

CHINA YUCHAI INTERNATIONAL LTD

Form 20-F

July 15, 2005

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**SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from _____ to _____

For the fiscal year ended December 31, 2004

Commission file number 1-13522

China Yuchai International Limited

(Exact Name of Registrant as Specified in Its Charter)

N/A

Bermuda

(Translation of Registrant's Name Into English)

(Jurisdiction of Incorporation or Organization)

16 Raffles Quay #26-00
Hong Leong Building
Singapore 048581
65-6220-8411

(Address and Telephone Number of Principal Executive Offices)

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

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

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

None
(Title of Class)

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

None
(Title of Class)

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

As of December 31, 2004, 35,340,000 shares of common stock, par value US\$0.10 per share, and one special share, par value US\$0.10 per share, were issued and outstanding.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

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Certain Definitions and Supplemental Information

All references to China, PRC and the State in this Annual Report are references to the People's Republic of China. Unless otherwise specified, all references in this Annual Report to U.S. dollars, dollars, US\$ or \$ are to United States dollars; all references to Renminbi or Rmb are to Renminbi, the legal tender currency of China. Unless otherwise specified, translation of amounts from Renminbi to U.S. dollars for the convenience of the reader has been made in this Annual Report at the rate of Rmb 8.2765 = US\$1.00, the rate quoted by the People's Bank of China on December 31, 2004. 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.

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

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

As of December 31, 2004, 35,340,000 shares of common stock, par value US\$0.10 per share of the Company (Common Stock), and one special share, par value US\$0.10 per share, of the Company were issued and outstanding. On June 7, 2005, the Company issued an additional 1,927,673 shares of Common Stock, thereby increasing the Company's issued and outstanding capital stock to 37,267,673 shares of Common Stock and one special share. Unless otherwise indicated herein, all percentage share amounts with respect to the Company are based on 37,267,673 shares issued and outstanding.

Cautionary Statements with Respect to Forward-Looking Statements

The Company wishes to caution readers that the forward-looking statements contained in this Annual Report, which include all statements which, at the time made, address future results of operations, are based upon the Company's interpretation of factors affecting the business and operations of the Company and its subsidiaries. The Company believes the following important factors, among others, in some cases have affected, and in the future could affect, the Company's actual consolidated results and could cause the Company's actual consolidated results for 2005, and beyond, to differ materially from those described in any forward-looking statements made by, or on behalf of, the Company:

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

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

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

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

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

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

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

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

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

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

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

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

Incorporation by Reference

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

PART I

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

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE.

Not Applicable.

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The selected financial information set forth below should be read in conjunction with, and is qualified in its entirety by reference to, Item 5. Operating and Financial Review and Prospects and the Company's audited consolidated financial statements and the related notes for the three-year period ended December 31, 2004 included in this Annual Report. The consolidated financial statements of the Company are prepared in conformity with US GAAP.

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

On February 7, 2005, the board of directors of the Company announced its approval of the implementation of a business expansion and diversification plan by the Company. Pursuant to this plan, the Company intends to look for new business opportunities to seek to reduce its financial dependence on Yuchai, which has historically been the Company's main operating asset. In March 2005, the Company completed an acquisition of 264.0 million new shares, representing an approximate 14.99% stake, in Thakral Corporation Ltd (TCL), a China-focused electronics distribution company, for approximately \$18.9 million (based on an exchange rate of Singapore dollar \$1.637 to US\$1.00).

The selected balance sheet data as of December 31, 2003 and 2004 and the statement of income data and cash flow statement data of the Company set forth below for the years ended December 31, 2002, 2003 and 2004 are derived from the consolidated financial statements of the Company included in this Annual Report, which have been audited by KPMG, Independent Registered Public Accounting Firm (the Consolidated Financial Statements). The selected balance sheet data of the Company set forth below as of December 31, 2000, 2001 and 2002 and the statement of income data and cash flow statement data for the years ended December 31, 2000 and 2001 are derived from the consolidated financial statements of the Company, which have been audited by KPMG, but which are not included in this Annual Report.

	As of and for the Year Ended December 31,					
	2000	2001	2002	2003	2004	2004
	Rmb	Rmb	Rmb	Rmb	Rmb	US\$⁽⁵⁾
	(in thousands)					
Statement of Income Data:						
Revenues, net	1,414,527	1,783,329	3,513,047	4,569,950	5,582,095	674,451
Cost of goods sold	960,079	1,183,403	2,371,080	3,192,794	4,006,886	484,128
Gross profit	454,448	599,926	1,141,967	1,377,156	1,575,209	190,323
Research and development cost	49,011	44,721	75,532	94,594	136,960	16,549
Selling, general and administrative expense	298,361	243,231	426,128	561,151	658,320	79,540
Amortization of goodwill ⁽¹⁾	16,859	16,859				

Operating income	90,217	295,115	640,307	721,411	779,929	94,234
Interest expense	27,886	29,784	25,144	23,624	31,757	3,836
Other (income)/expense, net	(1,685)	(3,858)	(10,287)	881	(5,682)	(686)

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	As of and for the Year Ended December 31,					
	2000	2001	2002	2003	2004	2004
	Rmb	Rmb	Rmb	Rmb	Rmb	US\$⁽⁵⁾
	(in thousands)					
Income before income taxes and minority interests	64,016	269,189	625,450	696,906	753,854	91,084
Income tax expense/(benefit)	10,682	(63,584)	83,242	112,924	105,165	12,707
Income before minority interests	53,334	332,773	542,208	583,982	648,689	78,377
Minority interests in income of consolidated subsidiaries	16,256	82,386	129,775	145,800	157,292	19,005
Net income	37,078	250,387	412,433	438,182	491,397	59,372
Basic and diluted earnings per share	1.05	7.09	11.67	12.40	13.90	1.68
Weighted average number of shares outstanding	35,340	35,340	35,340	35,340	35,340	35,340
Balance Sheet Data (at year end):						
Working capital ⁽²⁾	804,725	1,100,462	1,340,832	1,031,830	1,402,226	169,425
Goodwill ⁽¹⁾	229,495	212,636	212,636	212,636	212,636	25,692
Total assets	2,770,242	3,262,868	3,985,459	4,033,632	5,384,248	650,546
Long-term debt, excluding current installments	170,000	180,000	50,000		100,000	12,083
Minority interests	360,311	420,545	487,491	544,526	724,311	87,514
Capital stock	30,349	30,349	30,349	30,349	30,349	3,667
Stockholders equity	1,560,508	1,805,045	2,161,903	1,991,687	2,483,084	300,017
Statement of Cash Flows Data:						
Net cash provided by operating activities	170,735	59,273	659,500	1,075,274	589,608	71,240
Capital expenditures ⁽³⁾	14,958	43,043	174,850	372,775	552,902	66,804
Depreciation ⁽⁴⁾	125,981	113,680	118,872	125,519	132,789	16,045

(1) Goodwill represents the excess of cost over fair value of net assets of businesses acquired. The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. Such goodwill is no longer amortized, but instead is tested for impairment at least annually in accordance with the provisions of SFAS No. 142. Prior to the adoption of SFAS No. 142, goodwill was amortized over 20 years on a straight-line basis. For a discussion of goodwill, see Note 3(n) to the Company's Consolidated Financial Statements appearing elsewhere herein. The Company did not require any impairment upon transition to SFAS No. 142.

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

- (3) Purchase of property, plant and equipment, lease prepayment and payment for construction in progress.
- (4) Depreciation of property, plant and equipment and amortization of lease prepayments.
- (5) The Company's functional and reporting currency is Renminbi, and the translation of amounts from Renminbi to U.S. dollars is solely for the convenience of the reader. Translation of amounts from Renminbi to U.S. dollars has been made at the rate of Rmb 8.2765 = US\$1.00, the rate quoted by the People's Bank of China at the close of business on December 31, 2004. No representation is made that the Renminbi

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amounts could have been, or could be, converted into U.S. dollars at that rate or at any other rate prevailing on December 31, 2004 or any other date.

Dividends

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

Period	Dividend paid by the Company to its shareholders (per share)	Dividend Paid by Yuchai to the Company⁽¹⁾ (in thousands)
2000	US\$0.01	Rmb 72,284 (US\$8,732)
2001	US\$0.02	Rmb 72,284 (US\$8,720)
2002	US\$0.19	Rmb 245,766 (US\$29,694) ⁽²⁾
2003	US\$2.08	Rmb 61,433 (US\$7,422)
2004	US\$0.39	Rmb 231,309 (US\$27,906) ⁽³⁾

- (1) Dividends paid by Yuchai to the Company, as well as to other shareholders of Yuchai, were declared in Renminbi and paid in U.S. dollars (as shown in the parentheses) based on the exchange rates at local designated foreign exchange banks on the respective payment dates. For dividends paid for 2000, 2001, 2002, 2003 and 2004, the exchange rate used was Rmb 8.2781 = US\$1.00, Rmb 8.2894 = US\$1.00, Rmb 8.2767 = US\$1.00, Rmb 8.2767 = US\$1.00 and Rmb 8.2765 = US\$1.00, respectively.
- (2) The dividends declared for 2002 by Yuchai were paid to the Company in 2003 following execution of the July 2003 Agreement.
- (3) The dividends declared for 2004 by Yuchai were paid to the Company in 2005 following execution of the Reorganization Agreement.

Historical Exchange Rate Information

On June 16, 2005, the noon buying rate was Rmb 8.2765 = US\$1.00.

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

Period	Noon Buying Rate⁽¹⁾ (Rmb per US\$)	
	High	Low
December 2004	8.2767	8.2765
January 2005	8.2765	8.2765
February 2005	8.2765	8.2765
March 2005	8.2765	8.2765
April 2005	8.2765	8.2765
May 2005	8.2765	8.2735
June 2005	8.2765	8.2765

Period	Period End	Noon Buying Rate⁽¹⁾		
		Average⁽²⁾ (Rmb per US\$)	High	Low
2000	8.2774	8.2784	8.2799	8.2768
2001	8.2766	8.2772	8.2786	8.2763
2002	8.2800	8.2772	8.2800	8.2765
2003	8.2767	8.2771	8.2800	8.2765
2004	8.2765	8.2768	8.2774	8.2764
2005 (through June 30)	8.2765	8.2765	8.2765	8.2765

(1) The noon buying rate in New York for cable transfers payable in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. Since April 1994, the noon buying rate has been based on the rate quoted by the People's Bank of China. As a result, since April 1994, the noon buying rate and the People's Bank of China rate have been substantially similar. The People's Bank of China rate at the end of 2004 was Rmb 8.2765, compared with Rmb 8.2768 for the noon buying rate (average).

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

Risk Factors**Risks relating to our company and our business**

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

Our main operating asset is our ownership interest in Yuchai, and our primary source of cash flow continues to be our share of the dividends, if any, paid by Yuchai and investment earnings thereon. As a result of the agreement reached with Yuchai and its related parties pursuant to the July 2003 Agreement, we discontinued legal and arbitration proceedings initiated by us in May 2003 relating to difficulties with respect to our investment in Yuchai. In furtherance of the terms of the July 2003 Agreement, we, Yuchai and Coomber entered into the Reorganization

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Agreement in April 2005 and agreed on a restructuring plan for our company intended to be beneficial to our shareholders (see Item 4. Information on the Company Recent Developments). No assurance can be given as to when the corporate governance requirements relating to Yuchai and the restructuring plan in respect of our ownership of Yuchai, both as contemplated by the Reorganization Agreement, will be implemented, or that implementation of the Reorganization Agreement will effectively resolve all of the difficulties faced by us with respect to our investment in Yuchai.

In addition, the Reorganization Agreement contemplates the continued implementation of our recently adopted business expansion and diversification plan. One of the goals of this business expansion and diversification plan is to reduce our financial dependence on Yuchai. No assurance can be given that we will be able to successfully expand and diversify our business. We may not be able to identify suitable acquisition opportunities, or secure funding to consummate such acquisitions or successfully integrate such acquired businesses within our operations. Any failure to implement the terms of the Reorganization Agreement, including our continued expansion and diversification, could have a material adverse effect on our financial condition, results of operations, business or prospects.

We may experience disagreements with the Chinese stakeholders in Yuchai.

Although we own 76.4% of Yuchai's shares, and believe we have proper legal ownership of our investment and a controlling financial interest in Yuchai, in the event there is a dispute with Yuchai's Chinese stakeholders regarding our investment in Yuchai we may have to rely on the Chinese legal system for remedies. The Chinese legal system may not be as effective as compared to other more developed countries such as the United States (see Risks relating to Mainland China The Chinese legal system embodies uncertainties, which could limit the protections available to foreign investors). We have in the past experienced problems from time to time in obtaining assistance and cooperation of Yuchai's Chinese stakeholders in the daily management and operation of Yuchai. We have in the past also experienced problems from time to time in obtaining the assistance and cooperation of the State Holding Company in dealing with other various matters, including the implementation of corporate governance procedures, the payment of dividends, the holding of Yuchai board meetings and the resolution of employee-related matters. Examples of these problems are described elsewhere in this Annual Report. The July 2003 Agreement and the Reorganization Agreement are intended to resolve certain issues relating to our share ownership in Yuchai and the continued corporate governance and other difficulties which we have had with respect to Yuchai. As part of the terms of the Reorganization Agreement, Yuchai agreed that it would seek the requisite shareholder approval prior to entering into any material transactions (including any agreements or arrangements with parties related to Yuchai or any of its shareholders) and that it would comply with its governance requirements. Yuchai also acknowledged and affirmed CYI's continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai's board of directors. However, no assurance can be given that disagreements with Yuchai's management and/or Yuchai's Chinese stakeholders will not recur, including with respect to implementation of the Reorganization Agreement. Notwithstanding the existence of available legal remedies which we expect to pursue as appropriate if such disagreements arise in the future, we cannot assure you that any such disagreements will not have a material adverse effect on the implementation of the restructuring plan contemplated by the Reorganization Agreement and in turn on our financial condition, results of operations, business or prospects, including possibly our ability to fully exercise our controlling interest in Yuchai and consolidate Yuchai's financial statements in accordance with US GAAP in future periods.

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

Our sales are concentrated among the Dongfeng Group, which includes the Dongfeng Automobile Company, one of the largest state-owned automobile companies in China, and other major diesel truck manufacturers controlled by or affiliated with the Dongfeng Automobile Company. In 2004, the Dongfeng Group accounted for 21.0% of our

gross sales and included our two largest customers: Liuzhou Dongfeng Automobile and Hubei Dongfeng Automobile. Although we consider our relationships with the Dongfeng Group to be good, the loss of one or more of the companies within the Dongfeng Group as a customer would have a material adverse effect on our financial condition, results of operations, business or prospects.

In addition, we are highly dependent on the purchases made by the Dongfeng Group and have significant exposure to their liquidity arising from the high level of accounts receivable from them. We cannot assure you that the Dongfeng Group will be able to repay all the money they owe to us. In addition, the Dongfeng Group may not be

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able to continue purchasing the same volume of products from our company, which would significantly reduce our overall sales volume.

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

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

The diesel engine industry in China is highly competitive. We compete with many other domestic companies, most of which are state-owned enterprises. Some of our competitors have formed joint ventures with or have technology assistance relationships with foreign diesel engine manufacturers or foreign engine design consulting firms and use foreign technology that is more advanced than ours. We expect competition to intensify as a result of:

improvements in competitors' products;

increased production capacity of competitors;

increased utilization of unused capacity by competitors; and

price competition.

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

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

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

In the light-duty diesel engine market, our 4108, 4110 and 4112 light-duty engines introduced in 2000 were met with weak consumer demand due to strong competition and a high pricing structure. Although there had been an increase in sales of our 4-Series engines in 2003 and 2004, we cannot assure you that we will be able to continue to

improve our market share for light-duty diesel engines, and we may, in the future, decide to cease production of one or more of the models we are currently producing.

Our long-term business prospects will depend largely upon our ability to develop and introduce new or improved products at competitive prices. Our competitors in the diesel engine markets may be able to introduce new

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

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

We have achieved consistent growth in net revenues during the last four fiscal years, with net revenues increasing by 30.0% to Rmb 4,570.0 million in 2003 and by 22.0% to Rmb 5,582.1 million in 2004. We cannot assure you that we can continue to increase our net revenues or maintain our present level of net revenues. For example during 2004, we have increased production capacity to approximately 250,000 units after the completion of our second foundry and new 6L and 6M heavy-duty engines lines, and we may not be able to increase our net revenues commensurate with our increased levels of production capacity. Moreover, our future growth is dependent in large part on factors beyond our control, such as continued economic growth in China.

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

obtaining the necessary supplies;

hiring and training skilled production workers and management personnel;

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

maintaining quality standards and prices; and

controlling production costs.

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

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

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

The business and prospects for the diesel engine industry, and thus the business and prospects of our company, may also be adversely affected by Chinese government policy. For example, in 1998, the Chinese government announced a major initiative to boost consumer demand through investments in infrastructure projects and increased availability of bank credit. As a result, demand for trucks and other commercial vehicles, and thus demand for diesel

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engines, continued to increase from 2002 to 2004. However, we cannot assure you that the Chinese government will not change its policy in the future to de-emphasize the use of diesel engines, and any such change will adversely affect our financial condition, results of operations, business or prospects. For example, the Chinese government has recently announced measures to avoid overheating in certain sectors of the economy, which may include tight bank lending policies and increases in bank interest rates (see Risks relating to Mainland China Adverse changes in the economic policies of the Chinese government could have a material adverse effect on the overall economic growth of Mainland China, which could reduce the demand for our products and adversely affect our competitive position).

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

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

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

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

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

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

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

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

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

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

The value of the Renminbi is subject to changes in Chinese government policies and to international economic and political developments. Although the official exchange rate for the conversion of Renminbi to U.S. dollars has been stable, with Renminbi appreciating slightly against the U.S. dollar in recent years, the exchange rate of the Renminbi could become volatile against the U.S. dollar or other currencies. Since 1994, the conversion of Renminbi into Hong Kong and United States dollars has been based on rates set by the People's Bank of China, which are set daily based on the previous day's Chinese interbank foreign exchange market rate and current exchange rates on the world financial markets. The Chinese government has stated publicly that it intends to make the Renminbi fully convertible in the

future. However, we cannot predict when the Chinese government will allow free conversion of the Renminbi into foreign currency, and we cannot assure you that the Chinese government will not take steps that will cause the Renminbi to devalue. Substantially all of our operating revenue is denominated in Renminbi, while a major portion of our capital expenditures is denominated in U.S. dollars and Euros. Since we may not be able to hedge effectively against Renminbi devaluations, future movements in the exchange rate of Renminbi and other currencies could have an adverse effect on our financial condition and results of operations.

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We may be adversely affected by environmental regulations.

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

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

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

The market price for our common stock may be volatile.

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

our interim operating results;

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

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

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

changes in general economic conditions;

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

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

increases in labor and other costs.

Recent market activity of our stock price on the New York Stock Exchange, or NYSE, has been unpredictable. See Item 9. The Offer and Listing below. We cannot assure you that such volatility in the trading price and volume for our shares will stabilize in the future. In addition, in recent years, the stock market in general has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to their operating performance. These broad market fluctuations may materially adversely affect our stock price.

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Risks relating to Mainland China

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

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

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

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

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

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

The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the Chinese government began to promulgate a comprehensive system of laws and regulations governing economic matters in general including, for

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example, with respect to corporate organization and governance, foreign investments, commerce, taxation and trade. Legislation over the past 25 years has significantly enhanced the protections afforded to various forms of foreign investment in Mainland China. However, these laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties, which may limit the legal protections available to foreign investors.

At the National People's Congress held in March 2005, the Chinese government confirmed it intends to continue to implement a prudent fiscal and monetary policy so as not to over stimulate domestic demand. The Chinese government has also on various occasions reiterated its policy of furthering reforms in the socialist market economy and to increase the wealth of the rural population through development and subsidies programs. No assurance can be given that these changes will not have an adverse effect on business conditions in China generally or on our business in particular.

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

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

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

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

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

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

In 2003, several countries, including China, experienced an outbreak of a highly contagious form of atypical pneumonia known as severe acute respiratory syndrome, or SARS, which severely restricted the level of economic activity in affected areas, including Beijing and Guangdong Province. The SARS epidemic in China had an adverse impact on the sale of engines, particularly during the second and third quarters in 2003. Although this SARS outbreak was brought under control during 2003, there have been a number of cases reported in China and elsewhere

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in the Asia region since that outbreak. In addition, an infectious strain of influenza known as bird flu has also been reported from time to time in China, Hong Kong and other parts of Asia. Outbreaks of infectious diseases such as these could adversely affect general commercial activity, which could have a material adverse effect on our financial condition, results of operations, business or prospects.

ITEM 4. INFORMATION ON THE COMPANY.

History and Development

The Company

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

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

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

To the Company's knowledge, since January 1, 2004, there have not been any public takeover offers by third parties in respect of the Company's shares, nor has the Company made any public takeover offers in respect of the shares of other companies.

The Company's main operating asset is its ownership interest in Yuchai, and its primary source of cash flow has historically been its share of the dividends, if any, paid by Yuchai and investment interest thereon. The following is primarily a discussion of the business of Yuchai.

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

Company's main operating asset. The first step in implementing this plan occurred in March 2005, through the acquisition of an approximate 14.99% stake in TCL (as further described in Recent Developments below).

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Yuchai

Yuchai is one of the largest medium-duty diesel engine manufacturers in China and also produces diesel power generators and diesel engine parts.

Yuchai is located in Yulin City, Guangxi Zhuang Autonomous Region in southern China, approximately 280 miles west of Hong Kong. With a population of approximately 3.0 million, greater Yulin City is believed to be the sixth largest city in Guangxi Zhuang Autonomous Region.

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

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

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

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

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

Company became the owner of each of these six companies: Hong Leong Technology Systems (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd., Cathay Diesel Holdings Ltd., Goldman Sachs Guangxi Holdings (BVI) Ltd., Youngstar Holdings Ltd. and Earnest Assets Ltd.

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

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

Recent Developments

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

As an initial step in the implementation of this new business strategy, the Company completed in March 2005 an acquisition of 264.0 million newly-issued shares, representing an approximate 14.99% stake in the enlarged share capital of TCL, a China-focused electronics distribution company, for approximately \$18.9 million (based on an exchange rate of Singapore dollar \$1.637 to US\$1.00). The Company believes that it is currently the third largest shareholder in TCL.

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

TCL currently has ten directors on its board of which three directors were nominated by the Company. The Company intends to equity account for its investment in TCL with effect from April 1, 2005 since the Company believes it has the ability to exercise significant influence over the operating and financial policies of TCL.

In order to finance the acquisition of TCL shares, as well as other strategic acquisitions which the Company may consider from time to time as part of its business diversification strategy, in February 2005, the Company issued \$25.0 million in principal amount of convertible bonds due 2012 in a private placement and in March 2005 the Company also entered into a \$25.0 million unsecured revolving credit facility with a bank in Singapore. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources .

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

The Reorganization Agreement outlines a broad framework for restructuring the Company's ownership of Yuchai. The restructuring exercise contemplates the transfer of the Company's approximate 76.4% interest in Yuchai to a new company to be organized under Bermuda law (Newco) in exchange for shares of Newco and distribution of Newco's shares to the shareholders of the Company, subject to the successful implementation of the business diversification plan by the Company. No portion of the distribution is intended to be made in respect of the special share in the Company held by HLA, and Newco's capital structure is not intended to provide for any special share comparable to the existing special share in the Company. The Company is expected to be recapitalized or restructured as may be necessary in order to maintain its listing on the New York Stock Exchange. Therefore, the Company intends to seek to execute its business diversification plan and acquire assets or businesses of such size and sufficient historical operating results to permit such continued listing.

The Reorganization Agreement also provides that the Company may, if necessary to maintain its listing, retain up to 10 million Newco shares or approximately 22.0% of Newco's capital. If the Company does retain such Newco shares, then, subject to any necessary approval by the shareholders of the Company (i) the Company would grant to Coomber an irrevocable proxy to vote such shares for the election of directors to the board of Newco for such time as the Company owns those shares, and (ii) Newco and the Company would enter into a registration rights agreement to permit the Company to sell such shares to the public at such times as the Company determines that the sale of such shares would not affect the listing of the Company's shares on the New York Stock Exchange.

Subsequent to the execution of the Reorganization Agreement, a number of steps have been taken by the parties thereto towards its implementation. For example, Yuchai's directors and shareholders have confirmed that the amendments to Yuchai's Articles of Association and corporate governance guidelines required to be adopted by Yuchai pursuant to the Reorganization Agreement have been ratified and implemented, and that steps are being taken to have such amendments and guidelines approved by the relevant Chinese authorities. Yuchai has also paid a consultancy fee of US\$1.5 million to the Company, and has also commenced steps to rectify the disputed loan made to Yuchai Marketing Company Limited (YMC). Yuchai has also declared and paid dividends to its shareholders for profits earned in the financial years ended December 31, 2003 and 2004, resulting in the Company receiving dividends of Rmb 231.3 million (US\$27.9 million), following which the Company declared dividends representing approximately 50% of the amount of dividends paid to the Company by Yuchai, as contemplated in Section 1.5(c) of the Reorganization Agreement. In addition, the Company has been advised by Yuchai that Yuchai has appointed Credit Suisse First Boston as financial advisor to Yuchai to assist Yuchai with the implementation of the Reorganization Agreement.

Pursuant to Section 1.8 of the Reorganization Agreement, Yuchai is obligated to pay US\$20.0 million within five business days of the issuance of the Company's audited consolidated financial statements for the year ended December 31, 2004. The due date for such payment was June 24, 2005. The Company has not yet received such payment, and has sent a reminder to Yuchai with respect to this payment. The Chinese stakeholders have informed the Company that relevant Chinese government approval is required for this payment and that Yuchai has submitted an application to obtain such an approval.

Completion of the transactions contemplated by the Reorganization Agreement is subject to various conditions, including the receipt of all required regulatory and shareholder approvals. Based on current discussions and activities among the parties to the Reorganization Agreement with respect to the implementation thereof, the Company to date has not encountered any significant issues with respect to implementation of the Reorganization Agreement. Although the Company believes the parties to the Reorganization Agreement are working towards its implementation as expeditiously as possible, and have agreed an anticipated date of completion of September 30, 2005, no assurance can be given as to when all of the transactions contemplated therein will be consummated. If the transactions contemplated in the Reorganization Agreement have not been consummated by December 31, 2005, the Reorganization Agreement will terminate without further obligation on the parties to consummate the transactions contemplated therein, unless the parties subsequently agree to extend such termination date.

Table of Contents**Business Overview****Product Development***Overview*

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

To take advantage of anticipated growth in demand for diesel engines in China, Yuchai substantially expanded its manufacturing facilities from their production capacity of 37,000 units of medium-duty diesel engines in 1993 to approximately 80,000 units of light-duty diesel engines, 120,000 units of medium-duty diesel engines and 50,000 units of heavy-duty diesel engines in 2004. In response to the introduction of high power medium-duty engines introduced by its competitors in 1995, Yuchai began commercial production of the 6108 medium-duty engine in the third quarter of 1997. In addition, Yuchai began trial production of its 4-Series engines (as defined in 4-Series Light-Duty Diesel Engines below) in late 1999 and commenced commercial production of these engines in 2000. Due to strong competition, quality defects and a high pricing structure, sales of the 4-Series engines were weak in 2000, but improved in following years with the total number of units sold reaching 4,747 units, 20,735 units, 46,022 units and 71,562 units in 2001, 2002, 2003 and 2004, respectively. Yuchai also commenced trial marketing of the 6112 heavy-duty engine in early 1999 and began commercial production of these engines in the second half of 1999. The quality of the 6112 engine has improved significantly due to the improvements made in the past four years, which the Company believes has translated into higher sales. In addition, continued economic growth in China, together with the development of new highway infrastructure, has resulted in greater demand for long-haul, heavy-duty trucks. As a result, sales of the 6112 engine increased from 2,651 units in 2000 to 6,737 units in 2001, 15,371 units in 2002, 20,472 units in 2003 and 24,073 units in 2004. The Company also commenced engine development work on its new heavy-duty 6L and 6M engines in 2003. In 2003 and 2004, Yuchai sold 62 and 963 units of the 6L engine respectively. In addition, 818 units of the 6M engine were sold in 2004.

6105 Medium-Duty Diesel Engines

The 6105 medium-duty engine was historically Yuchai's primary product and was principally installed in medium-duty trucks. However, in response to the introduction of high-power medium-duty engines by its competitors in 1995, Yuchai has been increasing its production and sales efforts on the 6108 medium-duty engine. In 2001, Yuchai produced 31,245 units of the 6105 engine, or 39.7% of Yuchai's total production volume of 78,800 units for that year. Yuchai produced 39,644 units of the 6105 engine in 2002, representing 27.4% of Yuchai's total production volume of 144,463 units for that year. In 2003, Yuchai produced 43,325 units of the 6105 engine representing 24.0% of total production volume of 180,423 units. In 2004, Yuchai produced 55,910 units of the 6105 engine representing 24.4% of total production volume of 229,210 units. See Products Medium-Duty Diesel Engines 6105 Engines .

6108 Medium-Duty Diesel Engines

The 6108 medium-duty engine is an overall improvement over the 6105 medium-duty engine. In particular, the Company expects the 6108 engine to enhance Yuchai's competitiveness in the medium-duty diesel engine market in China. In 2002, 2003 and 2004, unit sales of the 6108 engine exceeded unit sales of the 6105 engine. See Products

Medium-Duty Diesel Engines 6108 Engines .

In 2001, Yuchai produced 33,062 units of the 6108 engine, or 42.0% of Yuchai's total production volume of 78,800 units for the year. Yuchai produced 61,950 units of the 6108 engine in 2002, representing 42.9% of Yuchai's

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total production volume of 144,463 units for the year. In 2003, Yuchai produced 64,054 units of the 6108 engine, representing 35.5% of Yuchai's total production volume of 180,423 units. In 2004, Yuchai produced 62,394 units of the 6108 engine, representing 27.2% of Yuchai's total production volume of 229,210 units.

6112 Heavy-Duty Diesel Engines

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

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

In 2001, Yuchai produced 8,134 units of the 6112 engine, or 10.3% of total production volume of 78,800 units for the year. Yuchai produced 17,201 units of the 6112 engine in 2002, representing 11.9% of Yuchai's total production volume of 144,463 units for that year. In 2003, Yuchai produced 22,024 units of the 6112 engine, representing 12.2% of Yuchai's total production volume of 180,423 units. In 2004, Yuchai produced 27,410 units of the 6112 engine, representing 12.0% of Yuchai's total production volume of 229,210 units.

6L Heavy-Duty Diesel Engines

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

6M Heavy-Duty Diesel Engines

The 6M heavy-duty engine family for heavy-duty trucks and passenger buses were developed based on technologies from USA, Japan and Germany in accordance with FEV procedures. It has a 10 litre displacement and power ranging from 280 to 390 horsepower. Yuchai's first commercial sales of 6M occurred in January 2004 with total sales of 818 units in 2004.

4-Series Light-Duty Diesel Engines

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

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

The 4108 engine was based on the 6105 and the 6108 engines. The 4108 engine is designed for light trucks and passenger vehicles. Trial production of the 4108 engine started in the third quarter of 2000, and commercial production of the 4108 engine began in 2001. The 4112 engine was primarily based on the 6112 engine. The 4112 engine is designed for use in light- to medium-duty cargo trucks and buses. The 4112 engine also features a low emission level that is compliant with Euro 2 standards. Trial production of the 4112 engine started in early 2001 and commercial production of the 4112 engine began in late 2001. Both the 4108 and 4112 engines have experienced minor technical problems which have since been resolved, and are facing strong competition.

In 2001, Yuchai produced 6,359 units of 4-Series engines, or 8.0% of total production volume of 78,800 units for the year. Yuchai produced 23,773 units of the 4-Series engines in 2002, representing 16.5% of Yuchai's total production volume of 144,463 units for that year. In 2003, Yuchai produced 50,264 units of the 4-Series engines, representing 27.9% of Yuchai's total production volume of 180,423 units. In 2004, Yuchai produced 79,498 units of the 4-Series engines, representing 34.7% of Yuchai's total production volume of 229,210 units.

Table of Contents**Products**

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

Type and Technical

Specifications	4110ZQ Engine	6105 Engine	6108 Engine	6112 Engine	6L Engine*	6M Engine*
Type	4-stroke, turbo-charged, water-cooling, in-line vertical	4-stroke, turbo-charged, water-cooling, in-line vertical	4-stroke, water-cooling, in-line vertical	4-stroke, turbo-charged, inner-cooling, water-cooling, or in-line vertical	4-stroke, turbo-charged, inner-cooling, water-cooling, 4 valve per cylinder in line vertical	4-stroke, turbo-charged, inner-cooling, or water-cooling, 4 valve per cylinder in line vertical
Rated Power	136 horsepower (100 kw)	230 horsepower (170 kw)	240 horsepower (177 kw)	270 horsepower (199 kw)	350 horsepower (258 kw)	390 horsepower (288 kw)
Number of Cylinders	4	6	6	6	6	6
Cylinder Displacement	4.257L	6,494L	7,255L	7.8L	8.424L	9.84L
Rated Speed	2800 r/min	2,500 r/min	2300 r/min	2400 r/min	2200 r/min	2100 r/min
Maximum Torque	392 N.m	810 N.m	860 N.m	980 N.m	1400 N.m	1680 N.m
Speed at Maximum Torque	1600-1800 r/min	1,700 r/min	1600 r/min	1500 r/min	1400 r/min	1600 r/min
Bore x Stroke	110 x 112 mm	105 x 125 mm	108 x 132 mm	112 x 132 mm	113 x 140 mm	120 x 145 mm
Minimum Fuel Consumption	< 248 g/kw.h	< 200 g/kw.h	< 228.5 g/kw.h	< 200 g/kw.h	< 198 g/kw.h	< 193 g/kw.h
Consumption Ratio of Oil to Fuel	< 0.5%	< 0.1%	< 0.15%	< 0.1%	< 0.1%	< 0.1%
Noise	< 115 dB(A)	< 99 dB(A)	< 97 dB(A)	< 98 dB(A)	< 98 dB(A)	< 96 dB(A)

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Smoke	< 3.5 Bosch	< 2.5 Bosch	< 2.5 Bosch	< 3 Bosch	< 3 Bosch	< 2 Bosch
Net Machine Weight	380 kg	650 kg	550 kg	642 kg	750 kg	880 kg
Dimensions (length x width x height)	863 x 664 x 843 mm	1226 x 803 x 1012 mm	1234 x 815 x 1100 mm	1224 x 815 x 986 mm	1388 x 716 x 1012 mm	1343 x 651 x 1095 mm

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

Besides diesel engines, Yuchai also produces a limited number of diesel power generators and diesel engine parts. The following table sets forth a breakdown of Yuchai's sales by major product category for each of the three years ended December 31, 2002, 2003 and 2004, respectively:

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Product	2002			2003			2004		
	Revenues, net Rmb (in thousands)	% of Revenues, net	Units Sold	Revenues, net Rmb (in thousands)	% of Revenues, net	Units Sold	Revenues, net Rmb (in thousands)	% of Revenues, net	Units Sold
Diesel engines									
6105	677,206	19.3%	36,135	911,190	19.9%	44,131	1,143,535	20.5%	50,609
6108	1,459,060	41.5%	58,042	1,504,140	32.9%	61,361	1,372,073	24.6%	57,908
6112	747,721	21.3%	15,371	1,003,791	22.0%	20,472	1,203,558	21.6%	24,073
6L				3,697	0.1%	62	60,056	1.1%	963
6M							37,312	0.6%	818
4-Series Diesel power generators & others ⁽¹⁾	361,214	10.3%	20,735	769,805	16.8%	46,022	1,183,992	21.2%	71,562
Total	3,513,047	100.0%	130,384	4,569,950	100.0%	172,219	5,582,095	100.0%	206,628

(1) Includes diesel engine parts, agricultural engines and industrial engines. Figures for the number of units sold for this category are not readily available.

Medium-Duty Diesel Engines***6105 Engines***

The 6105 medium-duty engine is a six-cylinder, four-stroke engine that offers up to 143 horsepower, and is principally installed in medium-duty trucks. Yuchai believes that its 6105 engine has a reputation for fuel efficiency, low noise levels, firm uphill traction and reliability. Yuchai also believes that its manufacturing quality control and the design of its engine blocks, which are thicker than those of its major domestic competitors as well as leading international manufacturers, make its engines more durable.

In response to the introduction of high-power medium-duty engines by its competitors in 1995, Yuchai began development of its 6108 medium-duty engine. Commercial production of the 6108 engine began in the third quarter of 1997. In 2002, 2003 and 2004 unit sales of the 6108 engine exceeded unit sales of the 6105 engine.

6108 Engines

The 6108 engine offers improved overall performance compared to the 6105 engine, principally because of greater horsepower, increased reliability and improved acceleration. Commencing in the third quarter of 1997, Yuchai began offering the 6108 engine to its customers as a premium model, along-side its standard 6105 engine, and plans to

eventually replace the 6105 engine with the 6108 engine. Yuchai's existing and planned production facilities for medium-duty diesel engines are designed to be capable of producing 6108 engines without major modification.

Yuchai sells its 6108 engine to a similar customer base to that which previously bought its 6105 engines. Although the increased competition in the medium-duty diesel market and Yuchai's delay in commercially introducing the 6108 engine had adversely affected Yuchai's market share, through an aggressive marketing program which included brand building and enhancing corporate image, Yuchai was able to increase its unit sales of the 6108 engine by 30.2% to 31,667 units in 2001 from 2000. Unit sales of the 6108 further increased to 58,042

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units in 2002, representing an increase of 83.3% over 2001. Due to the overall decline in the medium-duty truck market in China in 2003, medium-duty engines also decreased in unit quantity resulting in Yuchai achieving 61,361 units in 2003 as compared to 58,042 units in 2002, and sales of 57,908 units in 2004. There can be no assurance, however, that Yuchai will be able to maintain or improve its current market share or develop new markets for the 6108 engine.

Heavy-Duty Diesel Engines

The 6112 heavy-duty engine is a six-cylinder, four-stroke engine with a rated power ranging from 190 to 270 horsepower. Primarily as a result of unreliable key engine components supplied by domestic component manufacturers, the 6112 engine encountered significant technical problems during initial road testing and failed to perform satisfactorily under harsh environmental conditions. Although commercial production of the 6112 engine was delayed beyond the previously scheduled date, Yuchai was able to resolve these technical problems and commence trial marketing of the engine in early 1999. Commercial production of these engines began during the second half of 1999. In 2002, 2003 and 2004, Yuchai produced 17,011, 22,024 and 27,410 units of the 6112 engine, respectively. See

Item 5. Operating and Financial Review and Prospects Overview. With higher levels of acceptance by customers, 6112 engine unit sales have increased in 2004 as compared to 2003.

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

Light-Duty Diesel Engines

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

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

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Other Products

Diesel Power Generators

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

Diesel Engine Parts

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

Sales, Marketing and Services

Sales and Marketing

Yuchai distributes most of its engines directly to auto plants and retailers from its primary manufacturing facilities in Yulin City. In addition, Yuchai operates 28 regional sales offices in major geographic regions in China. With a sales force of approximately 558 persons nationwide, Yuchai provides a comprehensive range of services to its customers, including dispatching engineers to provide on-site assistance to major customers in the resolution of technical problems.

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

Advertising expenses increased by 18.8% in 2004 to Rmb 48.7 million in 2004 from Rmb 41.0 million in 2003. On the other hand, sales commissions decreased to Rmb 11.6 million in 2004 compared to Rmb 16.7 million in 2003. From 2002, Yuchai has changed its promotion strategies by offering lower selling prices to its customers rather than through emphasizing sales commissions paid to sales agents.

Yuchai believes that proximity to its factories in Yulin City is an important factor in the geographical make-up of its customers. Due in part to transportation and shipping costs, a substantial majority of Yuchai's engines are sold to customers in southern and central eastern China. Yuchai currently exports a minor portion of its diesel engines to Vietnam and Japan.

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

Yuchai has been continuing its sales efforts to retailers and end-users of diesel engines. Yuchai seeks to encourage end-users of gas engine trucks to replace their gas engines with Yuchai diesel engines by advertising the advantages of

diesel engines. Such sales of replacement engines are generally made through customer service centers at a retail price, which is higher than the sales price to truck manufacturers.

Customers' orders with Yuchai can be cancelled either by Yuchai or its customers prior to delivery in accordance with the sales contracts. As part of Yuchai's credit procedures to control and manage its trade accounts receivables, Yuchai would hold shipments for delivery if customers' credit position is not satisfactory or if customers have not made payments for earlier deliveries. There can be no assurance that such cost-controlling measures will successfully control Yuchai's trade receivable balance, or that they will not adversely

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affect the future purchase decisions of Yuchai's customers. Yuchai had net trade accounts receivable of Rmb 849.6 million as of December 31, 2003, representing 34.5% of the Company's total current assets at the same date. As of December 31, 2004, Yuchai had net trade accounts receivable of Rmb 875.6 million, representing 25.7% of the Company's total current assets as of the same date.

Customer Service

Yuchai believes that customer service is an important part of maintaining its market competitiveness. In addition to various services provided initially at its sales offices, Yuchai has a nationwide network of over 750 authorized service stations that provide repair and maintenance services, spare parts, retrofitting services and training to Yuchai's customers. To ensure a consistently high level of service, Yuchai trains the technicians at each of these service stations. In addition, Yuchai also owns and operates over 15 repair training centers. Any warranty-related services or repairs will be borne by Yuchai. Other than above, all non-warranty activities will be charged to customers.

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

Yuchai provides a repair and replacement warranty for all of its engines. Prior to 1993, Yuchai's warranty was for 12 months or 30,000 kilometers. In September 1993, Yuchai extended its warranty to 18 months or 50,000 kilometers and, in September 1994, Yuchai further extended its warranty from a period of 12 months or 120,000 kilometers to a period of 18 months or 180,000 kilometers, whichever is lower. For the years ended 2002, 2003 and 2004, warranty costs represented approximately 3.6%, 3.6% and 3.4% of net revenues, respectively.

Manufacturing

Yuchai's primary manufacturing facilities are located in Yulin City in the Guangxi Zhuang Autonomous Region. The principal production land area currently occupies approximately 960,900 square meters, including the existing production factory for the 6105 medium-duty engines, the existing production factory for the 6108 medium-duty engine (the 6108 Engine Factory), the 6112 Engine Factory and various testing and supporting facilities. In 2004, the annual production capacity of Yuchai's manufacturing facilities was approximately 80,000 units of light-duty diesel engines, 120,000 units of medium-duty diesel engines and 50,000 units of heavy diesel engines. In 2004, with the completion of the new second foundry and 6L and 6M heavy-duty diesel engines lines, Yuchai's total production capacity has increased to approximately 250,000 units at end 2004. Yuchai operated at less than full capacity in 2004.

Yuchai's production process involves the manufacture of key components and the assembly of the diesel engines from components and parts internally manufactured or purchased from third parties. Yuchai manufactures a substantial portion of the key components of its diesel engines, including the engine block, cylinder heads, crankshaft and camshaft. Yuchai cast and molded approximately 183,160 engine blocks in 2004, satisfying approximately 79% of its engine block needs in 2004. When necessary, Yuchai is able to purchase additional engine blocks from a domestic foundry under an existing requirement contract. Yuchai/ASIMCO Components Company Limited (Yuchai/ASIMCO) is one of Yuchai's principal suppliers of fuel injection pumps through two of its related companies. Yuchai purchases the remaining parts and components for its 6105 engines as well as raw materials, principally steel and cast iron, from domestic suppliers. Yuchai does not believe that it is dependent on any one supplier as it generally purchases supplies from at least two sources (except with respect to engine blocks where Yuchai currently has a purchase arrangement only with the domestic foundry referred to above). Yuchai manufactures internally the same key components for its 6108 engine as it does for the 6105 engine and purchases the remaining parts and components for its 6108 engine from domestic suppliers. The main parts for the 6112 heavy-duty engine, which are the engine blocks, cylinder heads, crankshaft and fuel pumps, are imported from foreign suppliers and the other parts are

purchased from domestic suppliers. Yuchai expects to reduce its reliance on imported parts and components in 2005.

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

Yuchai/ASIMCO is a joint venture between Yuchai and a subsidiary of Asian Strategic Investments Corporation (ASIMCO) that invests in factories in China that produce parts and components for diesel engines. ASIMCO is a joint venture among The Pacific Alliance Group Limited, Dean Witter Capital Corporation and TCW Capital Investment Corporation. As of December 31, 2004, Yuchai had contributed Rmb 5.7 million to Yuchai/ASIMCO and owned a 4.73% interest in the common stock of Yuchai/ASIMCO.

During 2000, at the State Holding Company's initiative, Yuchai established two new companies involved in the manufacture and sale of spare parts and components for diesel engines in China. Yuchai contributed a total of Rmb 105.0 million in assets to the companies and received equity interests of 71.8% and 97.0%, respectively, in the two companies. During 2002, Yuchai increased its equity interest in Guangxi Yulin Yuchai Machinery Spare Parts Manufacturing Company Limited, the subsidiary involved in the manufacture of spare parts, from 97.0% to 97.1% by an additional contribution of Rmb 4.3 million. The State Holding Company owns the remaining equity interests in these companies. Yuchai established these new companies to ensure access to a consistent and quality supply of spare parts and components for its diesel engines and to improve the quality of its customer service by maintaining a regular supply of these spare parts. The establishment of these companies by Yuchai was initially not made with the requisite corporate approvals, but was subsequently ratified by the Board of Directors of Yuchai in October 2001.

In March 2004, similarly at the State Holding Company's initiative, Yuchai established a new company, Yuchai Express Guarantee Company Limited (YEGCL), which provides credit guarantee, appraisal and consulting services to Yuchai's customers to purchase trucks that are mounted with Yuchai's diesel engines. Yuchai has contributed Rmb 100.0 million for the establishment of this company, in return for 76.9% of its share capital. YEGCL commenced operations in June 2004.

Also in March 2004, Coomber and the State Holding Company established a related company, YMC, to offer a complementary range of services with YEGCL. YMC and YEGCL provide a range of complementary services, such as insurance, financing, warranty servicing, administrative and marketing services to independent Chinese truck operators. This is intended to facilitate sales and servicing of Yuchai products. Yuchai loaned approximately Rmb 205.0 million to YMC in September 2004, the propriety of which was subsequently disputed by the Company, and which the Company believes should be resolved through the implementation of the Reorganization Agreement (see also Note 23 to the Company's Consolidated Financial Statements appearing elsewhere herein).

Capital Expenditures

Capital expenditures for routine upgrades to, and replacement of, equipment, plant and property were Rmb 174.9 million, Rmb 372.8 million and Rmb 552.9 million in 2002, 2003 and 2004, respectively. The Company funded its capital expenditures primarily from funds generated from operations and, when necessary, from bank loans obtained by Yuchai. The Company incurred capital expenditures in 2002 due to the 4-Series light-duty diesel engine series and the commencement of construction of the second foundry to produce engine blocks to meet its expected increased unit production. The Company incurred additional capital expenditures in 2003 relating to the completion of the second foundry as well as for the production line of the 6L and 6M heavy-duty diesel engine. The Company's capital expenditures for 2004 of Rmb 552.9 million were primarily used for the completion of the new production line for 6L and 6M heavy-duty engines, the second foundry described above, production capacity upgrading and the second stage of construction of Yuchai heavy-duty engine project. The Company expects that it will be able to

continue to fund its capital expenditures in 2005 in the same manner as in prior years, as described above and under Item 5. Operating and Financial Review and Prospects – Liquidity and Capital Resources .

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Seasonality

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

Trademarks

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

Competition

The diesel engine industry in China is highly competitive. Yuchai believes, based on internal studies, that competition is based primarily on performance, quality, price and after-sales service, and secondarily on noise, size and weight. Yuchai believes that its engines have a strong reputation among truck manufacturers and consumers for leading performance and reliability. In addition, Yuchai believes that its after-sales service to end-users of Yuchai engines, conducted through a nationwide network of over 750 authorized service stations and 15 Yuchai-owned repair training centers, gives Yuchai a competitive advantage over other diesel engine producers.

Most of Yuchai's major domestic competitors are state-owned enterprises. The Dongfeng Group, which is a major competitor of Yuchai and which controls two of Yuchai's largest competitors, is also one of Yuchai's major customers and controls Yuchai's other major customers, accounting in the aggregate for approximately 28.8% of Yuchai's total net revenues in 2004. Some of Yuchai's competitors have formed joint ventures with, or have technology assistance arrangements with, foreign diesel engine manufacturers or engine design consulting firms, and use foreign technology that is more advanced than Yuchai's technology. Yuchai believes several of its major competitors, as Yuchai itself, have unused production capacity. Yuchai expects competition to intensify as a result of, among other things, improvements in competitors' products, increased production capacity of competitors, increased utilization of unused capacity by competitors and price competition.

In the medium-duty diesel engine market, Yuchai's 6105 and 6108 engines compete primarily against the 6110 engines produced by a number of Yuchai's competitors. Initially, the introduction of the 6110 engine in 1995 had put considerable pressure on Yuchai's competitiveness in the medium-duty diesel engine market because it offered greater horsepower than Yuchai's 6105 engine. However, the commercial introduction of the 6108 engine in 1997 by Yuchai, which offers substantially the same horsepower as the 6110 engine, has allowed Yuchai to compete more effectively in the medium-duty diesel engine market. In competing with the 6110 engine, Yuchai focuses on the quality and price of, and the after-sales service on, the 6108 engine. There can be no assurance, however, that Yuchai will be able to maintain or improve its current market share or develop new markets for its medium-duty diesel engines.

In addition, Yuchai commenced trial marketing of its 6112 heavy-duty engine in early 1999, and began commercial production of these engines in the second half of 1999. Due to the delay in commercial production of the 6112 engine until 1999, however, Yuchai was not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is relatively price sensitive. As a result, the Company lowered its expectations for future sales volume and profitability of the 6112

engine. In 2004, the sales volume of the 6112 engine was 24,073 units, which was in line with the Company's expectations. However, there can be no assurance that Yuchai will be able to compete successfully in the heavy-duty diesel engine market in China with the existing producers (such as Weichei Power Co., Ltd.) or any new entrants.

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

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

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

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Organizational Structure

The following chart illustrates the organizational structure of the Company and Yuchai as at June 30, 2005, and is based on information generally known to Company or otherwise disclosed in filings made with the SEC (see also Item 7. Major Shareholders and Related Parties – Major Shareholders).

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Regulatory and Related Matters

Governance, Operation and Dissolution of Yuchai

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

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

Chinese laws and regulations applicable to a Sino-foreign joint stock company require that, before Yuchai distributes profits, it must: (i) satisfy all tax liabilities; (ii) recover losses in previous years; and (iii) make contributions to certain statutory reserves in an amount equal to at least 15.0% of net income for the year determined in accordance with generally accepted accounting principles in China (PRC GAAP).

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

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

Property, Plants and Equipment

Yuchai's headquarters is located in Yulin City in the Guangxi Zhuang Autonomous Region. Yuchai has the right to use approximately 1.5 million square meters of land, which is currently used primarily for the production of diesel engines and employee housing. The principal production land area for the manufacture of diesel engines currently occupies approximately 960,900 square meters, including a building for the current 6105 manufacturing facilities and recently completed facilities occupying approximately 620,000 square meters that comprise the 6108 Engine Factory, the 6112 Engine Factory, administrative offices and technical operations space. In addition, Yuchai leases 28 regional sales offices in PRC. During 2004, Yuchai increased production capacity to approximately 250,000 units after the completion of the second foundry and new 6L and 6M heavy-duty engines lines.

Environmental Matters

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

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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.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS.

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

During the fiscal years ended December 31, 2002, 2003 and 2004, the Company's sole operating asset has been its 76.4% ownership interest in Yuchai. As a result, the Company's financial condition and results of operations have depended primarily upon Yuchai's financial condition and results of operations. The Company acquired its initial 51.3% interest in Yuchai effective April 1, 1993, increased its interest to 71.4% in November 1994 through the China Everbright Purchase and then to 76.4% in December 1994 by purchasing additional Yuchai Shares with the net proceeds of its initial public offering. The Company's historical results of operations differ from those of Yuchai, primarily as a result of amortization of goodwill prior to 2002 which arose in connection with the three acquisitions, additional operating expenses and the minority interest of other Yuchai shareholders in Yuchai's income. In future financial periods, the Company's financial condition, results of operations, business and prospects may differ significantly from Yuchai, depending upon, among other things, the implementation of the Company's new business expansion and diversification plan and the consummation of the spin-off contemplated in the Reorganization Agreement (see Item 4. Information on the Company - Recent Developments). For example, in March 2005, the Company acquired an approximate 14.99% interest in TCL, which the Company currently accounts as an investment in an associate company.

Overview

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

Due to the increased demand for commercial vehicles in China during 2004, the Company's net revenues in 2004 increased by 22.1% to Rmb 5,582.1 million compared to Rmb 4,570.0 million in 2003. This increase was primarily a result of increased unit sales of diesel engines achieved through the Company's aggressive marketing program. The Company had income before minority interests of Rmb 648.7 million in 2004 compared to income before minority interests of Rmb 584.0 million in 2003. The increase in income before minority interests was primarily due to increase in sales volume. Sales of the 6108 medium-duty and 6112 heavy-duty engines accounted for 24.6% and 21.6%, respectively, of the Company's net revenues in 2004. The Company also introduced its new 6L and 6M heavy-duty diesel engines in 2003 and 2004, respectively, which together accounted for 2.4% of net revenues in 2004.

In 2004, the Company continued its efforts to control production costs and operating expenses. However, a large portion of the Company's costs and expenses relate to fixed costs incurred in connection with the production of its

diesel engines, which limits the Company's ability to significantly reduce its costs and expenses. The Company's cost of goods sold mainly includes cost of materials consumed, factory overhead, direct labor and depreciation. The Company analyzes its cost of goods sold based on its cost of manufacturing for each period. Cost of manufacturing for each period equals cost of goods sold for the period plus or minus the change in period end

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finished goods inventory. In 2004, cost of materials consumed accounted for approximately 78.9% of the cost of manufacturing. The Company's selling, general and administrative (SG&A) expenses include advertising expenses, provision for doubtful accounts, salaries and wages, sales commission expenses and a large number of smaller expenses.

The Company had effective income tax rates of 13.3%, 16.2% and 14.0% in 2002, 2003 and 2004, respectively. Yuchai was subject to PRC income tax at a rate of 24.0% of its income determined in accordance with PRC GAAP in 1993 prior to the restructuring. After becoming a Sino-foreign joint stock company, it was exempt from PRC income tax in 1994 and 1995. Under current laws, Yuchai is subject to PRC income tax at a rate of 7.5% for each of the three years from 1996 to 1998 and a rate of 10.0% for each of the three years from 1999 to 2001. Since January 1, 2002, Yuchai is subject to tax at a rate of 15.0% so long as it continues to qualify as a foreign-invested enterprise eligible for tax reductions under PRC income tax law. In addition to the PRC income tax, Yuchai has been subject to value-added taxes on its sales since January 1, 1994. Dividends received by the Company from Yuchai can be remitted from China without any PRC taxation under current Chinese law. See Item 10. Additional Information Taxation People's Republic of China Taxation .

The Company commenced trial marketing of its 6112 heavy-duty engine in early 1999, and began commercial production of these engines during the second half of 1999. Due to the delay in commercial production of the 6112 engine until 1999, however, the Company was not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is relatively price sensitive. With increasing customer acceptance of the 6112 engine in late 2001 through 2003, the sales volume of the 6112 engine improved significantly and the Company currently has no plan to reduce the price of the 6112 engine. However, given the 6112 engine's limited horsepower capacity, there can be no assurance that the Company will be able to continue to compete successfully in the heavy-duty diesel engine market in China with the existing producers or any new entrants.

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

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

Critical Accounting Policies

The preparation of financial statements in accordance with US GAAP require the Company's management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of the Company's assets and liabilities, disclosures of contingent liabilities and the reported amounts of revenues and

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expenses. These judgments, assumptions and estimates are reflected in the Company's accounting policies, which are more fully described in Note 3 to the Company's Consolidated Financial Statements appearing elsewhere herein.

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

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

Allowances for doubtful accounts;

Realization of the carrying value of inventories;

Allowance for product warranty;

Realization of deferred tax assets; and

Impairment of long-lived assets other than goodwill

Allowances for doubtful accounts

Allowance for doubtful accounts is management's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience by industry and national economic data. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by aging of such balances. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Changes in the allowances for doubtful accounts for each of the years in the three-year period ended December 31, 2004 are summarized as follows:

	2002	December 31,		
	Rmb	2003	2004	2004
		Rmb	Rmb	US\$
Balance at beginning of year	164,924	158,075	94,423	11,408
Add: Allowance made			13,034	1,576
Less: Written back to statements of income	(6,849)	(493)		
Doubtful debts written off		(63,159)		
Balance at end of year	158,075	94,423	107,457	12,984

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The Company believes that the present level of its allowance for doubtful debts adequately reflects probable losses related to impaired accounts receivable. However, changes in the assumptions used to assess the frequency and severity of doubtful accounts would have an impact on the Company's allowance for doubtful debts. If economic or specific industry trends change, the Company would adjust its allowances for doubtful accounts by recording additional expense or benefit. Management studies show that a decrease or increase of 5% in historical write-off experience would increase or decrease the provision for doubtful accounts by approximately Rmb 11.9 million (US\$1.4 million).

Realization of the carrying value of inventories

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

If market conditions or future product enhancements and developments change, the Company would adjust its provision for inventories by recording additional expense or benefit. In the preceding three years, there were no significant differences or adjustments between the book cost and the net realizable or market-value. Management studies show that a decrease or increase of 5.0% in historical charge experience would increase or decrease the provision for inventories by approximately Rmb 4.0 million (US\$0.5 million).

Allowance for product warranty

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

Changes in the allowances for product warranty for each of the years in the three-year period ended December 31, 2004 are summarized as follows:

	December 31,			
	2002	2003	2004	2004
	Rmb	Rmb	Rmb	US\$
Balance at beginning of year	29,699	66,864	101,215	12,230
Add: Allowance charged to statements of Income	127,058	162,369	190,205	22,981
Less: Allowance utilized	(89,893)	(128,018)	(165,306)	(19,973)
Balance at end of year	66,864	101,215	126,114	15,238

The Company's estimate of its warranty obligations is evaluated on an annual basis. In previous years, warranty claims have typically not been higher than the relevant provisions made in the Company's balance sheet. If the nature, frequency and average cost of warranty claims change, the Company would adjust its allowances for product warranty by recording additional expense or benefit so as to seek to ensure that accruals will be adequate to meet expected future obligations. Management studies show that a decrease or increase of 5.0% in historical utilization experience would increase or decrease the provision for product warranty by approximately Rmb 6.5 million (US\$0.8 million).

Realization of deferred tax assets

Deferred tax assets are reduced by a valuation allowance to the extent the Company concludes it is more likely than not that the assets will not be realized. Based on management's forecast of future taxable income, no valuation allowance for deferred tax assets is required at December 31, 2004.

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

Impairment of long-lived assets, other than goodwill

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

The Company has conducted a review on the conditions of the property, plant and equipment. In 2003, management identified that certain property, plant and equipment would no longer be used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed in accordance with SFAS No. 144. The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to estimated fair value. Since there was no active second hand resale market for these items relating to property, plant and equipment, management has adopted the discounted cash flow model to determine their fair value. Impairment loss of Rmb 12.4 million (US\$1.5 million) has been charged to income statements in 2003 under selling, general and administrative expense. In 2004, the Company has not identified circumstances which indicate that the carrying value of the property, plant and equipment may not be recoverable, hence no impairment loss was recognized.

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

Prior to the adoption of SFAS No. 144, the Company accounted for long-lived assets in accordance with SFAS No. 121, Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of .

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The following table sets forth the percentages of net revenues of certain income and expense items of Yuchai for the last three fiscal years ended December 31, 2002, 2003 and 2004, respectively:

	Percentage of Net Revenues		
	Year Ended December 31,		
	2002	2003	2004
Revenues, net	100.0%	100.0%	100.0%
Cost of goods sold	67.5%	69.9%	71.8%
Gross profit	32.5%	30.1%	28.2%
Research and development cost	2.2%	2.1%	2.5%
Selling, general and administrative expense	12.1%	12.3%	11.8%
Operating income	18.2%	15.8%	14.0%
Interest expense	0.7%	0.5%	0.6%
Other (Income)/expense, net	(0.3)%	0.0%	0.1%
Income before income taxes and minority interests	17.8%	15.2%	13.5%
Income tax expense	2.4%	2.5%	1.9%
Income before minority interests	15.4%	12.8%	11.6%
Minority interests in income of consolidated subsidiaries	3.7%	3.2%	2.8%
Net income	11.7%	9.6%	8.8%

2004 Compared to 2003

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

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

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

SG&A expenses (excluding research and development) increased by 17.3% to Rmb 658.3 million (US\$79.5 million) in 2004 from Rmb 561.2 million in 2003 and decreased as a percentage of net revenue from 12.3% in 2003 to 11.8% in 2004. This increase in SG&A was primarily due to the increase in sales. Research and development expenses increased to Rmb 137.0 million (US\$16.5 million) in 2004 from Rmb 94.6 million in 2003. Such increased expenses were primarily due to the development of the 6L engines and Euro 2 compliance. Advertising expenses included in SG&A increased by 18.8% to Rmb 48.7 million (US\$5.9 million) in 2004 from Rmb 41.0 million in 2003. Advertising expenses as a percentage of net revenue decreased to 0.9% in 2004 from 0.90% in 2003. Sales commission expenses included in SG&A expenses decreased by 30.5% to Rmb 11.6 million (US\$1.4 million) in 2004 from Rmb 16.7 million in 2003. Sales commission expenses as a percentage of net revenues decreased to 0.2% in 2004 from 0.4% in 2003. The increase in advertising and decrease in sales commission expenses reflected primarily higher costs incurred for the promotion of the 6L and 6M engines in 2004 and the change in Yuchai's promotion strategies by offering lower selling prices to customers rather than through sales commission paid to its sales agents. Salaries and wages as a percentage of net revenues was 7.4% in 2004 and 7.5% in 2003. In 2003, management identified that certain property, plant and equipment were no longer used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed in accordance with SFAS No. 144. The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to estimated fair value. Impairment loss of Rmb 12.4 million (US\$1.5 million) has been charged to income statements in 2003. In 2004, the Company has not identified circumstances which indicate that the carrying value of the property, plant and equipment may not be recoverable, hence no impairment loss was recognized. As a result of the foregoing, profits from operations increased to Rmb 779.9 million (US\$94.2 million) in 2004 compared to Rmb 721.4 million in 2003.

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

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

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

2003 Compared to 2002

Net revenue increased by 30.1% to Rmb 4,570.0 million (US\$552.1 million) in 2003 compared to Rmb 3,513.0 million in 2002. The increase in net revenue was primarily due to higher sales volume due to more aggressive marketing programs. Unit sales of diesel engines increased by 32.1% to 172,219 units in 2003 from 130,384 units in 2002.

Cost of goods sold increased by 34.7% to Rmb 3,192.8 million (US\$385.8 million) in 2003 from Rmb 2,371.1 million in 2002, and increased as a percentage of net revenue to 69.9% in 2003 from 67.5% in 2002. Cost of

manufacturing increased by 24.4% to Rmb 2,993.7 million (US\$361.7 million) in 2003 from Rmb 2,407.3 million in 2002, while cost of manufacturing as a percentage of net revenue decreased to 65.5% from 68.5% in 2002. Cost of materials consumed in costs of manufacturing increased by 25.9% to Rmb 2,479.9 million (US\$299.6 million) in 2003 from Rmb 1,969.1 million in 2002 (due to higher production throughput during 2003), while cost of materials consumed as a percentage of net revenues decreased to 54.5% in 2003 from 56.1% in 2002. Factory overhead (which does not include depreciation and salaries) included in cost of manufacturing increased by 30.5% to Rmb 191.9 million (US\$23.2 million) in 2003 from Rmb 147.1 million in 2002, due to higher variable factory expenses (such as utilities) arising from higher diesel engine production in 2003. Factory overhead as a percentage of net revenues remained fairly stable at 4.2% for both 2003 and 2002. Depreciation included in cost of manufacturing decreased to Rmb 88.7 million (US\$10.7 million) from Rmb 93.2 million in 2002. Depreciation as a percentage of net revenues decreased to 1.9% in 2003 from 2.7% in 2002.

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Gross profit increased by 20.6% to Rmb 1,377.2 million (US\$166.4 million) in 2003 from Rmb 1,142.0 million in 2002. Gross profit margin (gross profit divided by net revenues) decreased to 30.1% in 2003 compared to 32.5% in 2002, reflecting a shift in the sales mix whereby the gross margin for the 4-Series and industrial engines were lower than margins historically achieved for both medium and heavy-duty engines.

SG&A expenses (excluding research and development) increased by 31.7% to Rmb 561.2 million (US\$67.8 million) in 2003 from Rmb 426.1 million in 2002 and increased as a percentage of net revenue from 12.1% in 2002 to 12.3% in 2003. This increase in SG&A was primarily due to the increase in sales and costs arising from legal and professional fees incurred in connection with the legal and arbitration proceedings instituted by the Company in 2003. Research and development expenses increased to Rmb 94.6 million (US\$11.4 million) in 2003 from Rmb 75.5 million in 2002. Such increased expenses were primarily due to the development of the 6L and 6M engines and Euro 2 compliance. Advertising expenses included in SG&A increased by 28.5% to Rmb 41.0 million (US\$4.9 million) in 2003 from Rmb 31.9 million in 2002. Advertising expenses as a percentage of net revenue decreased to 0.90% in 2003 from 0.91% in 2002. Sales commission expenses included in SG&A expenses decreased by 5.6% to Rmb 16.7 million (US\$2.0 million) in 2003 from Rmb 17.7 million in 2002. Sales commission expenses as a percentage of net revenue decreased to 0.4% in 2003 from 0.5% in 2002. The decreases in advertising and sales commission expenses reflected primarily lower costs incurred for the promotion of the 6112 and 4-Series engines in 2002 and the change in Yuchai's promotion strategies by offering lower selling prices to customers rather than through sales commission paid to its sales agents. Salaries and wages as a percentage of net revenues increased to 7.5% in 2003 compared to 6.5% in 2002, due primarily to an increase in production. In 2003, management identified that certain property, plant and equipment were no longer used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed in accordance with SFAS No. 144. The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to estimated fair value. Impairment loss of Rmb 12.4 million (US\$1.5 million) has been charged to income statements in 2003. In 2002, the Company has not identified circumstances which indicate that the carrying value of the property, plant and equipment may not be recoverable, hence no impairment loss was recognized. As a result of the foregoing, profits from operations increased to Rmb 721.4 million (US\$87.2 million) in 2003 compared to Rmb 640.3 million in 2002.

Interest expenses decreased by 6.0% to Rmb 23.6 million (US\$2.9 million) in 2003 from Rmb 25.1 million in 2002, primarily due to the repayment of loans during the year.

Income before income taxes and minority interests in 2003 was Rmb 696.9 million (US\$84.2 million), as compared to Rmb 625.5 million in 2002. Income tax expenses in 2003 was Rmb 112.9 million (US\$13.6 million) compared to income tax credit of Rmb 83.2 million in 2002.

As a result of the foregoing factors, the Company had income before minority interests of Rmb 584.0 million (US\$70.6 million) in 2003 compared to Rmb 542.2 million in 2002, and net income of Rmb 438.2 million (US\$52.9 million) in 2003 compared to Rmb 412.4 million in 2002.

Inflation

The general annual inflation rate in China was approximately (0.1)%, 1.2% and 3.9% in 2002, 2003 and 2004, respectively. The Company's results of operations may be affected by inflation, particularly rising prices for parts and components, labor costs and other operating costs.

Table of Contents**Liquidity and Capital Resources**

The Company's primary sources of cash are funds from operations generated by Yuchai, as well as debt financing incurred by the Company. The Company's operations provided cash in 2002, 2003 and 2004. In 2004, the Company's primary cash requirements were for working capital to finance accounts receivable, inventories and capital expenditures to complete the expansion of production capacity. The Company believes that its working capital is sufficient for its requirements over the next year. Factors which may affect the Company's ability to generate funds from operations include increased competition (including as a result of China's admission to the WTO), fluctuations in customer demand for the Company's products, the Company's ability to collect and control its level of accounts receivable, the status of the Company's investment in Yuchai under Chinese law and the implementation of the Reorganization Agreement (see Item 4. Information on the Company - Recent Developments).

At December 31, 2004, the Company had approximately US\$87.3 million in cash on a consolidated basis which the Company considers would be sufficient to meet the Company's operational requirements at least for the next year. However, the Company believes that if the Company is considered on a stand alone basis without its investment in Yuchai, the Company would find it difficult to raise new capital (either debt or equity) on its own.

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

	Years ended December 31,			
	2002	2003	2004	2004
	Rmb	Rmb	Rmb	US\$
	(in thousands)			
Net cash provided by operating activities	659,500	1,075,274	589,608	71,240
Net cash used in investing activities	(174,164)	(372,373)	(753,367)	(91,025)
Net cash (used in)/provided by financing activities	(251,329)	(714,163)	254,493	30,749
Net increase/(decrease) in cash and cash equivalents	234,007	(11,262)	90,734	10,964

Net cash provided by operating activities decreased by Rmb 485.7 million in 2004. This decrease was principally caused by an increase in inventories and work-in-progress of Rmb 469.2 million, due to stocking up at end 2004 to meet expected higher sales in 2005. In addition, the decrease in net cash from operating activities in 2004 was also partly attributed to increase in other receivables of Rmb 106.6 million due primarily to increase in VAT recoverable. In addition, there was an increase in trade accounts payable in 2004 of Rmb 357.8 million arising from increased business activities from higher production. Net cash used in investing activities increased by Rmb 381.0 million in 2004, principally due to increase of Rmb 552.9 million used for purchase of property, plant and equipment and Rmb 205.0 million loan extended to YMC, a related company. Net cash provided by financing activities increased by Rmb 968.7 million in 2004, mainly due to net increase in proceeds from bank term loans of Rmb 240.0 million, and the dividend payment of Rmb 608.4 million made in 2003.

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

The Company expects that cash generated from operations and credit collection arrangements should provide the Company with sufficient financial flexibility to satisfy future bank obligations, capital expenditures and

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projected working capital requirements. However, at certain times cash generated from operations is subject to seasonal fluctuations. As a result, the Company may use periodic borrowings to supplement its working capital requirements. Yuchai has established banking relationships with a number of domestic Chinese banks, each of which will review Yuchai's loan applications on a case by case basis with reference to the loan limit approved by Yuchai's Board of Directors. As of December 31, 2004, Yuchai's board had approved borrowings up to a maximum of Rmb 800.0 million. Yuchai had outstanding borrowings of Rmb 530.0 million as at December 31, 2004. The interest rate applicable to the amounts borrowed ranges from 4.78% and 5.58% per annum. During its April 2005 board meeting, the Yuchai board of directors approved an increase in this borrowing limit to Rmb 2,000 million. As at May 31, 2005, Yuchai had outstanding borrowings of Rmb 925.3 million. The Company believes that should there be a need for further loans from banks, Yuchai could seek to drawdown additional amounts up to such limit from the Chinese domestic banks; however, no assurance can be given that such additional borrowings would be approved by such banks.

The Company's working capital as of December 31, 2004 was Rmb 1,332.5 million compared to Rmb 962.8 million as of December 31, 2003. The increase in working capital was primarily due to an increase in inventories, amounts due from related corporations, other receivables and prepayments. The Company's total liabilities increased by 45.4% to Rmb 2,176.9 million from Rmb 1,497.4 million, primarily as a result of higher accounts payable due to higher volume of purchase of raw materials and components to meet expected higher sales in 2005. In addition, the increase in total current liabilities was also partly due to increase in borrowings of Rmb 140.0 million. As of December 31, 2004, the Company had long-term debt, including current installments, totaling Rmb 100.0 million, of which none will mature in 2005. The Company had short-term debt totaling Rmb 430.0 million as of December 31, 2004.

The Company's capital expenditures were Rmb 552.9 million in 2004, Rmb 372.8 million in 2003 and Rmb 174.9 million in 2002. As of December 31, 2004, the Company had authorized and contracted for capital expenditure for improvement to existing production facilities in the amount of Rmb 373.4 million. As the Company's business continues to grow, it will also require additional funds for increased working capital requirements, including to finance increased accounts receivable. The Company expects to fund its capital expenditures and working capital requirements primarily from funds from operations generated by Yuchai and, to the extent that is insufficient, from bank loans incurred by Yuchai and the Company. Yuchai's ability to obtain financing is limited by government regulation and a general shortage of debt and equity financing in China. Any additional capital contribution by the Company to Yuchai would require, among other things, the approval of the MOC, which has broad discretion with respect to such approval.

In March 2005, the Company issued \$25.0 million in principal amount of convertible bonds due 2012 in a private placement. The convertible bonds carried interest at 2.0% per annum and matured in 2012, unless redeemed earlier in accordance with their terms. The bonds were convertible by their holders into newly issued ordinary shares of the Company at a conversion price of \$12.969 per share, subject to customary adjustments. The bonds were fully converted by their holders in June 2005. Upon conversion, the Company issued 1,927,673 ordinary shares, representing approximately 5.45% and 5.17% of the then existing and enlarged issued share capital of the Company, respectively. The Company received approximately \$24.9 million in proceeds from the convertible bond placement after deducting costs and expenses. Part of the proceeds of the offering was used to finance the TCL share acquisition described above. The remaining proceeds are intended to be used for other strategic acquisitions which the Company may consider from time to time as part of its business diversification strategy, and for general corporate purposes. Pending such use, the Company has invested the proceeds in short-term investments.

As an additional source of funding for the Company's business expansion and diversification related activities, the Company entered into a \$25.0 million unsecured revolving credit facility with The Bank of Tokyo Mitsubishi Limited, Singapore Branch, in March 2005. The facility has a tenure of three years and is subject to the requirement

that HLA retain ownership of the Company's special share and that the Company remains a consolidated subsidiary of HLA. The interest rate payable under the facility is 0.5% above the interbank rate of the lender from time to time. The Company has not drawn down this facility as of the date of this document. The purpose of this credit facility is to enable the Company to make new acquisitions as part of its diversification plans.

As part of its business strategy, Yuchai seeks from time to time opportunities to invest in domestic manufacturers of diesel engine parts and components, as well as in other related automotive businesses, including

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truck manufacturers, and insurance, warranty servicing and credit support for diesel engine customers. Yuchai may make such investments and acquisitions with funds provided by operations, future debt or equity financings or a combination thereof.

The following table sets forth information on the Company's material contractual obligation payments for the periods indicated as of December 31, 2004:

Contractual Obligations	Total	Payments Due by Period			More than 5 Years
		Less than 1 Year	1-3 Years	4-5 Years	
			(in Rmb millions)		
Short-Term Debt	430	430			
Long-Term Debt	100		100		
Purchase Obligations	373	373			
Total	903	803	100		

The Company has operating lease commitments of approximately Rmb 1.4 million (US\$0.2 million) over the next four years (2005-2008). There were no other commercial commitments of the Company as of December 31, 2004.

Off-Balance Sheet Arrangements

The Company has operating lease commitments of approximately Rmb 1.4 million (US\$0.2 million) over the next four years (2005-2008).

Outstanding bills discounted

As of December 31, 2003 and 2004, outstanding bills discounted with banks for which the Company has retained a recourse obligation totaled Rmb 729.6 million and Rmb 1,117.8 million (US\$135.1 million), respectively.

Outstanding letter of credits

As of December 31, 2003 and 2004, the Company had issued irrevocable letter of credits of Rmb 172.0 million and Rmb 165.9 million (US\$20.0 million), respectively.

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

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

In March 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143. This Interpretation clarifies that the term conditional asset retirement

obligation as used in SFAS No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. SFAS No. 143 acknowledges that in some cases sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The provision of this Interpretation shall be effective no later than the end of fiscal years ending after December 15, 2005. The adoption of FIN 47 is not expected to have a material effect on the Company's Consolidated Financial Statements.

SFAS No. 151

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - an amendment ARB No. 43 Chapter 4*. This Statement amends the guidance in ARB No. 43 Chapter 4, *Inventory Pricing* to clarify the accounting for abnormal amounts of idle facilities expense, handling costs, and wasted material (spoilage). This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provision of this Statement shall be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 is not expected to have a material effect on the Company's Consolidated Financial Statements.

SFAS No. 153

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29*. The guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, is based on the principle that exchanges of nonmonetary assets should be based on the fair value of the assets exchanged. This Statement amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement shall be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a material effect on the Company's Consolidated Financial Statements.

Table of Contents**Research and Development**

The Company has committed substantial resources to continually improve the technology of its products. The Company's internal development effort focuses primarily on improving manufacturing processes and adapting foreign technology to the Chinese market. In addition, the Company plans to continue to acquire advanced technology from Chinese research institutes, foreign engine design consulting firms and foreign diesel engine and engine parts manufacturers. As of December 31, 2004, the Company employed over 1,445 engineers, approximately 267 of whom were devoted to research and development, product enhancement and new designs. In 2002, 2003 and 2004, the Company spent approximately Rmb 75.5 million, Rmb 94.6 million and Rmb 137.0 million (US\$16.6 million), respectively, on research and development. The Company believes that it has been able to control to some extent the increase of research and development expenses due to the relatively low salary levels of engineers in China.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.**Directors and Senior Management of the Company**

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

The directors and executive officers of the Company as of June 30, 2005 are identified below.

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

(1) Also a director of Yuchai.

(2) Member of the Audit Committee.

(3) Member of the Compensation Committee.

(4) Member of the Special Committee.

(5) Appointed as director in 2005.

Mr. Teo Tong Kooi is the President of the Company and a Director of Yuchai. He is also a Director and Chief Executive Officer of Hong Leong Asia Ltd. as well as a Director of Henan Xinfei Electric Group and various building materials companies within the Hong Leong Group. He was previously the Managing Director of Tasek Corporation Berhad and a Director of Malaysia listed Bintai Kinden Corporation Berhad. Mr. Teo holds a Bachelor of Science degree in Marketing Management and a Master of Business Administration (both from Golden Gate University, San Francisco, California, USA). He has also completed the Executive Management Programme at the Stanford University Graduate School of Business and has 18 years of corporate and commercial banking experience with 12 years in senior management positions.

Mr. Gao Jia Lin is the Vice-President and a Director of the Company and Deputy Chairman and a Director of Yuchai. He has a mechanical engineering degree from Qinghua University, and joined Hong Leong (China) Limited in 1982. He is currently the Group Business Development Manager of Yuchai.

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

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

Mr. Kwek Leng Peck is a Director of the Company. Mr. Kwek is a member of the Kwek family, which controls the Hong Leong Group. Mr. Kwek serves as Executive Director of the Hong Leong Group, and has over 23 years of experience in trading, manufacturing, property investment and development, hotel operations, corporate finance and management. Mr. Kwek holds directorships on the boards of several Hong Leong Group companies, including HLA, City Developments Limited, HLC, Hong Leong Finance Limited, Hong Leong Foundation, Hong Leong Holdings Limited and CDL Hotels International Limited.

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

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

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

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

Management Pte. Ltd. and First Capital Corporation Ltd., where he was actively involved in management of the companies' funds in international equities.

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

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

Audit Committee

The members of the Audit Committee are Messrs. Tan Aik-Leang (Chairman), Raymond C. K. Ho and Neo Poh Kiat. The Audit Committee oversees the actions of the Company's independent public accountants and reviews the Company's internal accounting procedures. The Board has designated Mr. Tan Aik-Leang as the Company's Audit Committee Financial Expert.

Compensation Committee

The members of the Compensation Committee are Messrs. Kwek Leng Peck and Wong Hong Ren. The Compensation Committee reviews and approves executive appointments and remuneration, and administers the Company's employee benefit plans, including the Company's stock option plans, if any. See also Share Ownership Stock Option Plan .

Special Committee

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

Directors and Executive Officers of Yuchai

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

Yuchai's board of directors.

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The directors and executive officers of Yuchai as of June 30, 2005 are identified below.

Name	Position	Year First Elected or Appointed Director or Officer
	Chairman of the Board of Directors and Chief Executive Officer	1993
WANG Jianming		
GAO Jia Lin ⁽¹⁾	Deputy Chairman of the Board of Directors	1995
Raymond C.K. HO ⁽¹⁾	Director	2004
LI Tiansheng	General Manager and Director	2001
NEO Poh Kiat ⁽¹⁾	Director	2005
TAN Aik-Leang ⁽¹⁾	Director	2005
TEO Tong Kooi ⁽¹⁾	Director	2004
TING Sii Tien, Philip ⁽¹⁾	Director	2004
QIN Xiao Cong	Director	2003
SHAO Qihui	Director	2003
WONG Hong Ren ⁽¹⁾	Director	1993
YUAN Xu Cheng	Director	2003
ZENG Shiqiang	Assistant to Chairman and Director	1998
LIANG Weijian	Deputy General Manager	1992
LIM Poh Lea	Financial Controller	2004
SHEN Jie	Chief Engineer	2002
YANG Jianjun	Deputy General Manager	1997
YANG Weizhong	Chief Accountant	1992

(1) Also a Director of the Company.

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

Mr. Wang Jianming is the Chief Executive Officer and Chairman of the Board of Directors of Yuchai. Mr. Wang was the Chairman and a Director of Yuchai from 1994 to 2000 and the Chief Executive Officer of Yuchai from 1993 to 2000. Mr. Wang is also the legal personal representative of Yuchai, as well as the Vice-Chairman and legal representative of the State Holding Company. Mr. Wang has also previously served as a Director of the Company. Mr. Wang is a graduate of Shanghai Communications University.

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

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

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

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

Mr. Zeng Shiqiang is a Director of Yuchai and Assistant to the Chairman of the State Holding Company. He previously held the position of Chief Accountant at Yuchai.

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Mr. Liang Weijian serves as Deputy General Manager in charge of parts and supplies. Prior thereto, he served as Deputy Factory Manager of Yuchai and prior to that, he held the posts of Auto Branch Factory Manager, Technological Equipment Branch Factory Manager and General Engineering Office Director.

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

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

Mr. Yang Jianjun is the Deputy General Manager and is in charge of sales and marketing. Prior to joining Yuchai, he was Vice-Mayor of Yulin City.

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

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

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

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

Pursuant to Yuchai's Articles of Association, the Board of Directors of Yuchai consists of thirteen directors appointed for three-year terms. So long as the present ratio of Foreign Shares to the total number of State Shares and Legal Person Shares of Yuchai remains unchanged, a total of nine directors shall be elected from nominees of holders of Foreign Shares and a total of four directors shall be elected from nominees of holders of State Shares and Legal Person Shares. Actions generally may be taken by a majority vote of the directors present at a meeting at

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which a quorum is present. Attendance of at least seven directors (at least four representing holders of Foreign Shares and at least three representing holders of State Shares or Legal Person Shares) constitutes a quorum.

The Company is entitled under Yuchai's Articles of Association to elect nine of Yuchai's thirteen directors, thereby entitling it to effect all major decisions relating to Yuchai. As part of the terms of the Reorganization Agreement, Yuchai affirmed the continued rights of the Company, as Yuchai's majority shareholder, to direct the management and policies of Yuchai through Yuchai's board of directors. A two-thirds vote of the outstanding shares at a shareholders meeting at which a quorum is present is required for major corporate actions, such as an amendment to Yuchai's Articles of Association, significant sales or purchases of assets or a division, merger, acquisition or liquidation of Yuchai, or issuances of new common shares or other securities of Yuchai. Attendance of shareholders representing at least two-thirds of the outstanding Yuchai shares constitutes a quorum for shareholder meetings considering such major corporate actions.

However, although the Company's nominees constitute a majority of the Board of Directors of Yuchai, there have on various occasions in the past been periods of time when no board meetings have been held, despite Yuchai's Articles of Association requiring the Board of Directors to meet at least once every six months as well as repeated requests by the Company. Prior to execution of the Reorganization Agreement, Yuchai's Articles of Association contained stringent quorum provisions, which required that, three of the four directors elected by holders of State Shares or Legal Person Shares had to attend, in order for quorum to be achieved, and as a result Board of Directors meetings to be held. However, subsequent to execution of the Reorganization Agreement, these quorum requirements have been amended to permit a meeting to occur in circumstances in which a quorum for a Board of Directors meeting is not met on two occasions prior thereto.

Yuchai's management consists of a Chief Executive Officer, a General Manager and several Deputy General Managers, other senior officers designated by the board of directors and one senior manager designated by the Company. Yuchai's management handles daily operations and implements the corporate policies under the direction and guidance of the Board of Directors of the Company. In November 2003, Mr. Wang Jianming entered into a new contract of employment with Yuchai, pursuant to which he was appointed as Chief Executive Officer of Yuchai.

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

As a general matter, the Company requires access to certain financial books and records of Yuchai so as to be able to monitor its investment in Yuchai and to prepare the Company's consolidated financial statements. In early 2004, Yuchai management temporarily denied the Company such access. In response, the Company initiated dialogue with representatives of Yuchai and shortly thereafter agreed with Yuchai management to re-allow the Company full access to the financial books and records of Yuchai. Moreover, and as disclosed elsewhere in this Annual Report, the Company requires the cooperation of Yuchai and its Chinese shareholders and from time to time experiences certain problems in obtaining such cooperation. In response to such problems, the Company entered into dialogue with representatives of Yuchai and its Chinese shareholders and thereafter executed the Reorganization Agreement, which

the Company believes addresses these problems. As part of the terms of the Reorganization Agreement, Yuchai agreed that it would seek the requisite shareholder approval prior to entering into any material transactions (including any agreements or arrangements with parties related to Yuchai or any of its shareholders) and that it would comply with its governance requirements. However, no assurances can be given regarding implementation of the terms of the Reorganization Agreement (see also Item 3. Key Information Risk Factors Risks relating to our company and our business Our financial condition, results of operations, business and prospects may be adversely affected if we are unable to implement the Reorganization Agreement).

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Compensation

Company

For 2004, HLA charged Yuchai a management fee of US\$500,000 for management services, including the services of the Company's President and Chairman and the Company's Chief Financial Officer each of whom are employees of HLA. The Company paid an annual service fee in 2004 of US\$50,000 and US\$30,000 to each of the Company's independent and non-independent directors, respectively, and US\$20,000 to each of the Company's principal officers. See Item 7. Major Shareholders and Related Party Transactions .

Yuchai

The aggregate amount of compensation paid by Yuchai to all directors and executive officers of Yuchai during 2004 was approximately Rmb 26.6 million (US\$3.2 million). Yuchai has a management bonus plan for its executive, mid-level and junior officers under which annual incentive bonuses in an aggregate amount equal to 5.5% (3.5% for executive officers (allocated as 2.5% for the Chief Executive Officer and 1.0% for other executive officers) and 2.0% for mid-level and junior officers and employees) of Yuchai's after-tax profit must be paid if Yuchai achieves the after-tax profit approved in the annual budget by Yuchai's board of directors or, in the case of certain bonuses, if Yuchai achieves 80.0% of such budgeted after-tax profit. In addition, Yuchai's officers participate in an incentive pay program which is available to all employees and is based on performance and productivity.

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

Pursuant to an Employment Agreement, Yuchai appointed Mr. Wang Jianming as Chief Executive Officer of Yuchai for a term of six years beginning in September 2003, pursuant to which Yuchai has agreed to pay Mr. Wang a monthly base salary of Rmb 40,000 and an incentive bonus based on the sales and net after tax profit of Yuchai, as well as other performance criteria.

Employees

As of December 31, 2004, Yuchai employed approximately 7,153 people nationwide, inclusive of a sales force of 558 employees. Yuchai provides its employees with a fixed base salary and a bonus that is determined by the employees' performance and productivity. Yuchai also provides its employees with housing and meal subsidies and medical insurance. In the year ended December 31, 2004, the average annual base salary and bonus of an employee was approximately Rmb 58,000 (US\$7,008), an increase of approximately 26.0% from the previous year. Yuchai has not experienced any strikes or similar significant work stoppages. Yuchai believes that its employee relations are good.

Share Ownership

Stock Option Plan

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

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The following table sets forth certain information regarding beneficial ownership of the Company's shares of Common Stock as of June 30, 2005 by all persons who are known to the Company to own five percent (5%) or more of the outstanding shares of Common Stock.

Beneficial ownership is determined in accordance with rules of the SEC, which generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities and includes equity shares issuable pursuant to the exercise of stock options or warrants that are immediately exercisable or exercisable within 60 days of June 30, 2005. These shares are deemed to be outstanding and to be beneficially owned by the person holding those options or warrants for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated, all information with respect to the beneficial ownership of any principal shareholder has been furnished by such shareholder and, unless otherwise indicated, we believe that persons named in the table have sole voting and sole investment power with respect to all the equity shares shown as beneficially owned. The share numbers and percentages listed below are based on 37,267,673 common shares outstanding as of June 30, 2005.

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

- (1) Information based upon a report on Schedule 13D jointly filed by HLA and its wholly-owned subsidiaries, HLC, HLT, Flite Technology Industries Pte Ltd and Lydale Pte Ltd, with the SEC on July 19, 2002, as amended on September 10, 2003, October 7, 2003, October 15, 2003 and December 1, 2003, and other information provided by HLA to the Company.
- (2) Information based on a report on Schedule 13D filed by Coomber, Goldman, Zhong Lin and the State Holding Company, with the SEC on December 16, 2002, as amended on June 23, 2003, July 9, 2003, December 23, 2003, March 15, 2004, February 15, 2005 and April 18, 2005. Based on Amendment No. 4 to the Schedule 13D filed by Coomber and others with the SEC on December 23, 2003, Coomber is a wholly-owned subsidiary of Goldman, which is indirectly owned and controlled by Yulin City Municipal Government, or Yulin City Government, in Guangxi Zhuang Autonomous Region, PRC. Accordingly, the Yulin City Government is the ultimate beneficial owner of the 8,601,550 shares of the Company's Common Stock held of record by Coomber. Coomber has advised the Company of the following information. Coomber has entered into forward sale agreements with a financial institution as a counterparty, with respect to a total of 1,900,000 shares of the Company's Common Stock. On the respective settlement dates of these forward sales agreements, Coomber will have the option to settle the forward sales by delivery of cash or the Company's Common Stock. The counterparty may borrow the pledged shares from Coomber in connection with that party's hedging of its exposure under the forward sale arrangements. Coomber will temporarily cease to have voting rights with respect to any common stock borrowed by the counterparty but will reacquire such voting rights when the counterparty returns the borrowed shares to Coomber. In the event Coomber elects to settle the forward sale agreement or agreements entirely by delivering shares of the Company's Common Stock, its beneficial ownership of the Company's Common Stock could,

depending on the number of shares of the Company's Common Stock delivered, decrease to 6,701,550 shares, or approximately 19.0% of the Company's Common Stock, or to 4,601,550 shares, or approximately 13.0% of the Company's Common Stock, if it sells 2,100,000 shares pursuant to the Company's prospectus dated March 24, 2004.

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(3) Information based on a report on Schedule 13G jointly filed by Tai Tak Industries Pte Ltd and its affiliate, Tai Tak Securities Pte Ltd, with the SEC on March 7, 2005 and as amended on June 20, 2005.

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

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

As of the record date on June 13, 2005, there were 22,104,196 shares of Common Stock, or 59.3% shares of Common Stock, held of record by 50 persons with registered addresses in the United States.

The Special Share

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

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

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Share in addition to 7,831,169 shares of Common Stock, which is greater than the number stipulated in the provisions of the Company's Bye-Laws set forth above.

Related Party Transactions

Shareholders Agreement

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

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

Registration Rights Agreement

Pursuant to a Registration Rights Agreement (the "Registration Rights Agreement"), the Company has granted two demand registration rights to each of HLC, China Everbright, Cathay, GSCP and the Sun Yuan Shareholders (the "Selling Stockholders") requiring the Company, subject to certain conditions, to use its best efforts to prepare and file a registration statement on behalf of such shareholder under the Securities Act and to use its best efforts to qualify the

shares for offer and sale under any applicable U.S. state securities laws. Expenses incurred in connection with one demand registration for each such shareholder will be borne by the Company, and the Company and Yuchai will be required to indemnify the underwriters in connection with any demand registration. The Registration Rights Agreement also grants each such shareholder certain piggyback registration rights entitling each shareholder to sell Common Stock in any registered offerings of equity securities of the Company, for the account of

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the Company or on behalf of its security holders. China Everbright, Cathay, GSCP and the Sun Yuan shareholders are no longer shareholders of the Company.

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

Reorganization Agreement

On April 7, 2005, the Company entered into the Reorganization Agreement with Yuchai and Coomber, which is intended to be in furtherance of the terms of the July 2003 Agreement. See Item 4. Information on the Company Recent Developments.

Other Transactions

During each of 2002, 2003 and 2004, HLA charged Yuchai a management fee of US\$500,000 per annum for management, financial planning and control and other services, including the services of the Company's President and Chairman and its Chief Financial Officer, each of whom are employees of HLA. Such charges represent HLA's estimated direct costs of providing these services.

During each of 2002, 2003 and 2004, the State Holding Company charged Yuchai Rmb 24.2 million, Rmb 30.6 million and Rmb 21.2 million (US\$2.6 million) for certain general and administrative expenses on an actually incurred basis. The Company believes that the expenses charged to Yuchai by the State Holding Company would not have been materially different on a stand-alone basis because Yuchai could provide these services for itself at approximately the same cost.

During 2004, Yuchai granted a loan of Rmb 205.0 million to YMC, a subsidiary of Coomber, with an interest rate of interest of 5.58% for one year. This loan has been subsequently partly capitalized by Yuchai following execution of the Reorganization Agreement (see Note 23 to the Company's Consolidated Financial Statements included elsewhere therein).

The Company has undertaken other significant business transactions with related parties during the three years ended December 31, 2004, as set forth under Note 25 to the Company's Consolidated Financial Statements.

ITEM 8. FINANCIAL INFORMATION.

Consolidated Financial Statements

See Item 18. Financial Statements.

Legal Proceedings

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

Proceedings with Yuchai

The Company has from time to time encountered difficulties in obtaining the cooperation of the State Holding Company and Mr. Wang Jianming in the daily management and operation of Yuchai. The State Holding Company is a minority shareholder of Yuchai and is wholly-owned by the municipal government of Yulin City in the Guangxi Zhuang Autonomous Region. Mr. Wang is the Chairman, legal representative and Chief Executive Officer of Yuchai, as well as the Vice-Chairman and legal representative of the State Holding Company. In response to earlier difficulties with respect to corporate governance measures and certain dividends declared by Yuchai, the Company initiated legal and arbitration proceedings in New York, London and Singapore against Yuchai, Mr. Wang and other related parties in May 2003.

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

In April 2005, the Company, Yuchai and Coomber agreed steps relating to the adoption of corporate governance practices at Yuchai and a broad framework for the restructuring of the Company's ownership of Yuchai, and entered into the Reorganization Agreement. The Reorganization Agreement is intended to be in furtherance of the July 2003 Agreement. See Item 4. Information on the Company's Recent Developments and Note 23 to the Company's Consolidated Financial Statements for a detailed summary. Although the parties to the Reorganization Agreement expect to work towards its implementation as expeditiously as possible, no assurance can be given as to when the transactions contemplated therein will be consummated, or that implementation of the Reorganization Agreement will effectively resolve all of the difficulties faced by the Company with respect to its investment in Yuchai.

Other Legal Proceedings

Yuchai is involved in legal proceedings instituted by the Yulin Road Bureau against Yuchai and Nanning Hengji, an unrelated third party. In these proceedings, the Yulin Road Bureau has sought payment of Rmb 7.3 million (US\$0.9 million) from Yuchai and Nanning Hengji, as the construction cost of a road built by Yulin Road Bureau near Yuchai's factory. At trial, a Yulin court ordered Yuchai and Nanning Hengji to pay Rmb 4.6 million (US\$0.6 million) to the Yulin Road Bureau. Yuchai appealed this decision to a Guangxi court and Yuchai won this appeal. The Yulin Road Bureau subsequently further appealed and won. A retrial of this case has been ordered by the courts. A date for the retrial has not yet been fixed. The Company has previously recorded a provision of Rmb 4.6 million (US\$555,000) as at 31 December 2003 which was included in Accrued expense and other liabilities in the Company's Consolidated Financial Statements. The Company has retained this provision as at December 31, 2004, as such amount represents the Company's best estimate at the probable loss.

In 2003, the Yulin Branch of Bank of China (BOC) initiated legal proceedings to recover Rmb 6.6 million (US\$0.8 million) from Yuchai based on an irrevocable letter of guarantee issued by Yuchai to BOC in 1993 to secure a loan of US\$0.6 million to Great Wall Machinery Plant (Great Wall). At trial, a Yulin court ruled that if Great Wall could not repay the loan Yuchai would be liable to the BOC. Yuchai subsequently appealed, but lost the appeal. In January 2004, the State Holding Company issued a letter of commitment confirming that it would reimburse Yuchai in the event that Yuchai was required to pay on this guarantee. Based on the advice of its Chinese legal counsel, the Company has recorded a loss contingency equal to the amount of the claim, which has been offset by amounts to be reimbursed by the State Holding Company. The amount due to BOC and the amount due from State Holding Company have been recorded in Accrued expenses and other liabilities and Amounts due from related companies, respectively, as at December 31, 2003 and 2004.

See also Note 22 to the Company's Consolidated Financial Statements included elsewhere herein for a description of other legal claims which Yuchai is involved in.

Table of Contents**Policy on Dividend Distributions**

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

Chinese laws and regulations applicable to a Sino-foreign joint stock company require that before Yuchai distributes profits, it must: (i) satisfy all tax liabilities; (ii) recover losses in previous years; and (iii) make contributions to certain statutory reserves in an amount equal to at least 15% of net income for the year determined in accordance with PRC GAAP.

Any determination by Yuchai to declare a dividend will be at the discretion of Yuchai's shareholders and will be dependent upon Yuchai's financial condition, results of operations and other relevant factors. Yuchai's Articles of Association provide that dividends may be paid once a year. To the extent Yuchai has foreign currency available, dividends declared by shareholders at a shareholders' meeting to be paid to holders of Foreign Shares (currently only the Company) will be payable in foreign currency, and such shareholders will have priority thereto. If the foreign currency available is insufficient to pay such dividends, such dividends may be payable partly in Renminbi and partly in foreign currency. Dividends allocated to holders of Foreign Shares may be remitted in accordance with the relevant Chinese laws and regulations. In the event that the dividends are distributed in Renminbi, such dividends may be converted into foreign currency and remitted in accordance with the relevant Chinese laws, regulations and policies.

ITEM 9. THE OFFER AND LISTING.

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

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

	Period	US\$ High	US\$ Low
	1999	2.875	0.375
	2000	2.000	0.875
	2001	1.150	0.300
	2002	5.95	0.95
	2003	37.24	4.45
	2004	34.00	9.85
	2005 (through June 30, 2005)	13.89	7.12

	Period	US\$ High	US\$ Low
	2002 First Quarter	1.800	0.950
	2002 Second Quarter	3.45	1.60
	2002 Third Quarter	3.60	2.55
	2002 Fourth Quarter	5.95	3.35
	2003 First Quarter	7.10	4.45
	2003 Second Quarter	9.20	5.60

2003 Third Quarter	19.30	6.59
2003 Fourth Quarter	37.24	17.00
2004 First Quarter	32.22	18.53
2004 Second Quarter	22.79	15.80

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	Period	US\$ High	US\$ Low
	2004 Third Quarter	18.75	9.85
	2004 Fourth Quarter	18.46	12.65
	2005 First Quarter	13.55	8.13
	2005 Second Quarter	13.89	7.12

	Period	US\$ High	US\$ Low
	December 2004	18.46	12.65
	January 2005	13.55	9.29
	February 2005	12.48	10.17
	March 2005	11.49	8.13
	April 2005	12.41	7.02
	May 2005	13.80	10.02
	June 2005	13.89	12.14

ITEM 10. ADDITIONAL INFORMATION.

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

Memorandum of Association and Bye-Laws**Corporate Governance**

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

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

practices and those followed by U.S. companies.

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

Standard for U.S. Domestic Listed Companies

China Yuchai International Limited's Practice

Director Independence

A majority of the board must consist of independent directors.

Three of the Company's nine directors, Messrs. Raymond C. K. Ho, Neo Poh Kiat, Tan Aik-Leang, are independent within the meaning of the NYSE standards.

Independence is defined by various criteria including the absence of a material relationship between the director and the listed company. Directors who are employees, are immediate family of the chief executive officer or receive over \$100,000 per year in direct compensation from the listed company are not independent. Directors who are employees of or otherwise affiliated through immediate family with the listed company's independent auditor are also not independent.

The non-management directors of each company must meet at regularly scheduled executive sessions without management.

The Company's non-management directors do not meet periodically without management directors.

Audit Committee

Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Securities Exchange Act. The rule requires that the audit committee (i) be comprised entirely of independent directors; (ii) be directly responsible for the appointment, compensation and oversight of the independent auditor; (iii) adopt procedures for the receipt and treatment of complaints with respect to accounting and auditing issues; (iv) be authorized to engage independent counsel and other advisors it deems necessary in performing its duties; and (v) be given sufficient funding by the board of directors to compensate the independent auditors and other advisors as well as for the payment of ordinary administrative expenses incurred by the committee.

The Company's audit committee meets the requirements of Rule 10A-3 under the Securities Exchange Act.

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Standard for U.S. Domestic Listed Companies

The audit committee must consist of at least three members, and each member must be independent within the meaning established by the NYSE.

The Company's audit committee has a written charter that addresses the committee's purpose and responsibilities.

At a minimum, the committee's purpose must be to assist the board in the oversight of the integrity of the company's financial statements, the company's compliance with legal and regulatory requirements, the independent auditor's qualifications and independence and the performance of the company's internal audit function and independent auditors.

The audit committee is also required to review the independent auditing firm's annual report, describing the firm's internal quality control procedures, any material issues raised by the most recent internal quality control review or peer review of the firm and any steps taken to address such issues. The audit committee is also to assess the auditor's independence by reviewing all relationships between the company and its auditor. It must establish the company's hiring guidelines for employees and former employees of the independent auditor.

The committee must also discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditors, the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies, and policies with respect to risk assessment and risk management. It must also meet periodically with the internal auditors and the board of directors.

Each listed company must have disclosed whether their board of directors has identified an Audit Committee Financial Expert, and if not the reasons why the board has not done so.

Each listed company must have an internal audit function.

China Yuchai International Limited's Practice

The Company's audit committee consists of three members, each of whom is independent within the meaning established by the NYSE.

The audit committee must have a charter outlining the committee's purpose and responsibilities, which are similar in scope to those required of U.S. companies.

The Board of Directors has identified Mr. Tan Aik-Leang as the Company's Audit Committee Financial Expert.

The Company's internal audit function is provided by HLA.

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Standard for U.S. Domestic Listed Companies

China Yuchai International Limited's Practice

Compensation Committee

Listed companies must have a compensation committee composed entirely of independent board members as defined by the NYSE listing standards.

The Company's compensation committee has two members, neither of whom are independent within the meaning of the NYSE standards.

The committee must have a written charter that addresses its purpose and responsibilities.

These responsibilities include (i) reviewing and approving corporate goals and objectives relevant to CEO compensation; (ii) evaluating CEO performance and compensation in light of such goals and objectives for the CEO; (iii) based on such evaluation, reviewing and approving CEO compensation levels; (iv) recommending to the board non-CEO compensation, incentive compensation plans and equity-based plans; and (v) producing a report on executive compensation as required by the Securities and Exchange Commission to be included in the company's annual proxy statement or annual report. The committee must also conduct an annual performance self-evaluation.

The Company's compensation committee reviews among other things the Company's general compensation structure, and reviews, recommends or approves executive appointments, compensation and benefits of directors and executive officers, subject to ratification by the Board of Directors, and supervises the administration of the Company's employee benefit plans, if any.

Nominating/Corporate Governance Committee

Listed companies must have a nominating/corporate governance committee composed entirely of independent board members.

The Company does not have a nominating/corporate governance committee. However, certain responsibilities of this committee are undertaken by the Compensation Committee of the Company, such as the review and approval of executive appointments.

The committee must have a written charter that addresses its purpose and responsibilities, which include (i) identifying qualified individuals to become board member; (ii) selecting, or recommending that the board select, the director nominees for the next annual meeting of shareholders; (iii) developing and recommending to the board a set of corporate governance principles applicable to the company; (iv) overseeing the evaluation of the board and management; and (v) conducting an annual performance evaluation of the committee.

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Standard for U.S. Domestic Listed Companies

China Yuchai International Limited's Practice

Equity-Compensation Plans

Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions.

The Company intends to have its shareholders approve equity-compensation plans.

Corporate Governance Guidelines

Listed companies must adopt and disclose corporate governance guidelines.

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

Code of Business Conduct and Ethics

All listed companies, U.S. and foreign, must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

The Company has adopted a Code of Business Conduct and Ethics Policy, a copy of which is available upon request from the Company.

Directors

Director Interests and Voting

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

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

which the Company is a beneficially wholly-owned subsidiary) to the third party, for which such Director has assumed responsibility in whole or in part under a guarantee or indemnity;

- (c) a resolution about an offer of shares, debentures or other securities of the Company or any of its subsidiaries (or a company of which the Company is a beneficially wholly-owned subsidiary) for subscription or purchase in which such Director is to be a participant in the underwriting or sub-underwriting of the offer;
- (d) a resolution about any proposal involving any other company in which such Director is interested, whether directly or indirectly and whether as an officer or shareholder or otherwise, provided that such Director is not the holder of, or directly or indirectly beneficially interested in, 5% or more of

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(i) any class of the equity share capital of such company or in any third company through which such Director's interest is derived or (ii) the voting rights in that company;

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

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

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

Remuneration and Pensions

The total fees paid to the Directors (other than Directors appointed to an executive office) for performing their services as Directors must not exceed US\$250,000 each year or such lesser amount as the Board of Directors of the Company may determine. The Directors may decide the way in which the total sum shall be divided among them, except that any Director holding office for less than the whole of the relevant period for which the fees are paid will only receive part of the amount in proportion to the amount of time he has been a Director. The shareholders of the Company may by ordinary resolution increase the amount of the fees payable to the Directors.

The Board of Directors of the Company may grant special remuneration to any Director who shall render any special or extra services to or at the request of the Company. Such special remuneration may be paid to such Director in addition to or in substitution for his ordinary remuneration as a Director and may be payable by way of a lump sum, participation in profits or as otherwise determined by the Board of Directors of the Company.

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

Borrowing Powers

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

Qualification of Directors

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

Rights of Holders of shares of Common Stock

The holders of shares of Common Stock shall:

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

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

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

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

Rights of Holder of the Special Share

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

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

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

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

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

Modification of Shareholders Rights

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

Annual General and Special General Meetings

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

notice shall specify the intention to propose the resolution as a special resolution.

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

Limitations on Rights to Own Securities

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

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

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

Exchange Controls

Bermuda Exchange Controls

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

The Company has received the permission of the Bermuda Monetary Authority under the Exchange Control Act of 1972 and regulations thereunder for the transfer of shares of Common Stock to and between persons regarded as resident outside Bermuda for exchange control purposes and the issue of shares within the existing authorized capital of the Company to such persons for so long as such shares are listed on the NYSE. Issues and transfers of shares involving any person regarded as resident in Bermuda for exchange control purposes require specific prior approval under the Exchange Control Act of 1972.

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

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China Exchange Controls

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

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

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

The value of the Renminbi is subject to changes in Chinese government policies and to international economic and political developments. During the few years prior to 1994, the Renminbi experienced a devaluation against most major currencies, and a devaluation of approximately 50% of the Renminbi against the U.S. dollar occurred on January 3, 1994 in connection with the adoption of the new unitary exchange rate system. Since 1994, the official exchange rate for the conversion of Renminbi to U.S. dollars has generally been stable, and the Renminbi has appreciated slightly against other currencies. Any future devaluation of the Renminbi would increase the effective cost to Yuchai of foreign manufactured equipment or components, and of satisfying any other foreign currency denominated liabilities. In addition, any such devaluation would reduce the U.S. dollar value of any dividends declared in Renminbi.

Taxation

Bermuda Taxation

There is no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by shareholders of the Company other than by shareholders ordinarily resident in Bermuda. Neither the Company nor its shareholders (other than shareholders ordinarily resident in Bermuda) are subject to stamp or other similar duty on the issue, transfer or redemption of Common Stock. The Company has

received from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act of 1966, as amended, an assurance that, in the event that Bermuda enacts any legislation imposing any tax computed on profits or income, or computed on any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, the imposition of such tax shall not be applicable to the Company or to any of its operations, shares,

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debentures or other obligations of the Company, until March 28, 2016. This assurance does not, however, prevent the imposition of any such tax or duty on such persons as are ordinarily resident in Bermuda and holding such shares, debentures or obligations of the Company or on land in Bermuda leased or let to the Company.

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

People's Republic of China Taxation

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

Taxation of Dividends from Yuchai

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

Taxation of Disposition of Yuchai Shares

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

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

Income Tax

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

Under the tax law and regulations described above, Yuchai is qualified for the reduced tax rate of 15%. As a Sino-foreign joint stock company, Yuchai was also exempt from Chinese income tax for the years 1994 and 1995 and was entitled to a 50% tax exemption for each of the years 1996 to 1998. In addition, Yuchai has obtained approval to extend the 50% tax exemption for three additional years from 1999 to 2001 based on its qualification as

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an advanced technology enterprise as defined under the relevant local tax law and regulations. However, based on current interpretations of the PRC income tax law, Yuchai will be subject to a minimum tax rate of 10% during this three-year extension. As a result, under current laws, Yuchai was subject to tax at a rate of 7.5% during the three years from 1996 through 1998 and a rate of 10% during the three years from 1999 through 2001. Since January 1, 2002, Yuchai is subject to tax at a rate of 15% so long as it continues to qualify as a foreign-invested enterprise eligible for such reduction.

Value-Added Tax

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

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

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

United States Federal Income Taxation

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

a financial institution,

a dealer in securities,

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

a tax-exempt organization,

an insurance company,

a person liable for alternative minimum tax,

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- a person that actually or constructively owns 10% or more of the voting stock of the Company,
- a person that holds shares as part of a straddle or a hedging or conversion transaction, or
- a person whose functional currency is not the U.S. dollar.

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

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

- a citizen or resident of the United States,
- a domestic corporation,
- an estate the income of which is subject to United States Federal income tax regardless of its source, or
- a trust, if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

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

Taxation of Dividends

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

With respect to noncorporate taxpayers for taxable years beginning before January 1, 2009, dividends may be taxed at the lower applicable capital gains rate provided that (1) the common stock is readily tradable on an established securities market in the United States, (2) the Company is not a passive foreign investment company (as discussed below) for either the Company's taxable year in which the dividend was paid or the preceding taxable year, and (3) certain holding period requirements are met. Common stock is considered for purposes of clause (1) above to be readily tradable on an established securities market if it is listed on the New York Stock Exchange. U.S. Holders should consult their tax advisors regarding the availability of the lower rate for dividends paid with respect to the Company's common stock.

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

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Taxation of Capital Gains

Subject to the PFIC rules discussed below, upon the sale or other disposition of shares, a U.S. Holder will recognize capital gain or loss for United States Federal income tax purposes equal to the difference between the U.S. Holder's amount realized and the U.S. Holder's tax basis, in such shares. If a U.S. Holder receives consideration for shares paid in a currency other than U.S. dollars, the U.S. Holder's amount realized will be the U.S. dollar value of the payment received. In general, the U.S. dollar value of such a payment will be determined on the date of receipt of the payment for cash basis taxpayers and on the date of disposition for accrual basis taxpayers. However, if the shares are treated as traded on an established securities market and the U.S. Holder is a cash basis taxpayer or an accrual basis taxpayer who has made a special election, the U.S. dollar value of the amount realized in a foreign currency is determined by translating the amount received at the spot rate of exchange on the settlement date of the sale. Capital gain of a non-corporate U.S. Holder is generally taxed at a reduced rate where the property is held more than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

PFIC Rules

The Company believes that its shares should not be treated as stock of a PFIC for United States Federal income tax purposes for the taxable year that ended on December 31, 2004. It is possible that the Company may become a PFIC in 2005, however, as a result of the implementation of the Reorganization Agreement. If the Company were to be treated as a PFIC for any year during the Holder's holding period, unless a U.S. Holder elects to be taxed annually on a mark-to-market basis with respect to the shares (which election may be made only if the Company's shares are marketable stock), a U.S. Holder will be subject to special tax rules with respect to any excess distribution received and any gain realized from a sale or other disposition (including a pledge) of that holder's shares. Distributions a U.S. Holder receives in a taxable year that are greater than 125% of the average annual distributions received during the shorter of the three preceding taxable years or the holder's holding period for the shares will be treated as excess distributions. Under these special tax rules:

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

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

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

The tax liability for amounts allocated to years prior to the year of disposition or excess distribution cannot be offset by any net operating losses for such years, and gains (but not losses) realized on the sale of the shares cannot be treated as capital, even if you hold the shares as capital assets.

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

Documents on Display

It is possible to read and copy documents referred to in this annual report on Form 20-F that have been filed with the SEC at the SEC's public reference room located at 450 Fifth Street, NW, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. Additional

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

Table of Contents**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.**

The Company is subject to market rate risks due to fluctuations in interest rates. The majority of the Company's debt is variable rate short-term and long-term Renminbi denominated loans obtained from banks in China. The interest rates of such loans are generally established in accordance with directives announced from time to time by the People's Bank of China, which are in turn affected by various factors such as the general economic conditions in China and the monetary policies of the Chinese government. There is no ready market in China for the Company to enter into interest rate swaps or other instruments designed to mitigate its exposure to interest rate risks.

The Company is exposed to foreign currency risk as a result of having to obtain certain key components used in the manufacturing of Yuchai's heavy-duty engines from overseas suppliers. At December 31, 2004, the Company did not have any loans that were denominated in a foreign currency.

The following table provides certain interest rate risk information regarding the Company's short-term and long-term bank loans as of December 31, 2003 and 2004:

	As of December 31, 2004			As of December 31, 2003		
	Expected maturity dates 2005	2006	Total carrying amount	Estimated fair value ⁽²⁾	Total carrying amount	Estimated fair value ⁽²⁾
(Expressed in Rmb thousands, except interest rate)						
Floating rate debt:						
(i) Short-term bank loans denominated in Rmb	430,000		430,000	430,000	240,000	240,000
Weighted average interest rate ⁽¹⁾	5.28%		5.28%		4.98%	
(ii) Long-term bank loans denominated in Rmb		100,000	100,000	100,000	50,000	50,000
Weighted average interest rate ⁽¹⁾		5.22%	5.22%		5.94%	

(1) Weighted average interest rate is calculated based on the estimated interest rates applicable to individual bank loans outstanding as of December 31, 2004 and 2003.

(2) Fair value was estimated based on the floating interest rates applicable to similar loan instruments.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.

Not Applicable.

PART II**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES.**

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

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

Not Applicable.

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ITEM 15. CONTROLS AND PROCEDURES.

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

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

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

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT.

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

ITEM 16B. CODE OF ETHICS.

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

ITEM 16C. PRINCIPAL ACCOUNTANTS FEES AND SERVICES.

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

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	Audit fees	Audit-related fees	Tax fees	Others	Total
	(Expressed in Rmb thousands)				
2003	2,830	689			3,519
2004	3,447	331			3,778
<i>Audit fees</i>					

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

Audit-related fees

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

Tax fees

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

Others

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

The Company's Audit Committee has pre-approved the terms of KPMG's engagement by the Company for services to be performed for the Company during 2005.

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

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

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

Not Applicable.

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PART III

ITEM 17. FINANCIAL STATEMENTS.

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

ITEM 18. FINANCIAL STATEMENTS.

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China Yuchai International Limited

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ITEM 19. EXHIBITS.

Exhibits to this Annual Report:

- 1.1 Memorandum of Association of China Yuchai International Limited (the Registrant) (incorporated herein by reference to the Registration Statement on Form F-1, filed by the Registrant on November 9, 1994 (File No. 33-86162) (the Form F-1)).
- 1.2 Bye-laws of the Registrant (incorporated herein by reference to the Form F-1).
- 3.1 Subscription and Shareholders' Agreement of Diesel Machinery (BVI) Limited, dated November 9, 1994, among Diesel Machinery (BVI) Limited, Hong Leong Asia Ltd. (HLA) and China Everbright Holdings Company Limited (EB Holdings) (incorporated herein by reference to the Form F-1).
- 3.2 Supplemental Subscription and Shareholders Agreement, dated January 21, 2002, between EB Holdings and HLA (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2001, filed by the Registrant on June 25, 2002 (the Form 20-F FY 2001)).
- 3.3 Second Supplemental Subscription and Shareholders Agreement, dated May 17, 2002, between EB Holdings and HLA (incorporated herein by reference to the Form 20-F FY 2001).
- 4.1 Contract for the Subscription of Foreign Common Shares in Guangxi Yuchai Machinery Company Limited (Yuchai) and Conversion from a Joint Stock Limited Company into a Sino-Foreign Joint Stock Limited Company, dated April 1, 1993, among Yuchai, Guangxi Yuchai Machinery Holdings Company, Hong Leong Technology Systems (BVI) Ltd., Cathay Clemente Diesel Holdings Limited, Goldman Sachs Guangxi Holdings (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd. and Youngstar Holdings Limited, with amendments, dated May 27, 1994 and October 10, 1994 (incorporated herein by reference to the Form F-1).

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

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- 4.3 Amended and Restated Shareholders Agreement, dated as of November 9, 1994 among the Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte. Ltd., Coomber Investments Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd., and the Registrant (incorporated herein by reference to the Form F-1).
- 4.4 Form of Amended and Restated Registration Right Agreement, dated as of November 9, 1994, among the Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte. Ltd., Coomber Investments Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd., and the Registrant (incorporated herein by reference to the Form F-1).
- 4.5 Form of Subscription Agreement between the Registrant, its wholly-owned subsidiaries named therein and Yuchai (incorporated herein by reference to the Form F-1).
- 4.6 Form of Term Loan Agreement between the Registrant and Yuchai (incorporated herein by reference to the Form F-1).
- 4.7 Share Purchase and Subscription Agreement, dated as of November 9, 1994, between (i) the Registrant, (ii) China Everbright Holdings Company Limited and (iii) Coomber Investments Limited (incorporated herein by reference to the Form F-1).
- 4.8 Investment and Shareholders Agreement between CACG Limited IV and Guangxi Yuchai Machinery Company Limited, dated July 14, 1994, with a First Amendment dated September 5, 1994 (incorporated herein by reference to the Form F-1).
- 4.9 Employment Agreement, dated September 5, 2003, between Yuchai and Wang Jianming (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2003, filed by the Registrant on June 29, 2004 (the Form 20-F FY 2003).
- 4.10 Form of indemnification agreement entered into by the Company with each of Wrixon Frank Gasteen, Gao Jia Lin, Gan Khai Choon, Raymond C. K. Ho, Kwek Leng Peck, Liu Chee Ming, Wong Hong Ren, Philip Ting Sii Tien, Lim Poh Lea, Sheila Murugasu, Teo Tong Kooi, Neo Poh Kiat and Tan Aik-Leang (incorporated herein by reference to the Form 20-F FY 2003).
- 4.11 Agreement between the Company and Yuchai, dated July 19, 2003 (incorporated herein by reference to the Form 20-F FY 2003).
- 4.12 Reorganization Agreement between the Company, Coomber and Yuchai, dated April 7, 2005 (incorporated herein by reference to the Form 6-K filed by the Company on April 7, 2005).
- 8.1 Subsidiaries of the Registrant.
- 12.1 Certifications furnished pursuant to Section 302 of the Sarbanes-Oxley Act.
- 13.1 Certifications furnished pursuant to Section 906 of the Sarbanes-Oxley Act.
- 14.1 Consent of Independent Registered Public Accounting Firm.
The Company has not included as exhibits certain instruments with respect to its long-term debt, the total amount of debt authorized under each of which does not exceed 10% of its total consolidated assets. The Company hereby agrees to furnish a copy of any such instrument to the SEC upon request.

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SIGNATURES

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

CHINA YUCHAI INTERNATIONAL LIMITED

By: /s/ Philip Ting Sii Tien

Name: Philip TING Sii Tien

Title: Chief Financial Officer and Director

Date: July 15, 2005

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Exhibit Index

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CHINA YUCHAI INTERNATIONAL LIMITED
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2002, 2003 and 2004
(With Report of Independent Registered Public Accounting Firm)

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REPORT OF INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
China Yuchai International Limited

We have audited the accompanying consolidated balance sheets of China Yuchai International Limited (the Company) and subsidiaries as of December 31, 2003 and 2004, and the related consolidated statements of income, stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2004, all expressed in Renminbi. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Yuchai International Limited and subsidiaries as of December 31, 2003 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004 in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements as of and for the year ended December 31, 2004 have been translated into United States dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Renminbi have been translated into United States dollars on the basis set forth in Note 3(i) to the consolidated financial statements.

/s/ KPMG

Certified Public Accountants
Hong Kong,
June 15, 2005

Table of Contents**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****FOR YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004***(Rmb and US\$ amounts expressed in thousands, except per share data)*

	<i>Note</i>	<i>Years ended December 31,</i>			
		<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2004</i>
		<i>Rmb</i>	<i>Rmb</i>	<i>Rmb</i>	<i>US\$</i>
Revenues, net ^(a)	3(k), 26, 31	3,513,047	4,569,950	5,582,095	674,451
Cost of goods sold ^(a)	4	2,371,080	3,192,794	4,006,886	484,128
Gross profit		1,141,967	1,377,156	1,575,209	190,323
Research and development cost	3(m)	75,532	94,594	136,960	16,549
Selling, general and administrative expense	3(m), 4, 12, 22, 25(b)	426,128	561,151	658,320	79,540
Operating income		640,307	721,411	779,929	94,234
Interest expense	3(t), 5	25,144	23,624	31,757	3,836
Other (income)/ expense, net	6	(10,287)	881	(5,682)	(686)
Income before income taxes and minority interests		625,450	696,906	753,854	91,084
Income tax expense	7	83,242	112,924	105,165	12,707
Income before minority interests		542,208	583,982	648,689	78,377
Minority interests in income of consolidated subsidiaries		(129,775)	(145,800)	(157,292)	(19,005)
Net income		412,433	438,182	491,397	59,372
Net earnings per common share					
Basic	3(l)	11.67	12.40	13.90	1.68
Weighted average number of shares	3(l)	35,340,000	35,340,000	35,340,000	35,340,000

See accompanying notes to consolidated financial statements.

Table of Contents**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****FOR YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004 (CONTINUED)***(Rmb and US\$ amounts expressed in thousands, except per share data)*

(a) Includes the following income and expenses resulting from transactions with related parties (see Note 25)

	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2004</i>
	Rmb	Rmb	Rmb	US\$
Revenues, net	2,601	24,957	4,537	548
Cost of goods sold				
Purchase of raw materials and supplies in connection with sales to external customers	65,353	93,056	142,829	17,257

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Table of Contents**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2003 AND 2004***(Rmb and US\$ amounts expressed in thousands, except per share data)*

		<i>December 31,</i>		
	<i>Note</i>	<i>2003</i>	<i>2004</i>	<i>2004</i>
		<i>Rmb</i>	<i>Rmb</i>	<i>US\$</i>
ASSETS				
Current assets				
Cash and cash equivalents		631,938	722,672	87,316
Trade accounts receivable, net	8	849,611	875,565	105,788
Amounts due from related companies	9, 25(d)	55,011	85,614	10,344
Loans to a related company	9, 25(d)		205,000	24,769
Inventories, net	10	877,334	1,346,545	162,695
Prepaid expenses		37,496	58,565	7,076
Other receivables, net	11	8,833	115,414	13,946
Deferred income tax	7	69,026	69,704	8,423
Total current assets		2,529,249	3,479,079	420,357
Property, plant and equipment, net	12	735,641	1,158,931	140,026
Construction in progress	13	397,644	379,035	45,797
Lease prepayments, net	14	78,216	74,767	9,034
Investments	15	5,705	7,053	852
Goodwill	16	212,636	212,636	25,692
Deferred income taxes	7	74,541	72,747	8,788
Total assets		4,033,632	5,384,248	650,546

LIABILITIES AND STOCKHOLDERS EQUITY**Current liabilities**

Short-term bank loans	17(a)	240,000	430,000	51,954
Current instalments of long-term bank loans	17(b)	50,000		
Amount due to the holding company	25(g)	6,208	4,143	501
Amounts due to related companies	9, 25(d)	25,617	42,686	5,157
Trade accounts payable		731,966	1,089,717	131,663
Income taxes payable	7	47,229	25,387	3,067
Accrued expense and other liabilities	18	396,399	484,920	58,590

Total current liabilities		1,497,419	2,076,853	250,932
Long-term bank loans, excluding current instalments	17(b)		100,000	12,083
Total liabilities carried forward		1,497,419	2,176,853	263,015

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Table of Contents**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2003 AND 2004 (CONTINUED)***(Rmb and US\$ amounts expressed in thousands, except per share data)*

	<i>Note</i>	<i>December 31,</i> 2003 Rmb	<i>December 31,</i> 2004 Rmb	<i>2004</i> US\$
Total liabilities brought forward		1,497,419	2,176,853	263,015
Minority interests		544,526	724,311	87,514
Stockholders equity				
Common stock		30,349	30,349	3,667
Ordinary shares US\$0.10 par value: authorized 100,000,000 shares; issued and outstanding 35,340,000 shares at December 31, 2003 and 2004				
Special share US\$0.10 par value: authorized 1 share; issued and outstanding 1 share at December 31, 2003 and 2004				
Contributed surplus		1,486,934	1,486,934	179,657
Statutory reserves	20	229,920	266,229	32,167
Retained earnings		244,484	699,572	84,526
Total stockholders equity		1,991,687	2,483,084	300,017
Commitments and contingencies	21,22			
Total liabilities and stockholders equity		4,033,632		