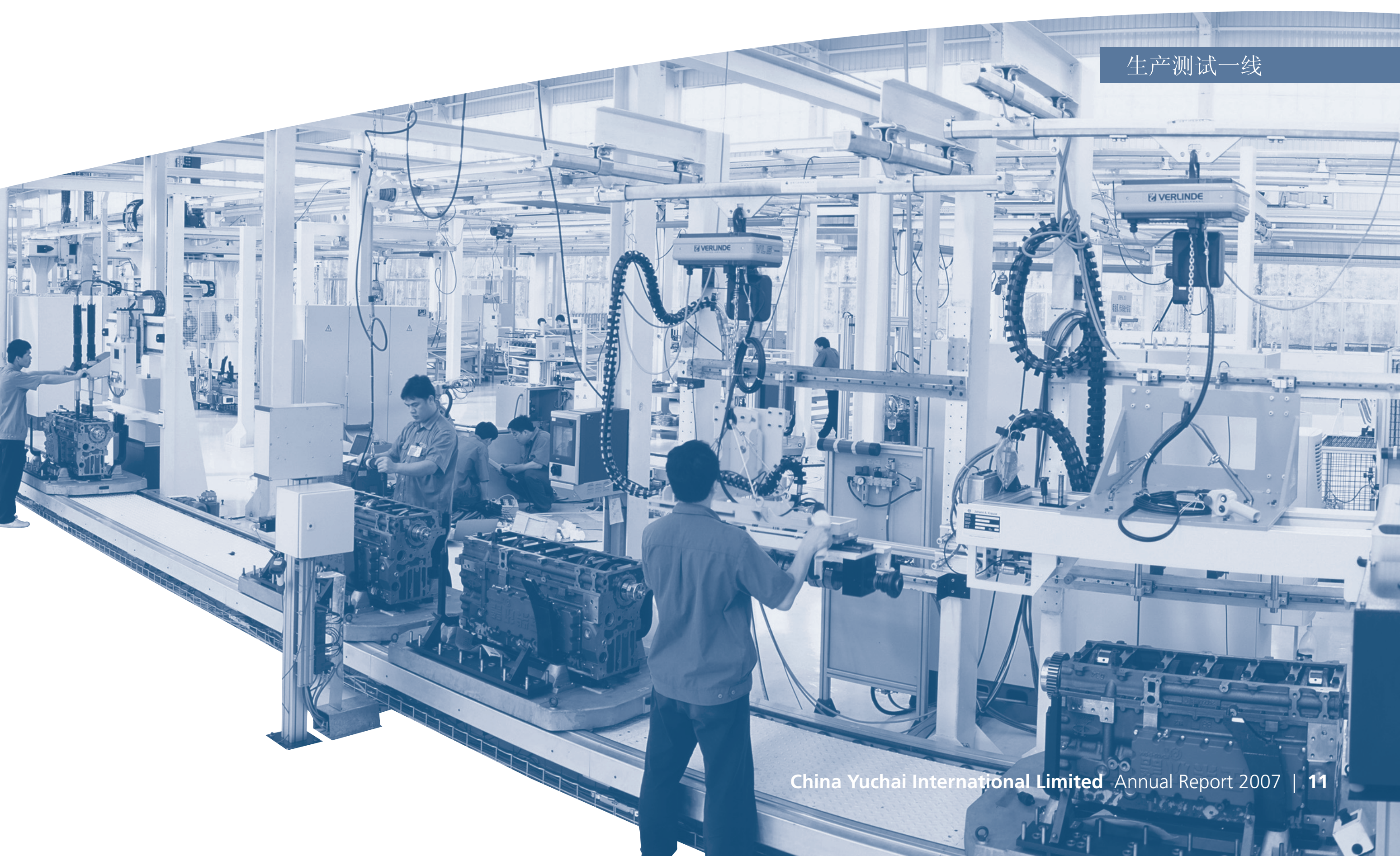
2007年，我们的净收入为人民币5.255亿元，相当于每股人民币14.10元（7,690万美元，相当于每股2.06美元），与2006年的人民币1.113亿元（相当于每股人民币2.99元）相比增加了372%。

由于2007年收入增加及为本公司未来销售增长准备的净库存较多，2007年年底，贸易应收款项净额有所增加。同样，我们的物业、厂房和设备净值也因生产设施扩充而有所上升。2008年9月，本公司支付2007年的中期现金股息每股0.10美元。

2007年，我们还致力于为客户创造更高的价值和服务。我们认为高品质的产品及有竞争力的价格仅仅是我们为客户提供的价值的一部分。为完善客户服务，我们将主要服务中心和地方分部的客户关系管理系统进行了计算机化。我们还改进了信息系统，从而进一步升级我们的按时交货、客户投诉处理和维修系统。

当前全球经济危机也影响了中国的经济，而2008年最后一个季度，市场对柴油机的需求量也有减缓现象。我们也预测2009年将是困难的一年。在此，我仅代表董事会及管理层向所有股东们持续给予的支持表示感谢。

张冬贵
主席
2009年 1月30日



生产测试一线

# 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 the Company's principal corporate governance practices, which are in compliance with Bermuda law, to those required of US companies.

| Standard for US Domestic Listed Companies | China Yuchai International Limited's Practice |
|---|---|
| **Director Independence**<br>• A majority of the board must consist of independent directors. | • Three of our eight directors, Messrs. Neo Poh Kiat, Tan Aik-Leang and Matthew Richards are independent within the meaning of the NYSE standards. |
| Independence is defined by various criteria including the absence of a material relationship between director and the listed company. Directors who are employees, are immediate family of the chief executive officer or receive over $100,000 per year in direct compensation from the listed company are not independent. Directors who are employees of or otherwise affiliated through immediate family with the listed company's independent auditor are also not independent. | |
| • The non-management directors of each company must meet at regularly scheduled executive sessions without management. | • Our non-management directors do not meet periodically without management directors. |
| **Audit Committee** | |
| • Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the 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. | • Our audit committee meets the requirements of Rule 10A-3 under the Exchange Act. |
| • 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. | • 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. |
| • The audit committee must have a written charter that addresses the committee's purpose and responsibilities. | • Our audit committee has a charter outlining the committee's purpose and responsibilities, which are similar in scope to those required of US companies. |

| Standard for US Domestic Listed Companies | China Yuchai International Limited's Practice |
|---|---|
| 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.<br><br>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.<br><br>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. | |
| • 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. | • The Board of Directors has identified Mr. Tan Aik-Leang as our Audit Committee Financial Expert. |
| • Each listed company must have an internal audit function. | • 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. |
| **Compensation Committee** | |
| • Listed companies must have a compensation committee composed entirely of independent board members as defined by the NYSE listing standards. | • Our compensation committee currently has three members, two of whom are independent within the meaning of the NYSE standards. |
| • The committee must have a written charter that addresses its purpose and responsibilities. | |

| Standard for US Domestic Listed Companies | China Yuchai International Limited's Practice |
|---|---|
| • 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. | • 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. |
| **Nominating/Corporate Governance Committee** | |
| • Listed companies must have a nominating/corporate governance committee composed entirely of independent board members. | • 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. |
| • The committee must have a written charter that addresses its purpose and responsibilities, which include (i) identifying qualified individuals to become board member; (ii) selecting, or recommending that the board select, the director nominees for the next annual meeting of shareholders; (iii) developing and recommending to the board a set of corporate governance principles applicable to the company; (iv) overseeing the evaluation of the board and management; and (v) conducting an annual performance evaluation of the committee. | |
| **Equity-Compensation Plans** | |
| • Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions. | • We intend to have our shareholders approve equity-compensation plans. |
| **Corporate Governance Guidelines** | |
| • Listed companies must adopt and disclose corporate governance guidelines. | • 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. |
| **Code of Business Conduct and Ethics** | |
| • 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. | • 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 http://www.cyilimited.com/invest_govt.asp. We intend to promptly disclose any amendment to or waivers of the Code for directors or executive officers. |

# 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 December 31, 2008, there are eight members elected to and serving on our Board of Directors, with three vacancies. Purusant to the rights afforded to the holder of the special share, Hong Leong Asia has designated Messrs. Teo Tong Kooi, 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 |
|---|---|---|
| TEO Tong Kooi (1) (2) (5) | President and Director | 2004 |
| GAN Khai Choon (1) (5) | Director | 1995 |
| KWEK Leng Peck (1) (3) | Director | 1994 |
| NEO Poh Kiat (1) (3) (4) | Director | 2005 |
| TAN Aik-Leang (1) (4) | Director | 2005 |
| Matthew RICHARDS (3) (4) | Director | 2006 |
| YAN Ping (1) | Director | 2007 |
| ZHANG Shi Yong (1) | Director | 2007 |

## Management Team

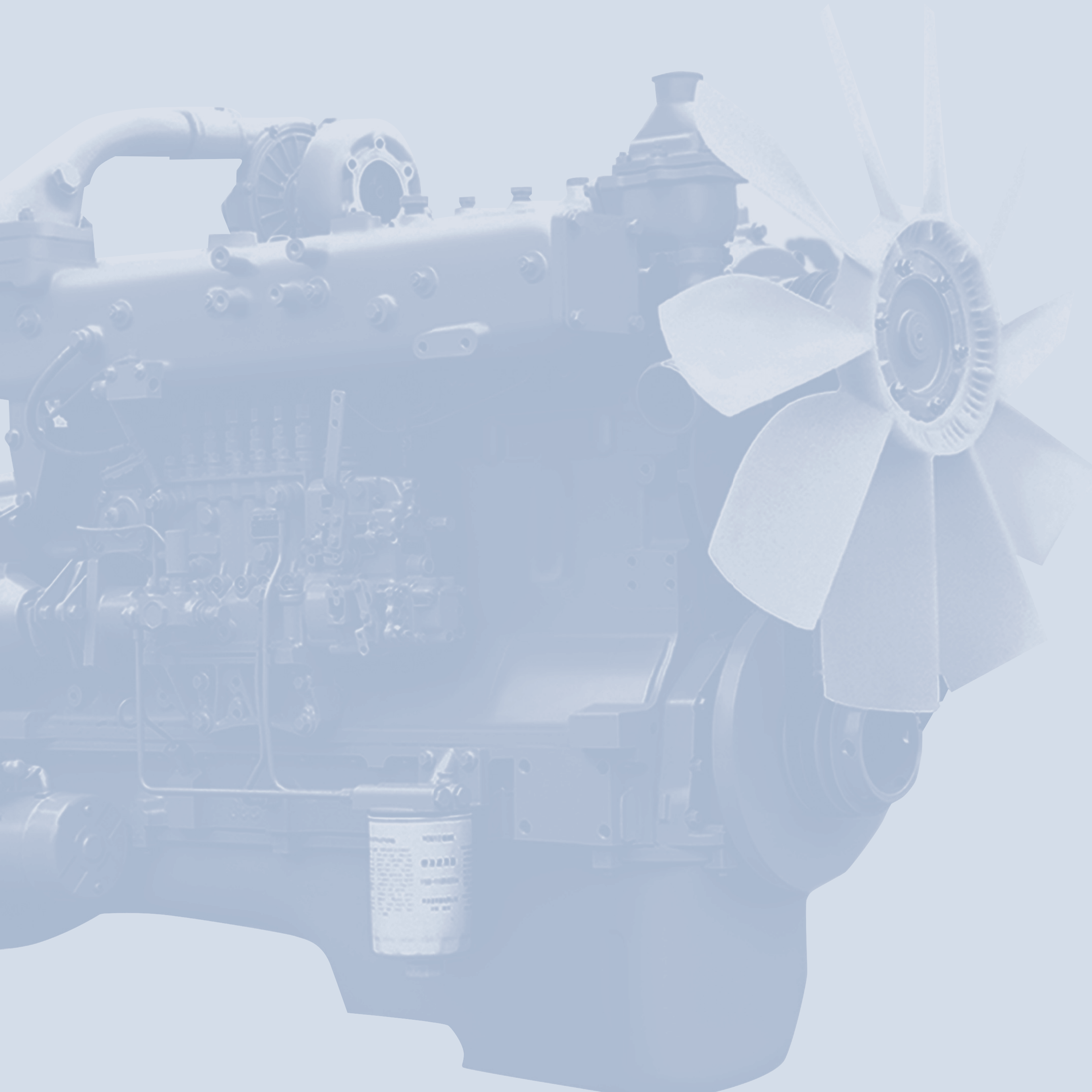
| Name | Position | Year First Elected or Appointed Director or Officer |
|---|---|---|
| TAN Wan Hong (1) (6) | Chief Operating Officer | 2008 |
| HOH Weng Ming | Chief Financial Officer | 2008 |
| FOO Shing Mei Deborah | General Counsel | 2007 |
| Ira Stuart OUTERBRIDGE III | Secretary | 2001 |

Mr. Gao Jia Lin resigned as a director and Vice- President of the Company on November 21, 2008 and as a director of Yuchai on November 20, 2008.

(1) Also a Director of Yuchai.
(2) Also a Director of TCL.
(3) Member of the Compensation Committee.
(4) Member of the Audit Committee.
(5) Also a Director of HLGE.
(6) Redesignated from Group General Manager to Chief Operating Officer with effect from November 21, 2008.

# Financial Report





# Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

China Yuchai International Limited:

We have audited China Yuchai International Limited's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). 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 China Yuchai International Limited'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, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included 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 a 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. Certain material weaknesses have been identified and included in management's assessment related to China Yuchai International Limited's (1) insufficient U.S. GAAP knowledge and resources, (2) equity method accounting, (3) financial statement closing process, (4) related party transactions, (5) inventory data maintenance, (6) selling price maintenance, (7) information technology, (8) provision for warranty costs and (9) approvals and authorizations.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of China Yuchai International Limited as of December 31, 2006 and 2007 and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for the years then ended. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 consolidated financial statements, and this report does not affect our report dated January 30, 2009, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, because of the effect of the aforementioned material weaknesses 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, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by COSO.

# Report of Independent Registered Public Accounting Firm

We do not express an opinion or any other form of assurance on management's statements referring to remediation measures to address material weaknesses in internal control over financial reporting.

/s/ KPMG LLP

Singapore

January 30, 2009

# Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

China Yuchai International Limited

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

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

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

As more fully described in Note 5 and Note 34 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.

The accompanying consolidated financial statements as of and for the year ended December 31, 2007 have been translated into U.S. dollars for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Renminbi have been translated into U.S. dollars on the basis set forth in Note 3(i) to the consolidated financial statements.

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, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated January 30, 2009, expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Singapore

January 30, 2009

# Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

China Yuchai International Limited

We have audited the accompanying consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows of China Yuchai International Limited and subsidiaries for the year ended December 31, 2005. 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 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 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 audit provides a reasonable basis for our opinion.

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

As further described in Note 2(b) to the consolidated financial statements, the consolidated financial statements of the Company for the year ended December 31, 2005 were restated for the correction of certain accounting errors.

As described in Note 5 to the consolidated financial statements, the Company recognized a provision for uncollectible loans to a related party in the amount of Rmb203 million as of December 31, 2005.

/s/ KPMG

Hong Kong

August 4, 2006, except as to Note 2(b) which is as of May 15, 2008

# Consolidated Statements of Operations

for years ended December 31, 2005, 2006 AND 2007

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

| | Note | Years ended December 31, 2005 Rmb | 2006 Rmb | 2007 Rmb | 2007 US$ |
|---|---|---|---|---|---|
| **Revenues, net [a]** | 3 [k], 27, 28, 33 [a] | 5,816,740 | 6,920,528 | 9,556,303 | 1,398,224 |
| **Cost of goods sold [a]** | 4, 27 | (4,673,357) | (5,648,407) | (7,611,585) | (1,113,684) |
| **Gross profit** | | 1,143,383 | 1,272,121 | 1,944,718 | 284,540 |
| **Research and development costs** | 3 [m] | (123,793) | (167,653) | (153,146) | (22,407) |
| **Selling, general and administrative expenses [a]** | 3 [m], 4, 14, 27 | (793,153) | (801,830) | (951,589) | (139,231) |
| **Provision for uncollectible loans to a related party** | 5 | (202,950) | – | – | – |
| **Gain on transfer of land use rights to a related party** | 27 | 2,533 | 1,841 | 1,573 | 230 |
| **Operating income** | | 26,020 | 304,479 | 841,556 | 123,132 |
| **Interest expense** | 6, 28 | (70,527) | (117,491) | (125,244) | (18,325) |
| **Equity in net income/(loss),net of affiliates** | 17 | (6,032) | (22,449) | 14,048 | 2,055 |
| **Other income, net [a]** | 7,27 | 25,449 | 38,856 | 53,554 | 7,836 |
| **Earnings/(loss) before income taxes and minority interests** | | (25,090) | 203,395 | 783,914 | 114,698 |
| **Income taxes** | 8 | (10,148) | (30,466) | (68,518) | (10,025) |
| **Income/(loss) before minority interests** | | (35,238) | 172,929 | 715,396 | 104,673 |
| **Minority interests in (income)/loss of consolidated subsidiaries** | | 2,947 | (61,645) | (189,927) | (27,789) |
| **Net income/(loss)** | | (32,291) | 111,284 | 525,469 | 76,884 |

| | Note | Years ended December 31, 2005 Rmb | 2006 Rmb | 2007 Rmb | 2007 US$ |
|---|---|---|---|---|---|
| **Earnings/ (loss) per common share** | | | | | |
| Basic | 3 [l] | (0.89) | 2.99 | 14.10 | 2.06 |
| Diluted | 3 [l] | (0.89) | 2.99 | 14.10 | 2.06 |
| **Weighted average number of shares** | | | | | |
| Basic | 3 [l] | 36,459,635 | 37,267,673 | 37,267,673 | 37,267,673 |
| Diluted | 3 [l] | 36,459,635 | 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 27)

| | 2005 Rmb | 2006 Rmb | 2007 Rmb | 2007 US$ |
|---|---|---|---|---|
| **Revenues, net** | 7,646 | 86,652 | 94,901 | 13,885 |
| **Cost of goods sold** | (417,816) | (592,535) | (573,926) | (83,974) |
| **Selling, general and administrative expenses** | (186,759) | (124,376) | (149,964) | (21,942) |
| **Other income, net** | 11,922 | 10,622 | 11,664 | 1,707 |

See accompanying notes to consolidated financial statements.

# Consolidated Balance Sheets

as of December 31, 2006 and 2007

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

| | Note | As of December 31, | | |
|---|---|---|---|---|
| | | 2006 | 2007 | 2007 |
| | | Rmb | Rmb | US$ |
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | 33 [g] | 745,933 | 520,945 | 76,222 |
| Trade accounts and bills receivable, net | 9 | 1,480,918 | 3,107,785 | 454,714 |
| Amounts due from related parties | 10, 27 | 158,512 | 143,652 | 21,018 |
| Loans receivable from a related party, net | 5 | 2,050 | 2,050 | 300 |
| Loans to customers, net | 11 | 11,486 | 3,361 | 492 |
| Inventories | 12 | 1,565,183 | 1,647,025 | 240,983 |
| Prepaid expenses | | 93,977 | 31,752 | 4,646 |
| Other receivables, net | 13 | 140,069 | 97,074 | 14,203 |
| Income taxes recoverable | | 10,750 | 27,990 | 4,095 |
| Deferred income taxes | 8 | 112,779 | 114,361 | 16,733 |
| **Total current assets** | | 4,321,657 | 5,695,995 | 833,406 |
| Property, plant and equipment, net | 14, 34 | 1,795,405 | 2,158,246 | 315,782 |
| Construction in progress | 15 | 288,559 | 184,921 | 27,057 |
| Lease prepayments | 16, 34 | 124,944 | 168,002 | 24,581 |
| Investments in affiliates | 17 | 508,246 | 505,009 | 73,890 |
| Other investments | 17 | 640,192 | 615,201 | 90,013 |
| Goodwill | 3 [n] | 212,636 | 218,311 | 31,942 |
| Deferred income taxes | 8 | 69,718 | 33,499 | 4,901 |
| **Total assets** | | 7,961,357 | 9,579,184 | 1,401,572 |
| **LIABILITIES, MINORITY INTERESTS AND STOCKHOLDERS' EQUITY** | | | | |
| **Current liabilities** | | | | |
| Short-term bank loans | 18 [a] | 1,009,134 | 819,164 | 119,855 |
| Amounts due to the holding company | 27 | 3,226 | 5,278 | 772 |
| Amounts due to related parties | 5, 10, 27 | 77,911 | 380,521 | 55,676 |
| Trade accounts payable | | 2,132,798 | 2,509,962 | 367,243 |
| Income taxes payable | | 1,789 | 5,663 | 829 |
| Accrued expenses and other liabilities | 20 | 639,350 | 946,675 | 138,512 |
| **Total current liabilities** | | 3,864,208 | 4,667,263 | 682,887 |
| Long-term bank loans, excluding current installments | 18 [b] | 675,454 | 767,929 | 112,359 |
| **Total liabilities** | | 4,539,662 | 5,435,192 | 795,246 |

See accompanying notes to consolidated financial statements.

# Consolidated Balance Sheets

as of December 31, 2006 and 2007 (Continued)
*(Rmb and US$ amounts expressed in thousands, except per share data)*

| | Note | As of December 31, | | |
|---|---|---|---|---|
| | | 2006 | 2007 | 2007 |
| | | Rmb | Rmb | US$ |
| **Total liabilities brought forward** | | 4,539,662 | 5,435,192 | 795,246 |
| **Minority interests** | | 693,296 | 849,527 | 124,299 |
| **Stockholders' equity** | | | | |
| Common stock | | 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, 2006 and 2007 | | | | |
| Special share | | | | |
| US$0.10 par value: | | | | |
| authorized 1 share; | | | | |
| issued and outstanding 1 share | | | | |
| at December 31, 2006 and 2007 | | – | – | – |
| Contributed surplus | | 1,692,251 | 1,692,251 | 247,601 |
| Statutory reserves | 22 | 267,586 | 270,339 | 39,555 |
| Accumulated other comprehensive income, net | | 85,643 | 154,580 | 22,617 |
| Retained earnings | | 650,974 | 1,145,350 | 167,580 |
| **Total stockholders' equity** | | 2,728,399 | 3,294,465 | 482,027 |
| Commitments and contingencies | 5, 23, 24 | – | – | – |
| **Total liabilities, minority interests and stockholders' equity** | | 7,961,357 | 9,579,184 | 1,401,572 |

See accompanying notes to consolidated financial statements.

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

for years ended December 31, 2005, 2006 and 2007

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

| | Note | Common stock Rmb | Contributed surplus Rmb | Statutory reserves Rmb | Retained earnings Rmb | Accumulated other comprehensive income Rmb | Total stockholders' equity Rmb |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2005 | | 30,349 | 1,486,934 | 266,229 | 699,572 | – | 2,483,084 |
| **2005** | | | | | | | |
| Net loss | | – | – | – | (32,291) | – | (32,291) |
| Net unrealized gains on investment securities held by an affiliate, net of nil tax | | – | – | – | – | 38,869 | 38,869 |
| Foreign currency translation adjustments, net of nil tax | | – | – | – | – | (10,018) | (10,018) |
| Comprehensive loss | | | | | | | (3,440) |
| Transfer to statutory reserves | 22 | – | – | 357 | (357) | – | – |
| Shares issued in connection with – Conversion of convertible debt into 1,927,673 common shares | 19 | 1,596 | 205,317 | – | – | – | 206,913 |
| Dividend declared (US$0.39 per share) | | – | – | – | (120,294) | – | (120,294) |
| Balance at December 31, 2005 | | 31,945 | 1,692,251 | 266,586 | 546,630 | 28,851 | 2,566,263 |
| **2006** | | | | | | | |
| Net income | | – | – | – | 111,284 | – | 111,284 |
| Net unrealized gains on investment securities, net of nil tax and reclassification adjustments [a] | | – | – | – | – | 56,840 | 56,840 |
| Net unrealized gains on investment securities held by an affiliate, net of nil tax | | – | – | – | – | 3,201 | 3,201 |
| Foreign currency translation adjustments, net of nil tax | | – | – | – | – | (3,249) | (3,249) |
| Comprehensive income | | | | | | | 168,076 |
| Transfer to statutory reserves | 22 | – | – | 1,000 | (1,000) | – | – |
| Dividend declared (US$0.02 per share) | | – | – | – | (5,940) | – | (5,940) |
| Balance at December 31, 2006 | | 31,945 | 1,692,251 | 267,586 | 650,974 | 85,643 | 2,728,399 |

See accompanying notes to consolidated financial statements.

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

for years ended December 31, 2005, 2006 and 2007

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

| | Note | Common stock | Contributed surplus | Statutory reserves | Retained earnings | Accumulated other comprehensive income | Total stockholders' equity |
|---|---|---|---|---|---|---|---|
| | | Rmb | Rmb | Rmb | Rmb | Rmb | Rmb |
| **2007** | | | | | | | |
| Net income | | – | – | – | 525,469 | – | 525,469 |
| Net unrealized gains on investment securities, net of nil tax [(a)] | | – | – | – | – | 80,612 | 80,612 |
| Net unrealized gains on investment securities held by an affiliate, net of nil tax | | – | – | – | – | 13,283 | 13,283 |
| Foreign currency translation adjustments, net of nil tax | | – | – | – | – | (24,958) | (24,958) |
| Comprehensive income | | | | | | | 594,406 |
| Transfer to statutory reserves | 22 | – | – | 2,753 | (2,753) | – | – |
| Dividend declared (US$0.10 per share) | | – | – | – | (28,340) | – | (28,340) |
| Balance at December 31, 2007 | | 31,945 | 1,692,251 | 270,339 | 1,145,350 | 154,580 | 3,294,465 |
| Balance at December 31, 2007 (in US$) | | 4,674 | 247,601 | 39,555 | 167,580 | 22,617 | 482,027 |

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

| | 2006 | 2007 |
|---|---|---|
| Unrealized holdings gains arising during the year | 97,332 | 98,090 |
| Redemption of investment securities in an affiliate taken to net income | (19,550) | (17,478) |
| Investment in affiliate upon conversion (Note 17(b)(i)) | (20,942) | – |
| Net unrealized gains on investment securities | 56,840 | 80,612 |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

for years ended December 31, 2005, 2006 and 2007
*(Rmb and US$ amounts expressed in thousands)*

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| **Cash provided by operating activities** | | | | |
| Net income/ (loss) | (32,291) | 111,284 | 525,469 | 76,884 |
| Adjustments to reconcile net income/ (loss) to net cash provided by operating activities: | | | | |
| – Depreciation and amortization of property, plant and equipment | 141,333 | 142,860 | 223,304 | 32,673 |
| – Lease prepayment charged to expense | 3,339 | 3,328 | 4,702 | 688 |
| – Provision for uncollectible loans to a related party | 202,950 | – | – | – |
| – Impairment of property, plant and equipment | – | 2,346 | 781 | 114 |
| – Loss on disposal of property, plant and equipment | 10,474 | 1,598 | 5,926 | 867 |
| – Gain on transfer of land use rights to a related party | (2,533) | (1,841) | (1,573) | (230) |
| – Deferred income tax expense/(benefit) | (20,050) | (19,996) | 34,637 | 5,068 |
| – Provision for losses/(recoveries) on guarantees | 12,318 | (7,410) | (4,237) | (620) |
| – Equity in losses/(income) of affiliates, net | 6,032 | 21,261 | (14,048) | (2,055) |
| – Dividend received from other investments | 7,815 | – | – | – |
| – Minority interests | (2,947) | 61,645 | 189,927 | 27,789 |
| – Gain on redemption of other investments | – | (28,457) | (17,478) | (2,557) |
| – Loss on dilution of investments in affiliates | – | 1,188 | 2,591 | 378 |
| – Net loss/(gain) on changes in fair value of embedded derivatives | – | 3,617 | (6,139) | (898) |
| – Exchange loss on financing activities | – | 38,388 | 38,622 | 5,651 |
| – Bad debt expense/(credit) | 25,587 | 21,582 | (11,008) | (1,611) |
| (Increase)/decrease in assets | | | | |
| – Inventories | (321,890) | 103,252 | (81,842) | (11,975) |
| – Amounts due from related parties, net | (115,074) | 77,401 | 52,088 | 7,621 |
| – Trade accounts and bills receivable | (328,875) | (323,647) | (1,615,859) | (236,423) |
| – Prepaid expenses | (79,757) | 44,345 | 62,225 | 9,104 |
| – Other receivables, net | (20,237) | (4,417) | 50,804 | 7,433 |
| – Loans to customers, net | (7,904) | (3,582) | 8,125 | 1,189 |
| – Income taxes recoverable/(payable), net | (67,232) | 32,885 | (13,366) | (1,956) |
| Increase/(decrease) in liabilities | | | | |
| – Trade accounts payable | 710,726 | 332,355 | 377,164 | 55,185 |
| – Accrued expenses and other liabilities | 112,828 | 25,236 | 271,687 | 39,752 |
| – Amount due to holding company | 158 | (1,075) | 2,052 | 300 |
| **Net cash provided by operating activities** | 234,770 | 634,146 | 84,554 | 12,371 |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

for years ended December 31, 2005, 2006 and 2007
*(Rmb and US$ amounts expressed in thousands)*

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| **Cash flow from investing activities** | | | | |
| Purchase of property, plant and equipment and construction in progress (includes interest capitalized) | (515,359) | (323,781) | (265,258) | (38,811) |
| Proceeds from disposal of property, plant and equipment | 3,826 | 2,134 | 5,236 | 766 |
| Proceeds from disposal of land use rights | 3,580 | 2,394 | 2,125 | 311 |
| Repayment of loans by a related party | 205,000 | – | – | – |
| Loans to a related party | (205,000) | – | – | – |
| Purchase of investments | (161,358) | (923,101) | – | – |
| Proceeds from disposal of other investments | – | – | 773 | 113 |
| Prepayments for land use right | – | (59,497) | (31) | (4) |
| Proceeds from redemption of investment securities | – | 11,907 | 88,652 | 12,971 |
| **Net cash used in investing activities** | (669,311) | (1,289,944) | (168,503) | (24,654) |
| **Cash flow from financing activities** | | | | |
| Proceeds from short-term bank loans | 1,188,178 | 974,978 | 649,164 | 94,982 |
| Proceeds from long-term bank loans | 50,000 | 687,473 | 197,044 | 28,830 |
| Proceeds from issuance of convertible debt | 206,913 | – | – | – |
| Repayments of short-term and long term bank loans | (805,343) | (962,835) | (933,533) | (136,589) |
| Dividends paid by subsidiaries to minority stockholders | (66,677) | (23,036) | (22,316) | (3,265) |
| Dividends paid to stockholders | (120,294) | (5,940) | (28,340) | (4,147) |
| Capital contributions from minority interests | – | – | 2,920 | 427 |
| **Net cash provided by/(used in) financing activities** | 452,777 | 670,640 | (135,061) | (19,762) |
| **Effect of foreign currency exchange on cash and cash equivalents** | (4,713) | (5,104) | (5,978) | (874) |
| **Net increase/(decrease) in cash and cash equivalents** | 13,523 | 9,738 | (224,988) | (32,919) |
| **Cash and cash equivalents at beginning of year** | 722,672 | 736,195 | 745,933 | 109,141 |
| **Cash and cash equivalents at end of year** | 736,195 | 745,933 | 520,945 | 76,222 |

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| **Supplemental disclosures of cash flow information** | | | | |
| Cash paid during the year for: | | | | |
| – Interest, net of amount capitalized | 70,527 | 117,491 | 125,860 | 18,415 |
| – Income taxes | 97,431 | 21,012 | 47,247 | 6,913 |

**Significant non-cash investing and financing transactions**

During 2005, the convertible debt issued was converted to 1,927,673 ordinary shares of the Company (see Note 19).

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 34).

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

*(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"), 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, 2007, Yuchai held an equity interest of 71.83%, 97.14% and 76.92% respectively in these companies. As at December 31, 2006 and 2007, YMMC had direct controlling interests in twenty-one and twenty-five 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 2007, Yuchai purchased a fourth subsidiary, Guangxi Yulin Hotel Company Ltd ("Yulin Hotel Company") (see Note 34).

In March 2005, the Company 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 1.00% of the ordinary shares of TCL in September 2005. As a result of the rights issue of 87,260,288 rights shares on February 16, 2006, the Company's equity interest in TCL increased to 19.36%. 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 36.61% 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 34.42%.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

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

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

On February 7, 2006, the Company acquired 29.13% 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 45.42% of the enlarged total number of ordinary shares in issue. 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 45.39%.

## 2 General

### *(a) Basis of presentation*

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

### *(b) Restatement of 2005 consolidated financial statements*

The Company's consolidated financial statements for the year ended December 31, 2005 were previously restated on May 30, 2008 to reflect certain adjustments to correct accounting errors for such period. The most significant adjustment was to correct accounting errors for the understatement of accounts payable of Rmb167.8 million by Yuchai at December 31, 2005. The accompanying 2005 consolidated financial statements reflect those previously restated financial statements of the Company and its subsidiaries.

## 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 Standard Board (the "FASB") Interpretation ("FIN") No. 46 (R), "Consolidation of Variable Interest Entities" ("FIN 46(R)") and to assess whether it is the primary beneficiary of such entities. If the determination is made that the 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, 2007.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

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

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

***(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 29 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 does not have any off-balance-sheet credit exposure related to its customers, except for outstanding bills discounted with banks (see Note 24(e)) and off-balance-sheet credit exposure of YEGCL (see Note 24(d)), that are subject to recourse for non-payment. The Group sells trade accounts and bills receivable to banks on an ongoing basis. The buyer is responsible for servicing the receivables upon maturity of the trade accounts receivable. Sales of the trade accounts receivable are accounted for under Statement of Financial Accounting Standards ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". Accordingly, trade accounts and bills receivable are derecognized, and 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 trade accounts and bills receivable of Rmb3,423,296, Rmb4,485,221 and Rmb4,403,828 (US$644,343), for the years ended December 31, 2005, 2006 and 2007, respectively. The Group has recorded discounts totaling Rmb44,362, Rmb54,720 and Rmb75,193 (US$11,002) in respect of sold trade accounts and bills receivable for the years ended December 31, 2005, 2006 and 2007, respectively, which has been included in interest expense.

Loans receivables primarily relate to initial working capital financing provided to Yuchai Marketing Company Limited ("YMCL"), a related party (see Note 5). The allowance for doubtful accounts is management's best estimate of the amount of credit losses in these existing loans. A loan is considered impaired pursuant to FASB Statement No.114, "Accounting by Creditors for Impairment of a Loan". A loan is impaired if it is probable that the Company will not collect all principal and interest contractually due. The Company does not accrue interest when a loan is considered impaired. The Company has elected to recognize 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 realizable value.

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

### *(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 terms |

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.

### *(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," 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.

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

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

Affiliates (cont'd)

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.

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 operations 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. 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.

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

### *(i) Foreign currency transactions and translation (cont'd)*

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 6.8346 = US$1.00, the rate quoted by the PBOC at the close of business on December 31, 2008. No representation is made that the Renminbi amounts could have been, or could be, converted into U.S. dollars at that rate or at any other rate prevailing on December 31, 2008 or any other date.

### *(j) Income taxes*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets are reduced by a valuation allowance to the extent 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 operations.

### *(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.

*(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/(loss) per share***

Basic earnings/(loss) per share is computed by dividing income/(loss) attributable to common shares by the weighted average number of common shares outstanding for the period. Diluted earnings/(loss) per share is calculated by dividing net earnings/(loss) 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. For 2005, the convertible debt issued by the Company was outstanding and no adjustment has been made as the effect would have been anti-dilutive. The Company's basic and diluted earnings/(loss) per share are as follows:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Net income/(loss)attributable to common shares | (32,291) | 111,284 | 525,469 | 76,884 |
| Earnings/(loss) per share | | | | |
| – Weighted average common shares outstanding during the year | | | | |
| Basic | 36,459,635 | 37,267,673 | 37,267,673 | 37,267,673 |
| Diluted | 36,459,635 | 37,267,673 | 37,267,673 | 37,267,673 |
| – Earnings/(loss) per common share | | | | |
| Basic | (0.89) | 2.99 | 14.10 | 2.06 |
| Diluted | (0.89) | 2.99 | 14.10 | 2.06 |

There were no potentially dilutive common shares during the years ended December 31, 2006 and 2007.

***(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 Rmb45,291, Rmb42,636 and Rmb17,248 (US$2,524) respectively, for the years ended December 31, 2005, 2006 and 2007.

Research and development expenses are shown net of government subsidies of Rmb5,915, Rmb7,858 and Rmb4,730 (US$692) for the years ended December 31, 2005, 2006 and 2007, respectively.

## 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 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. The results of the impairment testing in 2005, 2006 and 2007 did not result in any impairment of goodwill.

### *(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.

### *(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 estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

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

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

### *(r) Commitments and contingencies*

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

### *(s) Defined contribution plans*

The Group participates in the national pension schemes as defined by the laws of the countries in which it has operations. Yuchai and its subsidiaries make contributions to the defined contribution retirement plans, organized by the Guangxi Regional Government and Beijing City Government, 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.

### *(t) Leases*

Where the Company has the use of assets under operating leases, payments made under the leases are recognized in the consolidated statement of operations 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 operations in the accounting period in which they are incurred.

### *(u) Comparative information*

Certain immaterial presentation corrections have been made to prior year's financial statements to conform to presentation used in the current year. These include re-presentation of summarized financial statements for an affiliate.

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

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expenses disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. In February 2008, the FASB Staff Position, or FSP, SFAS No. 157-1, "Application of FASB SFAS No. 157 to SFAS No. 13 and its Related Interpretive Accounting Pronouncements That Address Leasing Transactions," and FSP SFAS No. 157-2, "Effective Date of SFAS No. 157." FSP SFAS No. 157-1 excludes from the scope of SFAS No.157 certain leasing transactions accounted for under SFAS No. 13, "Accounting for Leases". FSP SFAS No. 157-2 delays the effective date of SFAS No. 157 from 2008 to 2009 for all non financial assets and non financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The provisions of SFAS No. 157 will be applied prospectively to fair value measurements and disclosures for financial assets and financial liabilities and non financial assets and non financial liabilities recognized or disclosed at fair value in the financial statements on at least an annual basis beginning in the first quarter of 2008. Management does not believe the adoption of SFAS No. 157 will have a material impact on the consolidated financial statements at this time and will monitor any additional implementation guidance that may be issued.

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

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

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

In June 2007, the 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. 141R, "Business Combination" which replaces SFAS No. 141. SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquiree and the goodwill acquired. The Statement also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. This Statement is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008. The impact of the adoption of SFAS No. 141R on 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.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities". This Statement requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. This Statement applies to all entities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company intends to provide the additional disclosures under this Statement in fiscal 2009 if it applies.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

*(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 2008, the FASB issued FASB Staff Position ("FSP") no. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" (FSP EITF 03-6-1). EITF 03-6-1 clarifies whether instruments granted in share-based payment transactions should be included in the computation of EPS using the two-class method prior to vesting. The Company is in the process of analyzing the impact of FSP EITF03-6-1, which is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not expect the initial adoption of FSP EITF 03-6-1 to have a material impact on its 2009 financial statements.

**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, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| Cost of goods sold | 90,354 | 94,215 | 163,909 | 23,982 |
| Selling, general and administrative expenses | 50,979 | 48,645 | 59,395 | 8,691 |
| | 141,333 | 142,860 | 223,304 | 32,673 |

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

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| Selling, general and administrative expenses | 39,372 | 32,172 | 58,719 | 8,591 |

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

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| Selling, general and administrative expenses | 126,813 | 116,570 | 154,807 | 22,650 |

## 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 Rmb11,922, Rmb10,512 and Rmb11,548 (US$1,690) was received and recognized in 2005, 2006 and 2007, respectively (see Note 7).

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

In 2005, the Company discussed with the Chinese Shareholders the possibility of converting the loans into an equity investment in 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.

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

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.

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, 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, 2007. 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.

*(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)

An analysis of the allowance for doubtful loans for 2005, 2006 and 2007 is as follows:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Balance at beginning of year | – | 202,950 | 202,950 | 29,695 |
| Add: Charge to consolidated statements of operations | 202,950 | – | – | – |
| Less: Write-offs | – | – | – | – |
| Balance at end of year | 202,950 | 202,950 | 202,950 | 29,695 |

## 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 2005, 2006 and 2007:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Interest cost capitalized | 20,991 | 18,057 | 12,367 | 1,809 |
| Interest cost charged to consolidated statements of operations | 70,527 | 117,491 | 125,244 | 18,325 |
| Total interest cost incurred | 91,518 | 135,548 | 137,611 | 20,134 |

## 7 Other income, net

Other income, net consists of:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Interest income | 21,744 | 47,124 | 54,205 | 7,931 |
| Foreign exchange gain/(loss), net | 607 | (41,940) | (37,172) | (5,438) |
| Dividend income from other investments | 7,815 | – | 4,897 | 717 |
| Rental income | 6,078 | 1,766 | 1,499 | 219 |
| Loss on dilution of equity interests in affiliates | – | (1,188) | (2,591) | (379) |
| Gain on redemption of other investments (Note 17(b)(ii)) | – | 28,457 | 17,478 | 2,557 |
| Net gain/(loss) on changes in fair value of embedded derivatives (Note 17(b)) | – | (3,617) | 6,139 | 898 |
| Others, net | (10,795) | 8,254 | 9,099 | 1,331 |
| | 25,449 | 38,856 | 53,554 | 7,836 |

## 8 Income taxes

***Bermuda tax***

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

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

***PRC income tax***

As Yuchai is a sino-foreign enterprise in the Western Region of the PRC that is engaged in an encouraged industry, its PRC statutory income tax rate is 15% in 2005, 2006 and 2007 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 2005, 2006 and 2007.

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, 2007 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 paid 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 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 as the Company does not plan to indefinitely reinvest these earnings.

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

## 8 Income taxes (cont'd)

***PRC income tax (cont'd)***

Earnings/(loss) before income taxes and minority interests comprise the following:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| PRC | 17,942 | 292,359 | 845,239 | 123,671 |
| Non-PRC | (43,032) | (88,964) | (61,325) | (8,973) |
| Total | (25,090) | 203,395 | 783,914 | 114,698 |

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

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| PRC | | | | |
| Current tax expense | 30,198 | 50,462 | 33,881 | 4,958 |
| Deferred tax expense/(benefit) | (20,050) | (19,996) | 34,637 | 5,067 |
| | 10,148 | 30,466 | 68,518 | 10,025 |

Income tax expense reported in the consolidated statements of operations differs from the amount computed by applying the PRC income tax rate of 15% for the three years ended December 31, 2007 for the following reasons:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| Computed "expected" tax expense/(benefit) | (3,764) | 30,509 | 117,587 | 17,205 |
| Adjustments resulting from: | | | | |
| – Non-deductible expenses related to errors correction (see Note (ii)) | 10,623 | 7,795 | – | – |
| – Non-deductible expenses | 5,703 | 4,053 | 8,411 | 1,231 |
| – Effect of change in tax law on allowance for doubtful loans to a related party (see Note (iii)) | – | – | 27,650 | 4,045 |
| – Tax credits on purchase of property, plant and equipment (see Note (i)) | (43,535) | (6,895) | (70,877) | (10,370) |
| – Tax credits on purchase of property, plant and equipment forfeited | – | – | 8,861 | 1,296 |
| – Tax credits for R& D expense (see Note (i)) | – | (10,386) | (11,877) | (1,738) |
| – Change in valuation allowance | 45,231 | (6,492) | (34,699) | (5,077) |
| – Tax rate differential | (4,110) | 11,882 | 18,314 | 2,680 |
| – Other | – | – | 5,148 | 753 |
| Actual tax expense | 10,148 | 30,466 | 68,518 | 10,025 |

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

## 8 Income taxes (cont'd)

***PRC income tax (cont'd)***

Notes:

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

(ii) Amount relates to non-deductible permanent differences from the restatement of the Company's 2005 financial statements as at May 15, 2008 as such expenses are not expected to be deductible in accordance with PRC regulations.

(iii) 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 a deductible temporary difference due to a change in CIT law in 2007.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at December 31, 2006 and 2007 are presented below:

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Trade accounts receivable | 36,806 | 31,836 | 4,658 |
| Inventories | 23,251 | 19,124 | 2,798 |
| Property, plant and equipment | 26,982 | 31,407 | 4,595 |
| Accrued expenses and other liabilities | 49,384 | 68,381 | 10,005 |
| Tax losses carried forward | 5,075 | 1,152 | 169 |
| Tax credits | 50,434 | – | – |
| Loans to a related party | 29,304 | – | – |
| Total gross deferred tax assets | 221,236 | 151,900 | 22,225 |
| Less: Valuation allowance (see Note (i)) | 38,739 | 4,040 | 591 |
| Net deferred tax assets | 182,497 | 147,860 | 21,634 |

Note: (i) An analysis of the valuation allowance for 2006 and 2007 is as follows:

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Balance at beginning of year | 45,231 | 38,739 | 5,668 |
| Less: | | | |
| Reduction in valuation allowance for forfeited unused tax credits | – | (8,861) | (1,297) |
| Realization of deferred tax assets in the current year | – | (25,838) | (3,780) |
| Reduction in valuation allowance for changes in circumstances that caused a change in judgment about the realizability of deferred tax assets | (6,492) | – | – |
| Balance at end of year | 38,739 | 4,040 | 591 |

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007
*(Rmb and US$ amounts expressed in thousands, except per share data)*

## 8 Income taxes (cont'd)

***PRC income tax (cont'd)***

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

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Net deferred tax assets comprise: | | | |
| Current portion | 112,779 | 114,361 | 16,733 |
| Non-current portion | 69,718 | 33,499 | 4,901 |
| | 182,497 | 147,860 | 21,634 |

As of December 31, 2007, Yuchai was granted tax credits amounting to Rmb11,877 (US$1,738) in relation to approved research and development costs and Rmb70,877 (US$10,370) relating to the purchase of certain domestic equipment. According to the relevant laws and regulations in the PRC prior to the new CIT law, the amount of credits relating to the purchase of certain domestic equipment entitled for deduction each year is limited to the incremental current income tax expense of the subsidiary for the year compared to the income tax expense of the subsidiary in the year immediately prior to the year the credit was approved. All the approved tax credits, including credits of Rmb50,434 (US$7,379) relating to the purchase of certain domestic equipment carried over from prior years, were fully utilized against current income taxes in 2007, except for Rmb8,861 (US$1,296) that have been forfeited as of December 31, 2007 due to provisions of the new CIT law, which no longer allows such tax credits to be accrued and existing credits unused as of December 31, 2007 are not permitted to be carried forward.

As at December 31, 2007, one of the subsidiaries of the Company had tax loss carry forwards for PRC income tax purposes of Rmb4,608 (US$674), 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 Rmb4,040 (US$591) has been provided for all of its deferred tax assets as at December 31, 2007. The reduction in valuation allowance in 2007 primarily arises from the reversal of a valuation allowance for tax credits of Rmb18,241 carried forward from 2005 that have been utilized in 2007 due to unforseeable positive results actually achieved during the current year, for unused tax credits of Rmb8,861 that were forfeited as of December 31, 2007, and for deferred tax assets of other subsidiaries that were previously loss making but have now become profitable. 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, 2007.

The Company and its subsidiaries adopted the provisions of FIN 48 on January 1, 2007, and there was no material effect on the consolidated financial statements. As a result, the Company and its subsidiaries did not record any cumulative effect adjustment related to adopting FIN 48.

As of January 1, 2007, and for the 12-month period ended December 31, 2007, 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 addition, the Company and its subsidiaries do not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months.

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

## 8 Income taxes (cont'd)

***PRC income tax (cont'd)***

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.

In 2006, the provincial tax bureau completed an examination of Yuchai's PRC income tax returns for 2001 through 2005. The tax bureau did not make any adjustment to Yuchai's tax positions, and no surcharge or penalty was imposed. The income tax returns of Yuchai for the years ended December 31, 2005 through 2007 remain subject to examination by the PRC tax authorities. For all other PRC subsidiaries, the income tax returns for the years ended December 31, 2003 through 2007 are open to examination.

## 9 Trade accounts and bills receivable, net

Trade accounts and bills receivable, net comprise:

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Trade accounts receivable | 517,130 | 732,682 | 107,203 |
| Less: Allowance for doubtful accounts | 90,365 | 64,893 | 9,495 |
| | 426,765 | 667,789 | 97,708 |
| Bills receivable | 1,054,153 | 2,439,996 | 357,006 |
| | 1,480,918 | 3,107,785 | 454,714 |

An analysis of the allowance for doubtful accounts for 2005, 2006 and 2007 is as follows:

| | December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Balance at beginning of year | 107,457 | 69,047 | 90,365 | 13,222 |
| Add: | | | | |
| Charge (credit) to consolidated statements of operations | 25,587 | 21,582 | (11,008) | (1,611) |
| Less: | | | | |
| Written off | (63,997) | (264) | (14,464) | (2,116) |
| Balance at end of year | 69,047 | 90,365 | 64,893 | 9,495 |

At December 31, 2006 and 2007, gross trade accounts receivable due from a major customer, Dongfeng Automobile Company and its affiliates ("the Dongfeng companies") were Rmb121,336 and Rmb117,728 (US$17,225), respectively. See Note 33(a) for further discussion of customer concentration risk.

As of December 31, 2006 and 2007, no trade accounts receivable was pledged as security under loan arrangements (see Note 18(a)).

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

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

| | December 31, 2006 Rmb | December 31, 2007 Rmb | December 31, 2007 US$ |
|---|---|---|---|
| Amounts due from: | | | |
| SHC & subsidiaries | 54,987 | 88,207 | 12,906 |
| YMCL & subsidiaries | 96,547 | 27,459 | 4,018 |
| Others | 6,978 | 27,986 | 4,094 |
| Due within one year | 158,512 | 143,652 | 21,018 |

An analysis of the allowance for doubtful accounts due from related parties for 2005, 2006 and 2007 is as follows:

| | December 31, 2005 Rmb | December 31, 2006 Rmb | December 31, 2007 Rmb | December 31, 2007 US$ |
|---|---|---|---|---|
| Balance at beginning of year | – | – | 33,170 | 4,853 |
| Add: | | | | |
| Charge to consolidated statements of operations in current year | – | 33,170 | – | – |
| Less: | | | | |
| Written off | – | – | (3,863) | (565) |
| Balance at end of year | – | 33,170 | 29,307 | 4,288 |

| | December 31, 2006 Rmb | December 31, 2007 Rmb | December 31, 2007 US$ |
|---|---|---|---|
| Amounts due to: | | | |
| SHC & subsidiaries | 64,761 | 183,595 | 26,863 |
| YMCL & subsidiaries | 3,863 | 191,184 | 27,973 |
| HLMS | 9,287 | 5,742 | 840 |
| Due within one year | 77,911 | 380,521 | 55,676 |

Related parties include Guangxi Yuchai Mechanical and Electronics Company ("GYMEC"), Hong Leong Management Services Pte. Ltd. ("HLMS"), TCL, HLGE, YMCL (excluding YMCL loans disclosed in Note 5), State Holding Company ("SHC") and their subsidiaries and affiliates. At December 31, 2007, the amounts due from/to related parties are unsecured, interest free and arose principally from transactions as disclosed in Note 27 and from the purchase of all of the share capital of Yulin Hotel Company (see Note 34). 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.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

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

## 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 5.31% to 7.49% per annum and are repayable in installments within one year. The loans are secured and guaranteed by independent third parties.

## 12 Inventories

Inventories are comprised of:

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Raw materials | 1,058,619 | 942,798 | 137,945 |
| Work in progress | 24,251 | 17,647 | 2,581 |
| Finished goods | 482,313 | 686,580 | 100,457 |
| | 1,565,183 | 1,647,025 | 240,983 |

## 13 Other receivables, net

Other receivables, net comprise:

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| VAT recoverable | 66,005 | 8,063 | 1,180 |
| Staff loans | 6,602 | 3,406 | 498 |
| Staff advances | 4,803 | 4,665 | 682 |
| Amounts due under guarantee contracts, net (see Note 24(d)) | 15,189 | 10,440 | 1,528 |
| Land deposit | 5,000 | 5,000 | 732 |
| Interest receivable from affiliates | 19,658 | 50,599 | 7,403 |
| Others | 22,812 | 14,901 | 2,180 |
| | 140,069 | 97,074 | 14,203 |

*(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, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Buildings, including leasehold improvements | 854,241 | 1,096,622 | 160,452 |
| Machinery and equipment | 2,119,912 | 2,426,938 | 355,096 |
| Office and computer equipment | 97,342 | 106,995 | 15,654 |
| | 3,071,495 | 3,630,555 | 531,202 |
| Less: Accumulated depreciation and amortization | 1,276,090 | 1,472,309 | 215,420 |
| Property, plant and equipment, net | 1,795,405 | 2,158,246 | 315,782 |

Loss on disposal of property, plant and equipment for the years ended December 31, 2005, 2006 and 2007 is included in "Selling, general and administrative expenses" as follows:

| | December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| Loss on disposal of property, plant and equipment | 10,474 | 1,598 | 5,926 | 867 |

## 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, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Diesel engine production line and facilities projects | 172,278 | 86,543 | 12,662 |
| Factories auxiliary facilities | 47,680 | 47,068 | 6,887 |
| Second foundry | 8,704 | 12,034 | 1,761 |
| Others | 59,897 | 39,276 | 5,747 |
| | 288,559 | 184,921 | 27,057 |

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

## 16 Lease prepayments

The lease prepayments are summarized as follows:

| | December 31, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Gross payments for land use rights | 155,596 | 203,127 | 29,721 |
| Less: Amounts charged to expense | 30,652 | 35,125 | 5,140 |
| Lease prepayments | 124,944 | 168,002 | 24,581 |

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 Rmb3,339, Rmb3,328 and Rmb4,702 (US$688) for the years ended December 31, 2005, 2006 and 2007, respectively.

## 17 Investments

### *(a) Investments as of December 31, 2006 and 2007 are summarized as follows:*

| | December 31, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Investments in affiliates under the equity method | 508,246 | 505,009 | 73,890 |
| Other investments in debt and equity securities of affiliates (see Note 17 (e)) | 640,192 | 615,201 | 90,013 |
| | 1,148,438 | 1,120,210 | 163,903 |

### *(b) Investments in affiliates accounted for using the equity method as of December 31, 2006 and 2007 are as follows:*

| | December 31, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Listed: | | | |
| TCL (see Note (i)) | 385,583 | 387,930 | 56,760 |
| HLGE (see Note (ii)) | 117,360 | 112,648 | 16,482 |
| Unlisted: | | | |
| Others (see Note (iii)) | 5,303 | 4,431 | 648 |
| | 508,246 | 505,009 | 73,890 |

The retained earnings of the Company included accumulated losses of Rmb28,555 and Rmb17,098 (US$2,502) attributable from affiliates as of December 31, 2006 and 2007, respectively.

## 17 Investments (cont'd)

### *(b) Investments in affiliates accounted for using the equity method as of December 31, 2006 and 2007 are as follows: (cont'd)*

Notes:

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

In February 2006, the Company acquired an additional 3.37% 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 17.25%. As of December 31, 2006, the Company's equity interest in TCL was 36.61%.

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 34.42%. The loss in dilution was Rmb2,591 (US$379).

As of December 31, 2007, the Company held 898,990,352 shares (2006: 898,990,352 shares) of TCL's ordinary shares. As of December 31, 2006 and 2007, the Company's underlying equity in net assets of TCL exceeded the carrying amount of its investment in TCL by Rmb64,897 and Rmb66,063 (US$9,666), 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.

The fair value, based on the quoted market price, of the TCL shares held by the Company was S$80.9 million (Rmb405,560) and S$49.4 million (Rmb 235,047) as of December 31, 2007 and December 31, 2008 respectively. It is reasonably possible that in 2008 the Company will need to recognize an other than temporary impairment charge pertaining to its investment in TCL.

**17 Investments (cont'd)**

***(b) Investments in affiliates accounted for using the equity method as of December 31, 2006 and 2007 are as follows: (cont'd)***

(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.

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.

*(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, 2006 and 2007 are as follows: (cont'd)***

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

| | Fair value S$'000 |
|---|---|
| SSecured bonds | 109,543 |
| RCPS A | 1,948 |
| RCPS A–Embedded equity derivatives | 137 |
| RCPS B | 7,221 |
| Ordinary shares | 12,766 |
| | 131,615 |

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.

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.

*(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, 2006 and 2007 are as follows: (cont'd)***

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. As of December 31, 2007, the Company held 387,614,839 shares (2006: 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%.

As of December 31, 2006 and 2007, the Company's carrying value of its investments in HLGE exceeded its underlying equity in HLGE's net assets by Rmb148,145 and Rmb139,937 (US$20,475), 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) and S$21.3 million (Rmb101,344) as of December 31, 2007 and December 31, 2008 respectively. The fair values of its other debt and equity investments in HLGE at December 31, 2008 have not yet been determined.

It is reasonably possible that in 2008 the Company will need to recognize an other than temporary impairment charge pertaining to its investments in HLGE.

(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 loss of these PRC entities amounts to Rmb198 (US$29).

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

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| *Financial position* | | | |
| Current assets | 979,767 | 941,398 | 137,740 |
| Property, plant and equipment, net | 113,457 | 96,405 | 14,105 |
| Other assets | 369,498 | 407,627 | 59,642 |
| Total assets | 1,462,722 | 1,445,430 | 211,487 |
| Current liabilities | 139,208 | 102,736 | 15,032 |
| Long term debt | 65,497 | 1,549 | 227 |
| Total liabilities | 204,705 | 104,285 | 15,259 |
| Minority interests | 27,256 | 22,165 | 3,243 |
| Stockholders' equity | 1,230,761 | 1,318,980 | 192,985 |
| Total liabilities, minority interests and stockholders' equity | 1,462,722 | 1,445,430 | 211,487 |

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for years ended December 31, 2005, 2006 and 2007

*(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, 2006 and 2007, and the years ended December 31, 2006 and 2007 is as follows: (cont'd)***

| | Year ended December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| *Statement of operations* | | | |
| Revenue | 1,225,028 | 1,451,188 | 212,330 |
| Gross profit | 62,796 | 88,446 | 12,941 |
| Operating profit/(loss) | (97,426) | 25,915 | 3,792 |
| Income tax credit/(expense) | 9,089 | (9,011) | (1,319) |
| Income/(loss) before minority interest | (88,337) | 16,904 | 2,473 |
| Minority interests in income of consolidated subsidiaries | 4,997 | 2,367 | 346 |
| Net income/(loss) | (83,340) | 14,537 | 2,127 |
| The Company's equity in income/(loss) of TCL | (23,923) | 5,925 | 867 |

The Company's equity in income/(loss) of TCL, net of nil tax, is determined as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Based on the respective equity interest | (24,448) | 4,997 | 731 |
| Adjustment to account for the basis difference | 525 | 928 | 136 |
| | (23,923) | 5,925 | 867 |

***(d) Summarized consolidated financial information of HLGE as of December 31, 2006 and 2007 and for the period from February 3, 2006 to December 31, 2006 and the year ended December 31, 2007 is as follows:***

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| *Financial position* | | | |
| Current assets | 371,762 | 356,135 | 52,108 |
| Property, plant and equipment, net | 92,278 | 86,331 | 12,632 |
| Other assets | 347,807 | 303,193 | 44,361 |
| Total assets | 811,847 | 745,659 | 109,101 |
| Current liabilities | 62,065 | 51,850 | 7,586 |
| Non-current liabilities | 817,560 | 753,930 | 110,311 |
| Total liabilities | 879,625 | 805,780 | 117,897 |
| Stockholders' deficit | (67,778) | (60,121) | (8,796) |
| Total liabilities and stockholders' deficit | 811,847 | 745,659 | 109,101 |

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for years ended December 31, 2005, 2006 and 2007

*(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 and 2007 and for the period from February 3, 2006 to December 31, 2006 and the year ended December 31, 2007 is as follows: (cont'd)***

| | Period from February 3, 2006 to December 31, 2006 | Year ended December 31, 2007 | Year ended December 31, 2007 |
|---|---|---|---|
| | Rmb | Rmb | US$ |
| *Statement of operations* | | | |
| Revenue | 37,110 | 30,065 | 4,399 |
| Gross profit | 19,133 | 18,009 | 2,635 |
| Operating profit | (2,556) | 22,502 | 3,293 |
| Income tax expense | (265) | (2,376) | (348) |
| Income before minority interest | (2,821) | 20,126 | 2,945 |
| Equity in net income/(loss), net of affiliates | (18,853) | 8,751 | 1,280 |
| Profit/(loss) from continuing operations | (21,674) | 28,877 | 4,225 |
| Income from discontinued operations | 44,213 | – | – |
| Net income | 22,539 | 28,877 | 4,225 |
| The Company's equity in income of HLGE | 1,395 | 8,321 | 1,218 |

The Company's equity in income of HLGE, net of nil tax, is determined as follows:

| | Period from February 3, 2006 to December 31, 2006 | Year ended December 31, 2007 | Year ended December 31, 2007 |
|---|---|---|---|
| | Rmb | Rmb | US$ |
| Based on the respective equity interest | 6,865 | 11,716 | 1,715 |
| Adjustment to account for the basis difference | (5,470) | (3,395) | (497) |
| | 1,395 | 8,321 | 1,218 |

***(e) Other investments as of December 31, 2006 and 2007 not described above are summarized as follows:***

| | 2006 | 2007 | 2007 |
|---|---|---|---|
| | Rmb | Rmb | US$ |
| Available for sale securities, at fair value: | | | |
| Unsecured bonds | 589,637 | 558,852 | 81,768 |
| RCPS A | 10,646 | 12,736 | 1,864 |
| Embedded derivatives | | | |
| RCPS A – Embedded equity derivatives | 1,505 | 7,383 | 1,080 |
| Investment securities, at cost: | | | |
| Unquoted equity securities | 6,355 | 6,255 | 915 |
| RCPS B | 32,049 | 29,975 | 4,386 |
| | 640,192 | 615,201 | 90,013 |

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for years ended December 31, 2005, 2006 and 2007

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

## 17 Investments (cont'd)

### *(e) Other investments as of December 31, 2006 and 2007 not described above are summarized as follows: (cont'd)*

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 Rmb608,946 (US$89,097) (2006: Rmb633,837).

Initial fair value, gross unrealized holding gain, and period-end fair value of available-for-sale securities as of December 31, 2007, were as follows:

| | Initial fair value | Gross unrealized holding gains | Carrying value (Fair v alue) | Carrying value (Fair value) |
|---|---|---|---|---|
| | Rmb | Rmb | Rmb | US$ |
| Unsecured bonds of HLGE | 461,645 | 97,207 | 558,852 | 81,768 |
| RCPS A of HLGE | 8,513 | 4,223 | 12,736 | 1,864 |
| | 470,158 | 101,430 | 571,588 | 83,632 |

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, 2006 and 2007:

| | December 31, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Due after one year through five years | 589,637 | 558,852 | 81,768 |
| Due after five years through ten years | 10,646 | 12,736 | 1,864 |

## 18 Bank debt

### *(a) Short-term bank loans*

Short-term bank loans are denominated as follows:

| | December 31, | | |
|---|---|---|---|
| | 2006 | 2007 | 2007 |
| | Rmb | Rmb | US$ |
| Renminbi denominated loans | 806,506 | 819,164 | 119,855 |
| Singapore dollars denominated loans | 202,628 | – | – |
| | 1,009,134 | 819,164 | 119,855 |

The weighted average interest rate of short-term bank loans at December 31, 2006 and 2007 was 4.05% and 4.03% per annum, respectively.

As of December 31, 2006, short-term bank loans consist of unsecured loans of Rmb512,628 (US$74,737) and unsecured bonds of Rmb496,506 (US$72,386).

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).

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

## 18 Bank debt (cont'd)

### *(b) Long-term bank loans*

Long-term bank loans comprise

| | Interest rate at December 31, 2007 (per annum) | December 31, 2006 Rmb | December 31, 2007 Rmb | December 31, 2007 US$ |
|---|---|---|---|---|
| US$ denominated loans (unless otherwise stated): | | | | |
| Due in 2008 (multi-currency) | 3.01% - 3.24% | 575,454 | 457,787 [(a),(c)&(d)] | 66,981 |
| Due in 2010 (multi-currency) | 2.68% - 3.01% | – | 225,142 [(e)] | 32,941 |
| Due in 2010 (RMB denominated loans) | 5.85% | 100,000 | 85,000 | 12,437 |
| Total long-term bank loans outstanding | | 675,454 | 767,929 | 112,359 |
| Less: Amounts due within one year included under current liabilities | | – | – | – |
| Amounts due after one year | | 675,454 | 767,929 | 112,359 |

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:

(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 Rmb2,658,071 (US$388,914) as at December 31, 2007. The commitment fee incurred was Rmb191 (US$28).

(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 35(b) was used to partially refinance this facility which was fully repaid.

## 18 Bank debt (cont'd)

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

(d) US$25.0 million credit facility with Bank of Tokyo-Mitsubishi, UFJ Ltd, Singapore Branch ("BOTM"):

On March 23, 2005, in furtherance of its business expansion plans, the Company entered into a revolving credit facility agreement with the BOTM with a committed aggregate value of US$25.0 million for a three years duration. Among other things, the terms of the facility require that 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. On March 20, 2008, this credit facility expired and the new facility with same bank as stated in note 35(a) was used to refinance this facility which was fully repaid.

(e) 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 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 2007 audited consolidated accounts has been received from the bank granting an extension of time until February 28, 2009.

(f) S$60.0 million credit facility with Oversea-Chinese Banking Corporation Limited ("OCBC"):

On January 26, 2006, in furtherance of its acquisitions and business expansion plans, the Company entered into a revolving credit facility agreement with OCBC with a committed aggregate value of S$60.0 million for a period of 18 months. Among other terms, the terms of the facility require that 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 30 June and 31 December 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 30 June and 31 December of each year not exceeding 2.0 times, as well as negative pledge provisions and customary drawdown requirements. At all times during the period from January 1, 2007 to July 26, 2007, the Company was in compliance with these financial covenants. The loan has been fully repaid as at December 31, 2007.

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

## 19 Convertible debt

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

## 20 Accrued expenses and other liabilities

Accrued expenses and other liabilities comprise:

| | December 31, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Deposits from customers | 57,577 | 32,951 | 4,821 |
| Staff welfare payable (see Note (i)) | 15,041 | 15,041 | 2,201 |
| Accrued product warranty (see Note 21) | 163,701 | 194,898 | 28,516 |
| Wages payable | 127,382 | 153,270 | 22,426 |
| Management bonus payable (see Note (ii)) | 15,035 | 94,312 | 13,799 |
| Payable for construction in progress | 49,147 | 67,707 | 9,907 |
| Accrued research and development expenses | 26,947 | 8,559 | 1,252 |
| Accrued advertising expense | 4,165 | 13,096 | 1,916 |
| Accrued legal fee and other professional fees | 3,421 | 14,298 | 2,092 |
| Accrued expenses for litigation and guarantees (see Notes 24(c) and (d)) | 7,849 | 7,102 | 1,039 |
| Individual income tax withholding | 3,890 | 10,124 | 1,481 |
| VAT payable | – | 13,816 | 2,021 |
| Guarantee deposit | – | 10,000 | 1,463 |
| Accrued sales discount | 59,769 | 94,055 | 13,762 |
| Accrued interest | 2,749 | 2,133 | 312 |
| Other payables | 20,764 | 628 | 92 |
| Accrued retirement benefits | 5,747 | 5,747 | 841 |
| Other accruals and liabilities | 76,166 | 208,938 | 30,571 |
| | 639,350 | 946,675 | 138,512 |

Note:

(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.

(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.

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

## 21 Accrued product warranty

An analysis of the accrued product warranty for 2005, 2006 and 2007 is as follows:

| | December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Balance at beginning of year | 126,114 | 142,126 | 163,701 | 23,952 |
| Allowance charged to consolidated statements of operations | 179,184 | 200,892 | 233,838 | 34,214 |
| Less: Amounts utilized | (163,172) | (179,317) | (202,641) | (29,650) |
| Balance at end of year | 142,126 | 163,701 | 194,898 | 28,516 |

## 22 Statutory reserves

The Company's attributable share in the statutory reserves of Yuchai and its subsidiaries for the three years ended December 31, 2007 is as follows:

| | December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| ***Statutory general reserve (see Note (ii))*** | | | | |
| Balance at January 1 | 170,041 | 170,280 | 171,280 | 25,061 |
| Transfer from retained earnings | 239 | 1,000 | 2,753 | 403 |
| Balance at December 31 | 170,280 | 171,280 | 174,033 | 25,464 |
| ***Statutory public welfare fund (see Note (iii))*** | | | | |
| Balance at January 1 | 70,482 | 70,600 | 70,600 | 10,330 |
| Transfer from retained earnings | 118 | – | – | – |
| Balance at December 31 | 70,600 | 70,600 | 70,600 | 10,330 |
| ***General surplus reserve*** | | | | |
| Balance at January 1 and December 31 | 25,706 | 25,706 | 25,706 | 3,761 |
| **Total** | 266,586 | 267,586 | 270,339 | 39,555 |

Notes:

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

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

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

## 22 Statutory reserves (cont'd)

(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.

## 23 Commitments

At December 31, 2007, the Group had the following commitments:

| | December 31, | |
|---|---|---|
| | 2007 | 2007 |
| | Rmb | US$ |
| ***Authorized and contracted for:*** | | |
| Improvement to existing production facilities | 112,880 | 16,516 |

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, 2007 are:

| | Rmb | US$ |
|---|---|---|
| 2008 | 5,398 | 790 |
| 2009 | 3,338 | 488 |
| 2010 | 2,451 | 359 |
| 2011 | 866 | 127 |
| 2012 and thereafter | 24 | 3 |
| | 12,077 | 1,767 |

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

| | December 31, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb | Rmb | Rmb | US$ |
| Rental expense | 8,726 | 10,113 | 10,780 | 1,577 |

## 24 Contingencies

### *(a) Product liability*

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

### *(b) Environmental liability*

China adopted its Environmental Protection Law in 1989, and the State Council and the State Environmental Protection Agency promulgate regulations as required from time to time. The Environmental Protection Law addresses issues relating to environmental quality, waste disposal and emissions, including air, water and noise emissions. Environmental regulations have not had a material impact on Yuchai's results of operations. Yuchai delivers, on a regular basis, burned sand and certain other waste products to a waste disposal site approved by the local government and makes payments in respect thereof. Yuchai expects that environmental standards and their enforcement in China will, as in many other countries, become more stringent over time, especially as technical advances make achievement of higher standards more feasible. Yuchai has built an air filter system to reduce the level of dust and fumes resulting from its production of diesel engines. The PRC emission standard equivalent to Euro III is expected to be implemented progressively throughout China from 2008. Yuchai believes it will be able to comply with the new standard.

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.

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.

## 24 Contingencies (cont'd)

### *(c) Dispute with Bank of China (cont'd)*

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

In 2005, 2006 and 2007, 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.

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, 2005, 2006 and 2007, 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 Rmb4,268, Rmb4,250 and Rmb nil (US$nil) of premium fees in 2005, 2006 and 2007, 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 2005, 2006 and 2007 amounted to Rmb1,167, Rmb4,718 and Rmb2,176 (US$318), respectively. As of December 31, 2005, 2006 and 2007, deferred guarantee fee revenue amounted to Rmb3,326, Rmb2,858 and Rmb682 (US$100), 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, 2006 and 2007, YEGCL had gross receivables of Rmb26,896 and Rmb20,162 (US$2,950), 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 Rmb12,467 and Rmb9,722 (US$1,422) for other receivables, and Rmb2,611 and Rmb1,119 for potential losses associated with the guarantee at December 31, 2006 and 2007 respectively. The net receivable amount of Rmb15,189 and Rmb10,440 (US$1,528), is included in "Other receivables, net " in the accompanying consolidated balance sheets (See Note 13).

As of December 31, 2006 and 2007, the maximum potential amount future undiscounted payments YEGCL could be required to make under the guarantees was Rmb132,345 and Rmb43,701 (US$6,394), respectively. YEGCL held cash deposits of Rmb12,389 and Rmb9,999 as of December 31, 2006 and 2007 and security interests in automobiles with an aggregate initial purchase value of Rmb431,781 and Rmb380,080 as of December 31, 2006 and 2007, 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 Rmb2,611 and Rmb1,119 (US$164) as of December 31, 2006 and 2007, respectively, included in "Accrued expenses and other liabilities".

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

## 24 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, | | |
|---|---|---|---|
| | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **US$** |
| Balance at beginning of year | 13,571 | 15,078 | 2,206 |
| Charged/(credited) to consolidated statements of operations | 1,507 | (4,237) | (620) |
| Balance at end of year | 15,078 | 10,841 | 1,586 |
| Balance allocated to: | | | |
| Allowance for uncollectible other receivables | 12,467 | 9,722 | 1,422 |
| Potential losses associated with the guarantees | 2,611 | 1,119 | 164 |
| | 15,078 | 10,841 | 1,586 |

### *(e) Outstanding bank bills discounted*

As of December 31, 2007, outstanding bills receivable discounted with banks for which the Group has retained a recourse obligation totaled Rmb171,221 (US$25,052). Management has assessed the fair value of the recourse obligation arising from these discounted bank bills to be immaterial based on the Company's default experience and the credit status of the issuing banks.

### *(f) Outstanding letters of credit*

As of December 31, 2007, the Group issued irrevocable letters of credit totaling Rmb82,149 (US$12,020).

### *(g) Other outstanding litigation*

In addition to the matters disclosed in Note 24(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.

## 25 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, 2005, 2006 and 2007

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

## 25 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 Co-operation Agreement relating to governance related issues are being adhered to by Yuchai.

## 26 Retirement and other postretirement benefits

As stipulated by the regulations of the PRC, Yuchai and its subsidiaries participate in defined contribution retirement plans organized by the Guangxi Regional Government and Beijing City Government for its staff. All staff are entitled to an annual pension equal to a fixed proportion of their final basic salary amount at their retirement date. For the years ended December 31, 2005, 2006 and 2007, 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 Rmb33,299, Rmb42,254 and Rmb48,107 (US$7,039), respectively, for the years ended December 31, 2005, 2006 and 2007.

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

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for years ended December 31, 2005, 2006 and 2007

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

## 27 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 Note 5 and 34), the Group has undertaken other significant business transactions with related parties during the three years ended December 31, 2007. The following is a summary of these transactions:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Sales of diesel engines to State Holding Company, its subsidiaries and affiliates (see Note (i)) | 7,646 | 20,923 | 59,521 | 8,709 |
| Sales of raw materials to YMCL (see Note (i)) | – | 65,729 | 35,380 | 5,177 |
| Purchase of raw materials and supplies from subsidiaries and affiliates of State Holding Company (see Note (i)) | (235,329) | (377,129) | (571,393) | (83,603) |
| Purchase of raw materials and supplies from YMCL (see Note (ii)) | (60,756) | (201,802) | – | – |
| Purchase of trucks from YMCL (see Note (ii)) | (77,324) | – | – | – |
| Processing fee to a subsidiary of YMCL (see Note (iii)) | (44,407) | (13,604) | (2,533) | (371) |
| Delivery expense charged by a subsidiary of YMCL (see Note (iii)) | (126,028) | (90,840) | (115,500) | (16,899) |
| General and administrative expenses | | | | |
| – charged by State Holding Company (see Note (iv)) | (25,931) | (19,821) | (21,447) | (3,138) |
| – charged by HLA (see Note (v)) | (4,035) | (4,061) | (12,471) | (1,825) |
| – charged by an affiliate of HLA (see Note (vi)) | (30,765) | (9,654) | (546) | (80) |
| Interest earned from balance due from an affiliate of HLA | 70 | 110 | 116 | 17 |

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Gain on disposal of land use rights to a subsidiary of State Holding Company (See Note (vii)) | 2,533 | 1,841 | 1,573 | 230 |

Notes:

(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.

**27 Other related party transactions (cont'd)**

(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) General and administrative expenses charged by HLA This relates to management fee charged by HLA to the Company.

(vi) General and administrative expenses charged by an affiliate of HLA The fee was paid to Hong Leong Management Services Pte Ltd., an affiliate of HLA. In 2006, there was service fee that includes Rmb9,654 in relation to the consultancy services performed for the acquisition of interests in TCL during 2005 and HLGE in 2006. The remaining amounts in 2006 were mainly in relation to securing additional credit facilities and entering into the Reorganization Agreement. These transactions were approved by the Board of Directors. In 2007, there was service fee of Rmb546 (US$80) in relation to administrative filings of the Company's subsidiaries. Management considers that all of the above transactions were entered into in the normal course of business.

(vii) Gain on disposal of land use rights to a subsidiary of State Holding Company

The Group has disposed of certain land use rights with net book value of Rmb 1,047, Rmb552 and Rmb552 (US$81) to a subsidiary of the State Holding Company for a consideration of Rmb3,580, Rmb2,394 and Rmb2,125 (US$311) in the years ended December 31, 2005, 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, 2005, 2006 and 2007

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

## 28 Segment information

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

The Company's operating segments are Yuchai, TCL and HLGE for the years ended December 31, 2006 and 2007. Prior to the purchase of HLGE, the Company's operating segments were Yuchai and TCL.

The segment result for Yuchai is based on earnings before income taxes and 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, 2005, 2006 and 2007:

| | 2005 | | 2006 | | | 2007 | | |
|---|---|---|---|---|---|---|---|---|
| | Yuchai | TCL | Yuchai | TCL | HLGE | Yuchai | TCL | HLGE |
| | Rmb | Rmb | Rmb | Rmb | Rmb | Rmb | Rmb | Rmb |
| Segment revenue from external customers | 5,816,740 | – | 6,920,528 | – | – | 9,556,303 | – | – |
| Interest income | 21,744 | – | 16,329 | – | – | 3,139 | – | – |
| Interest expense | 70,527 | – | 89,119 | – | – | 99,504 | – | – |
| Depreciation and amortization | 144,672 | – | 146,188 | – | – | 227,960 | – | – |
| Equity in income/(losses) of affiliates | 50 | – | 79 | – | – | (198) | – | – |
| Segment profit / (loss) | 30,179 | (5,982) | 292,359 | (23,923) | 1,395 | 845,239 | 5,925 | 8,321 |
| Significant non-cash items: | | | | | | | | |
| – Provision for uncollectible loans to a related party | 202,950 | – | – | – | – | – | – | – |
| – Other adjustments to provisions and allowances | 53,895 | – | 98,352 | – | – | 4,726 | – | – |
| Segment assets | 6,235,585 | 184,095 | 6,479,886 | 385,583 | 117,360 | 7,843,056 | 387,930 | 112,648 |
| Total expenditures for additions to long-lived assets | 515,359 | – | 323,781 | – | – | 536,660 | – | – |

The segment result for Yuchai for 2006 was corrected in the current year to exclude certain corporate expenses to conform with the current year's presentation. The Company recorded a decrease in segment profit for Yuchai of Rmb2,423 and a corresponding increase in other corporate general and administrative expenses as compared with the amounts previously reported in the Company's 2006 consolidated financial statements.

Reconciliation of segment information to the consolidated financial statements for the years ended December 2005, 2006 and 2007.

# Notes to Consolidated Financial Statements

for years ended December 31, 2005, 2006 and 2007

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

## 28 Segment information (cont'd)

| | 2005 | 2006 | 2007 | 2007 |
|---|---|---|---|---|
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Total segment profit | 24,197 | 269,831 | 859,485 | 125,755 |
| Service fee to an affiliate of HLA (see Note 27) | (30,765) | (9,654) | (546) | (80) |
| Other corporate general and administrative expenses | (18,522) | (56,782) | (75,025) | (10,977) |
| Consolidated earnings/(loss) before income taxes and minority interests | (25,090) | 203,395 | 783,914 | 114,698 |
| Total segment assets | 6,419,680 | 6,982,829 | 8,343,634 | 1,220,794 |
| Corporate cash and cash equivalents | 247,332 | 100,990 | 81,257 | 11,889 |
| Other investments (long-term) [(a)] | – | 633,837 | 608,946 | 89,098 |
| Assets acquired from Yulin Hotel Company (Note 34) | – | – | 272,397 | 39,856 |
| Other corporate assets [(b)] | 12,618 | 243,701 | 272,950 | 39,935 |
| Consolidated total assets | 6,679,630 | 7,961,357 | 9,579,184 | 1,401,572 |

Note (a): includes HLGE unsecured bonds (Rmb558,852), RCPS A (Rmb20,119), RCPS B (Rmb29,975) (see Note 17(e)).
Note (b): includes corporate's property, plant and equipment, goodwill and other receivables.

Note (b): includes HLGE unsecured bonds (Rmb558,852), RCPS A (Rmb20,119), RCPS B (Rmb29,975) (See Note 17(e)).

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

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| ***Revenues, net*** | | | | |
| 4F Light-Duty Diesel Engines | – | 264,335 | 380,601 | 55,687 |
| 4108 Light-Duty Diesel Engines | 634,532 | 941,657 | 1,218,838 | 178,333 |
| 4110 Light-Duty Diesel Engines | 595,239 | 644,116 | 1,189,995 | 174,113 |
| 4112 Light-Duty Diesel Engines | 321,548 | 372,423 | 469,015 | 68,624 |
| 6105 Medium-Duty Diesel Engines | 1,744,953 | 1,705,399 | 2,132,590 | 312,029 |
| 6108 Medium-Duty Diesel Engines | 809,054 | 991,190 | 1,424,391 | 208,409 |
| 6112 Heavy-Duty Diesel Engines | 785,236 | 725,288 | 643,373 | 94,135 |
| 6113 Heavy-Duty Diesel Engines | 192,850 | 365,717 | 877,177 | 128,344 |
| Diesel Engine Parts | 488,414 | 875,453 | 1,218,147 | 178,232 |
| Guarantee fees | 244,914 | 34,950 | 2,176 | 318 |
| | 5,816,740 | 6,920,528 | 9,556,303 | 1,398,224 |

## 28 Segment information (cont'd)

Revenues from customers based on their geographical location for the years ended December 31, 2005, 2006 and 2007 (in Rmb thousands) are as follows:

| | 2005 | 2006 | 2007 | |
|---|---|---|---|---|
| | Sales Revenue | Sales Revenue | Sales Revenue | |
| | Rmb (in thousands) | Rmb (in thousands) | Rmb (in thousands) | US$ (in thousands) |
| China | 5,703,360 | 6,893,551 | 9,533,767 | 1,394,927 |
| Other countries | 113,380 | 26,977 | 22,536 | 3,297 |
| | 5,816,740 | 6,920,528 | 9,556,303 | 1,398,224 |

## 29 Foreign currency exchange

The Renminbi is not fully convertible into foreign currencies. All foreign exchange transactions involving Renminbi must take place either through the PBOC or other institutions authorized to buy and sell foreign exchange. The exchange rate adopted for the foreign exchange transactions 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.

## 30 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 22. Such dividends may be paid partly in Renminbi and partly in foreign currency. In the event that dividends are distributed in Renminbi, the dividends may be converted into foreign currency and remitted in accordance with relevant PRC laws, regulations and policies and to the extent permitted by PRC market conditions. Dividends of Yuchai are determined based on distributable 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.

## 31 Derivative instrument and hedging activities

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

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

## 32 Fair value of financial instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. The carrying amount of cash and cash equivalents, trade accounts receivable, bills receivable, short term amounts due from related parties, prepaid expenses, other receivables, short-term bank loans, current instalments of long-term bank loans, trade accounts payable, amount due to the holding company and amounts due to related parties approximates their fair value because of the short maturity of these instruments. It was not practicable for 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.

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

## 33 Significant concentrations and risks

### *(a) Customer concentration*

Substantially all of the 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, | | | |
|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2007** |
| | **Rmb** | **Rmb** | **Rmb** | **US$** |
| Liuzhou Dongfeng Automobile (see Note (i)) | 385,049 | 453,090 | 658,585 | 96,360 |
| Hubei Dongfeng Automobile (see Note (ii)) | 333,452 | 238,400 | 333,612 | 48,812 |

Notes:

(i) Sales to Liuzhou Dongfeng Automobile for the year ended December 31, 2005, 2006 and 2007 was approximately 6.6%, 6.5% and 6.9% of total sales.

(ii) Sales to Hubei Dongfeng Automobile for the year ended December 31, 2005, 2006 and 2007 was approximately 5.7%, 3.4% and 3.5% of total sales.

Both customers are controlled by or affiliated with Dongfeng Automobile Company. At December 31, 2006 and 2007, approximately 23.5% and 16.1% 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 28 "Revenues from external customers by product category".

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for years ended December 31, 2005, 2006 and 2007

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

**33 Significant concentrations and risks (cont'd)**

***(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.

***(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 25, 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, operating results 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.

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

## 33 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, | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 |
| | Rmb<br>PRC | Rmb<br>Singapore | Rmb<br>PRC | US$<br>Singapore |
| Rmb | 644,944 | – | 439,689 | – |
| USD | – | 99,506 | – | 79,872 |
| SGD | – | 1,483 | – | 1,384 |
| | 644,944 | 100,989 | 439,689 | 81,256 |

## 34 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 operations or cash flows. The Yulin Hotel Company will be included in Yuchai's operating segment beginning 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. The principal assets of Yulin Hotel Company were the Yulin Hotel and YMCL's central office building in Guilin. The Company is in the process of finalizing, through internal studies and third-party valuations, the fair values of the property and equipment. Consequently, the purchase price allocation set forth below is preliminary and subject to adjustment as additional information is obtained. When the allocation process is completed, adjustments to recorded values may result. The following table summarizes the preliminary allocation of the purchase price assigned to the fair values of the assets acquired and liabilities assumed as of the date of acquisition:

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

## 34 Acquisitions (cont'd)

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

No pro forma income statement has been provided because management believes the pro forma effects are immaterial to the Company's consolidated results of operations for the years ending December 31, 2006 and 2007.

## 35 Subsequent events

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

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.

### *(b) DBS S$50m 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. Compliance with this undertaking in relation to the production of the 2007 audited consolidated accounts will be no later than February 28, 2009.

### *(c) Repayment of Short Term Bonds of Rmb650 million by Yuchai*

On April 18, 2007, Yuchai issued the second tranche of short term bonds of Rmb 650.0 million (US$95.1 million) under approval given by PBOC on May 30, 2006 and the funds were used to pay off the short term loans from three local banks. The bonds were issued at discount and an amount totaling Rmb 633.0 million (US$92.6 million) was received by Yuchai. The bonds matured and were fully repaid in April, 2008.

## 35 Subsequent events (cont'd)

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

In June 2008, HLGE partially redeemed the New Bonds. 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).

### *(e) RCPS B Redemption by HLGE*

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.

### *(f) Joint Venture Company with Geely and Yinlun*

In December 2007, Yuchai entered into an Equity Joint Venture Agreement with Geely and Yinlun to establish a joint venture company in Jining, Shandong Province to engage in the development, production and sales of a proprietary diesel engine and its parts for passenger vehicles. As of December 31, 2008, the joint venture company has been duly incorporated with registered capital of Rmb 150 million and paid-up capital of Rmb 45 million, out of which Yuchai has already contributed Rmb 23.4 million.

### *(g) Joint Venture Company with Geely and Yinlun*

In December 2007, Yuchai entered into an Equity Joint Venture Agreement with Geely and Yinlun to establish a joint venture company in Tiantai, Zhejiang Province to engage in the development, production and sales of a proprietary diesel engine and its parts for passenger vehicles. And as of December 31, 2008, the joint venture company has been duly incorporated with a registered capital of Rmb 100 million and paid up capital of Rmb 30 million, out of which Yuchai has already contributed Rmb 15.6 million.

# Reference Information

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