FMC TECHNOLOGIES INC
Form 10-Q
October 24, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2014
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 001-16489

FMC Technologies, Inc.
(Exact name of registrant as specified in its charter)

Delaware	36-4412642
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5875 N. Sam Houston Parkway W., Houston, Texas	77086
(Address of principal executive offices)	(Zip Code)

(281) 591-4000
(Registrant's telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer (Do not check if a smaller reporting company)	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 21, 2014

Common Stock, par value $0.01 per share	233,846,456

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains “forward-looking statements” intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact contained in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements usually relate to future events and anticipated revenues, earnings, cash flows or other aspects of our operations or operating results. Forward-looking statements are often identified by the words “believe,” “expect,” “anticipate,” “plan,” “intend,” “fores “should,” “would,” “could,” “may,” “estimate,” “outlook” and similar expressions, including the negative thereof. The absence these words, however, does not mean that the statements are not forward-looking. These forward-looking statements are based on our current expectations, beliefs and assumptions concerning future developments and business conditions and their potential effect on us. While management believes that these forward-looking statements are reasonable as and when made, there can be no assurance that future developments affecting us will be those that we anticipate.

All of our forward-looking statements involve risks and uncertainties (some of which are significant or beyond our control) and assumptions that could cause actual results to differ materially from our historical experience and our present expectations or projections. Known material factors that could cause actual results to differ materially from those contemplated in the forward-looking statements include those set forth in Part II, Item 1A, “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q and Part I, Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as well as the following:

- Demand for our systems and services, which is affected by changes in the price of, and demand for, crude oil and natural gas in domestic and international markets;
- Potential liabilities arising out of the installation or use of our systems;
- U.S. and international laws and regulations, including environmental regulations, that may increase our costs, limit the demand for our products and services or restrict our operations;
- Disruptions in the political, regulatory, economic and social conditions of the foreign countries in which we conduct business;
- Fluctuations in currency markets worldwide;
- Cost overruns that may affect profit realized on our fixed price contracts;
- Disruptions in the timely delivery of our backlog and its effect on our future sales, profitability and our relationships with our customers;
- The cumulative loss of major contracts or alliances;
- Rising costs and availability of raw materials;
- Our dependence on the continuing services of key managers and employees and our ability to attract, retain and motivate additional highly-skilled employees for the operation and expansion of our business;
- A failure of our information technology infrastructure or any significant breach of security;
- Our ability to develop and implement new technologies and services, as well as our ability to protect and maintain critical intellectual property assets;
- Deterioration in future expected profitability or cash flows and its effect on our goodwill;
- The outcome of uninsured claims and litigation against us; and
- Downgrade in the ratings of our debt could restrict our ability to access the debt capital markets.

We wish to caution you not to place undue reliance on any forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly update or revise any of our forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise, except to the extent required by law.

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PART I—FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
FMC TECHNOLOGIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions, except per share data)	2014	2013	2014	2013
Revenue:				
Product revenue	$1,559.0	$1,370.5	$4,598.5	$4,070.0
Service and other revenue	417.7	354.0	1,187.9	1,008.4
Total revenue	1,976.7	1,724.5	5,786.4	5,078.4
Costs and expenses:				
Cost of product revenue	1,198.9	1,106.6	3,545.3	3,280.8
Cost of service and other revenue	280.7	247.2	845.6	730.3
Selling, general and administrative expense	170.8	165.9	542.0	508.8
Research and development expense	29.9	27.2	84.6	84.9
Total costs and expenses	1,680.3	1,546.9	5,017.5	4,604.8
Gain on sale of Material Handling Products (Note 4)	(1.3)	—	84.3	—
Other income (expense), net	(26.5)	(0.2)	(29.2)	1.0
Income before net interest expense and income taxes	268.6	177.4	824.0	474.6
Net interest expense	(8.0)	(8.2)	(24.5)	(25.1)
Income before income taxes	260.6	169.2	799.5	449.5
Provision for income taxes	90.1	51.8	264.8	122.0
Net income	170.5	117.4	534.7	327.5
Net income attributable to noncontrolling interests	(0.7)	(1.4)	(3.4)	(3.9)
Net income attributable to FMC Technologies, Inc.	$169.8	$116.0	$531.3	$323.6
Earnings per share attributable to FMC Technologies, Inc. (Note 3):				
Basic	$0.72	$0.49	$2.24	$1.36
Diluted	$0.72	$0.49	$2.24	$1.35
Weighted average shares outstanding (Note 3):				
Basic	236.4	238.2	236.8	238.4
Diluted	237.0	238.9	237.3	239.2

The accompanying notes are an integral part of the condensed consolidated financial statements.

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FMC TECHNOLOGIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2014	2013	2014	2013
Net income	$170.5	$117.4	$534.7	$327.5
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments [1]	(60.8)	8.9	(44.4)	(70.1)
Net gains (losses) on hedging instruments:				
Net gains (losses) arising during the period	(40.7)	23.3	(49.1)	17.1
Reclassification adjustment for net losses (gains) included in net income	2.0	(0.6)	(4.9)	(1.7)
Net gains (losses) on hedging instruments [2]	(38.7)	22.7	(54.0)	15.4
Pension and other post-retirement benefits:				
Reclassification adjustment for amortization of prior service credit included in net income	—	(0.1)	(0.1)	(0.3)
Reclassification adjustment for amortization of net actuarial loss included in net income	3.1	5.1	9.1	15.3
Net pension and other post-retirement benefits [3]	3.1	5.0	9.0	15.0
Other comprehensive income (loss), net of tax	(96.4)	36.6	(89.4)	(39.7)
Comprehensive income	74.1	154.0	445.3	287.8
Comprehensive income attributable to noncontrolling interest	(0.7)	(1.4)	(3.4)	(3.9)
Comprehensive income attributable to FMC Technologies, Inc.	$73.4	$152.6	$441.9	$283.9

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(1) Net of income tax (expense) benefit of $5.5 and $(0.8) for the three months ended September 30, 2014 and 2013, respectively, and $4.3 and $1.2 for the nine months ended September 30, 2014 and 2013, respectively.

(2) Net of income tax (expense) benefit of $9.9 and $(11.2) for the three months ended September 30, 2014 and 2013, respectively, and $9.0 and $2.8 for the nine months ended September 30, 2014 and 2013, respectively.

(3) Net of income tax (expense) benefit of $(1.4) and $(2.7) for the three months ended September 30, 2014 and 2013, respectively, and $(4.8) and $(8.1) for the nine months ended September 30, 2014 and 2013, respectively.

The accompanying notes are an integral part of the condensed consolidated financial statements.

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FMC TECHNOLOGIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except par value data)	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and cash equivalents	$511.5	$399.1
Trade receivables, net of allowances of $9.4 in 2014 and $7.4 in 2013	2,268.8	2,067.2
Inventories, net (Note 5)	1,046.1	980.4
Derivative financial instruments (Note 12)	125.8	165.9
Prepaid expenses	64.8	41.5
Deferred income taxes	55.0	59.1
Other current assets	331.4	309.8
Total current assets	4,403.4	4,023.0
Investments	38.3	44.3
Property, plant and equipment, net of accumulated depreciation of $835.9 in 2014 and $770.2 in 2013	1,447.0	1,349.1
Goodwill	566.2	580.7
Intangible assets, net of accumulated amortization of $114.4 in 2014 and $97.3 in 2013	292.9	315.3
Deferred income taxes	37.7	36.9
Derivative financial instruments (Note 12)	41.8	68.5
Other assets	207.1	187.8
Total assets	$7,034.4	$6,605.6
Liabilities and equity		
Short-term debt and current portion of long-term debt	$10.0	$42.5
Accounts payable, trade	707.8	750.7
Advance payments and progress billings	1,036.6	803.2
Accrued payroll	257.0	222.0
Derivative financial instruments (Note 12)	136.0	171.3
Income taxes payable	95.3	138.1
Deferred income taxes	73.5	66.4
Other current liabilities	381.9	420.5
Total current liabilities	2,698.1	2,614.7
Long-term debt, less current portion (Note 6)	1,337.0	1,329.8
Accrued pension and other post-retirement benefits, less current portion	79.2	84.0
Derivative financial instruments (Note 12)	67.9	47.1
Deferred income taxes	75.7	90.3
Other liabilities	102.9	103.4
Commitments and contingent liabilities (Note 14)		
Stockholders' equity (Note 11):		
Preferred stock, $0.01 par value, 12.0 shares authorized in 2014 and 2013; no shares issued in 2014 or 2013	—	—
Common stock, $0.01 par value, 600.0 shares authorized in 2014 and 2013; 286.3 shares issued in 2014 and 2013; 233.9 and 235.8 shares outstanding in 2014 and 2013, respectively	2.9	2.9
Common stock held in employee benefit trust, at cost; 0.2 shares in 2014 and 2013	(9.2)	(7.7)
Treasury stock, at cost; 52.2 and 50.3 shares in 2014 and 2013, respectively	(1,313.2)	(1,196.6)

Capital in excess of par value of common stock	727.4	713.2
Retained earnings	3,675.7	3,146.1
Accumulated other comprehensive loss	(430.1)	(340.7)
Total FMC Technologies, Inc. stockholders' equity	2,653.5	2,317.2
Noncontrolling interests	20.1	19.1
Total equity	2,673.6	2,336.3
Total liabilities and equity	$7,034.4	$6,605.6

The accompanying notes are an integral part of the condensed consolidated financial statements.

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FMC TECHNOLOGIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)	Nine Months Ended September 30, 2014	2013
Cash provided (required) by operating activities:		
Net income	$534.7	$327.5
Adjustments to reconcile net income to cash provided (required) by operating activities:		
Depreciation	129.5	117.4
Amortization	43.9	35.6
Employee benefit plan and stock-based compensation costs	53.1	71.9
Deferred income tax provision	7.0	69.2
Unrealized loss on derivative instruments	31.8	3.7
Gain on sale of Material Handling Products	(84.3)	—
Other	14.4	24.3
Changes in operating assets and liabilities, net of effects of acquisitions:		
Trade receivables, net	(276.2)	(218.3)
Inventories, net	(105.4)	(104.1)
Accounts payable, trade	(13.4)	4.0
Advance payments and progress billings	253.1	311.0
Income taxes	(53.2)	(58.0)
Payment of Multi Phase Meters earn-out consideration	(41.5)	(32.2)
Accrued pension and other post-retirement benefits, net	(27.3)	(53.2)
Other assets and liabilities, net	17.1	(73.6)
Cash provided by operating activities	483.3	425.2
Cash provided (required) by investing activities:		
Capital expenditures	(283.7)	(237.5)
Proceeds from sale of Material Handling Products, net of cash divested	105.6	—
Other	8.9	2.3
Cash required by investing activities	(169.2)	(235.2)
Cash provided (required) by financing activities:		
Net increase (decrease) in short-term debt	(25.3)	2.2
Net increase in commercial paper	6.6	41.0
Repayments of long-term debt	(1.9)	(136.0)
Purchase of treasury stock	(129.8)	(70.8)
Payment of Multi Phase Meters earn-out consideration	(31.0)	(25.1)
Payments related to taxes withheld on stock-based compensation	(13.0)	(17.2)
Excess tax benefits	2.2	7.7
Other	(3.7)	27.9
Cash required by financing activities	(195.9)	(170.3)
Effect of exchange rate changes on cash and cash equivalents	(5.8)	(1.6)
Increase in cash and cash equivalents	112.4	18.1
Cash and cash equivalents, beginning of period	399.1	342.1
Cash and cash equivalents, end of period	$511.5	$360.2

The accompanying notes are an integral part of the condensed consolidated financial statements.

FMC TECHNOLOGIES, INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
NOTE 1. BASIS OF PRESENTATION
The accompanying unaudited condensed consolidated financial statements of FMC Technologies, Inc. and its consolidated subsidiaries ("FMC Technologies") have been prepared in accordance with United States generally accepted accounting principles ("GAAP") and rules and regulations of the Securities and Exchange Commission ("SEC") pertaining to interim financial information. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP have been condensed or omitted. Therefore, these statements should be read in conjunction with the audited consolidated financial statements, and notes thereto, which are included in our Annual Report on Form 10-K for the year ended December 31, 2013.
On February 25, 2011, our Board of Directors approved a stock split of our outstanding shares of common stock. The stock split was completed in the form of a stock dividend; however, upon issuance of the common stock pursuant to the stock split, an amount equal to the aggregate par value of the additional shares of common stock issued was not reclassified from capital in excess of par value to common stock during the first quarter of 2011. This adjustment was made during the first quarter of 2014. All prior-year amounts have been revised to conform to the current year presentation. This adjustment had no overall effect on total equity and did not impact our overall financial position or results of operations for any period presented.
On April 10, 2012, we executed an intercompany foreign currency transaction in the form of a loan from one subsidiary to another. The loan is considered a long-term investment subject to the foreign currency remeasurement exception under GAAP; however, the interest receivable on the lending subsidiary's financial statements subject to foreign currency remeasurement was inadvertently recorded with the related intercompany loan and was not remeasured using current foreign currency exchange rates at each quarterly period and recorded in income. Additionally, intercompany interest penalties and related income tax benefits were not recorded by the borrowing subsidiary when such penalties were incurred. As a result, the effect of the correction during the three months ended September 30, 2014 was an $8.1 million, or $0.03 per diluted share, reduction to net income.
Our accounting policies are in accordance with GAAP. The preparation of financial statements in conformity with these accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Ultimate results could differ from our estimates.
In the opinion of management, the statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of our financial condition and operating results as of and for the periods presented. Revenue, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these statements may not be representative of the results that may be expected for the year ending December 31, 2014.
NOTE 2. RECENTLY ADOPTED ACCOUNTING STANDARDS
Effective January 1, 2014, we adopted Accounting Standards Update ("ASU") No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" issued by the Financial Accounting Standards Board ("FASB"). This update requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the amended guidance, unrecognized tax benefits are netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the unrecognized tax benefits. The updated guidance is applied prospectively, effective January 1, 2014. The adoption of this update concerns presentation and disclosure only as it relates to our condensed consolidated financial statements.

Effective January 1, 2014, we adopted ASU No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" issued by the FASB. This update changes the requirements of reporting discontinued operations. Under the amended guidance, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The amendments in this update are effective for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years, with early adoption permitted. The adoption of this update concerns presentation and disclosure only as it relates to our condensed consolidated financial statements.

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NOTE 3. EARNINGS PER SHARE

A reconciliation of the number of shares used for the basic and diluted earnings per share calculation was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions, except per share data)	2014	2013	2014	2013
Net income attributable to FMC Technologies, Inc.	$169.8	$116.0	$531.3	$323.6
Weighted average number of shares outstanding	236.4	238.2	236.8	238.4
Dilutive effect of restricted stock units and stock options	0.6	0.7	0.5	0.8
Total shares and dilutive securities	237.0	238.9	237.3	239.2
Basic earnings per share attributable to FMC Technologies, Inc.	$0.72	$0.49	$2.24	$1.36
Diluted earnings per share attributable to FMC Technologies, Inc.	$0.72	$0.49	$2.24	$1.35

NOTE 4. SALE OF MATERIAL HANDLING PRODUCTS

On April 30, 2014, we completed the sale of our equity interests of Technisys, Inc., a Utah corporation, and FMC Technologies Energy Holdings Ltd., a private limited liability company organized under the laws of Hong Kong, and assets primarily representing a product line of our material handling business (“Material Handling Products”) to Syntron Material Handling, LLC, an affiliate of Levine Leichtman Capital Partners Private Capital Solutions II, L.P. Material Handling Products was historically reported in our Energy Infrastructure segment. Net of working capital adjustments, we recognized a pretax gain of $84.3 million on the sale during the nine months ended September 30, 2014.

NOTE 5. INVENTORIES

Inventories consisted of the following:

(In millions)	September 30, 2014	December 31, 2013
Raw materials	$ 190.6	$ 186.3
Work in process	193.3	141.4
Finished goods	860.5	830.3
	1,244.4	1,158.0
LIFO and valuation adjustments	(198.3)	(177.6)
Inventories, net	$ 1,046.1	$ 980.4

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NOTE 6. DEBT

In September 2004, we entered into agreements for the sale and leaseback of an office building having a net book value of $8.5 million. Under the terms of the agreement, the building was sold for $9.7 million in net proceeds and leased back to us under a 10-year lease. We subleased this property to a third party under a lease agreement that was accounted for as an operating lease. We accounted for the transaction as a financing transaction and amortized the related obligation using an effective annual interest rate of 5.37%. In September 2014, the sale and leaseback expired and resulted in an immaterial noncash gain.

Long-term debt consisted of the following:

(In millions)	September 30, 2014	December 31, 2013
Commercial paper [1]	$ 508.0	$ 501.4
2.00% Notes due 2017	299.6	299.5
3.45% Notes due 2022	499.7	499.6
Term loan	24.7	25.9
Property financing	8.9	13.9
Total long-term debt	1,340.9	1,340.3
Less: current portion	(3.9)	(10.5)
Long-term debt, less current portion	$ 1,337.0	$ 1,329.8

(1) Committed credit available under our revolving credit facility provided the ability to refinance our commercial paper obligations on a long-term basis. As we have both the ability and intent to refinance these obligations on a long-term basis, our commercial paper borrowings were classified as long-term in the condensed consolidated balance sheets at September 30, 2014 and December 31, 2013. As of September 30, 2014, our commercial paper borrowings had a weighted average interest rate of 0.30%.

NOTE 7. INCOME TAXES

Our income tax provisions for the three months ended September 30, 2014 and 2013, reflected effective tax rates of 34.7% and 30.9%, respectively. The year-over-year increase was primarily due to changes in U.S. and foreign tax law effective from 2014 and an unfavorable change in the forecasted country mix of earnings, partially offset by lower charges related to settlements of tax examinations outside the US and the tax impact of the remeasurement of the Multi Phase Meters earn-out consideration in 2013.

Our income tax provisions for the nine months ended September 30, 2014 and 2013, reflected effective tax rates of 33.3% and 27.4%, respectively. Excluding a retroactive benefit related to the American Taxpayer Relief Act of 2012 recorded in the first quarter of 2013, our effective tax rate for the nine months ended September 30, 2013 was 28.9%. The year-over-year increase from this adjusted rate was primarily due to changes in U.S. and foreign tax law effective from 2014 and an unfavorable change in the forecasted country mix of earnings, partially offset by lower charges related to settlements of tax examinations outside the US and the tax impact of the remeasurement of the Multi Phase Meters earn-out consideration in 2013.

Our effective tax rate can fluctuate depending on our country mix of earnings, since our foreign earnings are generally subject to lower tax rates than in the United States. In certain jurisdictions, primarily Singapore and Malaysia, our tax rate is significantly less than the relevant statutory rate due to tax holidays.

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NOTE 8. WARRANTY OBLIGATIONS

Warranty cost and accrual information was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2014	2013	2014	2013
Balance at beginning of period	$19.4	$15.9	$18.0	$15.4
Expense for new warranties	7.4	4.8	18.3	18.7
Adjustments to existing accruals	(0.3)	—	0.3	0.6
Claims paid	(4.7)	(4.6)	(14.8)	(18.6)
Balance at end of period	$21.8	$16.1	$21.8	$16.1

NOTE 9. PENSION AND OTHER POST-RETIREMENT BENEFITS

In October 2009, the Board of Directors amended the U.S. Qualified and Non-Qualified Defined Benefit Pension Plans ("U.S. Pension Plans") to freeze participation in the U.S. Pension Plans for all new nonunion employees hired on or after January 1, 2010, and current nonunion employees with less than five years of vesting service as of December 31, 2009 ("frozen participants"). The Company amended the U.S. Qualified Pension Plan, and effective June 1, 2014, the assets and liabilities attributable to participants who are (i) either frozen participants or participants that had terminated service and subsequently became re-employed on or after January 1, 2010, and (ii) active employees of FMC Technologies as of June 1, 2014 were transferred from the U.S. Qualified Pension Plan to the FMC Technologies, Inc. Frozen Retirement Plan ("Frozen Plan"). As of June 1, 2014, the benefits under the Frozen Plan were actuarially equivalent to the benefits each participant would have received under the U.S. Qualified Pension Plan. Under the Frozen Plan, participants have the option to accept cash or an annuity upon the Frozen Plan's termination.

The components of net periodic benefit cost were as follows:

	Pension Benefits			
	Three Months Ended September 30,			Nine Months Ended September 30,
	2014		2013	2014
Total stockholders equity	2,483,084	2,566,263	317,991	
Commitments and contingencies	23, 24			
Total liabilities and stockholders equity	5,384,248	6,679,630	827,690	

See accompanying notes to consolidated financial statements.

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Form 20-F/A (Amendment No. 1)

C HINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

AND COMPREHENSIVE INCOME (LOSS)

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005

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

	Note	Common stock Rmb	Contributed surplus Rmb	Statutory reserves Rmb	Retained earnings Rmb	Accumulated other comprehensive income Rmb	Total stockholders equity Rmb
Balance at January 1, 2003		30,349	1,486,934	170,806	473,814		2,161,903
2003							
Net income					438,182		438,182
Transfer to statutory reserves	22			59,114	(59,114)		
Dividend declared (US$2.08 per share)					(608,398)		(608,398)
Balance at December 31, 2003		30,349	1,486,934	229,920	244,484		1,991,687
2004							
Net income					491,397		491,397
Transfer to statutory reserves	22			36,309	(36,309)		
Balance at December 31, 2004		30,349	1,486,934	266,229	699,572		2,483,084
2005 (Restated Note 2A)							
Net loss					(32,291)		(32,291)
Net unrealized appreciation in fair value of investment securities held by an affiliate, net of nil tax						38,869	38,869
Foreign currency translation adjustment, net of nil tax						(10,018)	(10,018)
Total comprehensive loss							(3,440)
Transfer to statutory reserves	22			357	(357)		
Shares issued in connection with							
Conversion of 2% convertible debt, 1,927,673 shares	19	1,596	205,317				206,913
Dividend declared (US$0.39 per share)					(120,294)		(120,294)
Balance at December 31, 2005		31,945	1,692,251	266,586	546,630	28,851	2,566,263
Balance at December 31, 2005 (in US$)		3,958	209,691	33,033	67,734	3,575	317,991

See accompanying notes to consolidated financial statements.

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Form 20-F/A (Amendment No. 1)

C HINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005

(Rmb and US$ amounts expressed in thousands)

	Years ended December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$
			Restated (Note 2A)	
Cash provided by operating activities				
Net income (loss)	438,182	491,397	(32,291)	(4,001)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization of property, plant and equipment, and lease prepayments	125,519	132,789	144,672	17,927
Provision for uncollectible loans to a related party			202,950	25,148
Impairment of property, plant and equipment	12,405			
Loss on disposal of property, plant and equipment	3,359	12,998	10,474	1,298
Gain on transfer of land use rights to a related party			(2,533)	(314)
Deferred income taxes	6,253	1,116	(20,050)	(2,485)
Provision for losses on guarantees			12,318	1,526
Equity in losses of affiliates			6,032	747
Dividend received from an affiliated company			7,815	968
Minority interests	145,800	157,292	(2,947)	(365)
(Increase)/decrease in assets				
Inventories, net	(34,105)	(469,211)	(321,890)	(39,886)
Amounts due from related parties, net	(36,446)	(5,534)	(115,074)	(14,259)
Trade accounts receivable, net	153,524	(25,954)	(303,288)	(37,581)
Prepaid expenses, net	64,752	(21,069)	(79,757)	(9,884)
Other receivables, net	9,885	(106,581)	(20,237)	(2,507)
Increase/(decrease) in liabilities				
Trade accounts payable	103,065	357,751	710,726	88,068
Income taxes payable	(11,181)	(21,842)	(67,232)	(8,331)
Accrued expenses and other liabilities	90,154	88,521	112,828	13,981
Amount due to holding company	4,108	(2,065)	158	20
Net cash provided by operating activities	1,075,274	589,608	242,674	30,070
Cash flow from investing activities				
Purchase of property, plant and equipment, lease prepayments and construction in progress	(372,775)	(552,902)	(515,359)	(63,860)
Proceeds from disposal of property, plant and equipment	402	5,883	3,826	474
Proceeds from disposal of land use rights			3,580	444
Repayment of loans by a related party			205,000	25,402
Loans to a related party		(205,000)	(205,000)	(25,402)
Loans to customers, net			(7,904)	(979)
Purchase of investments		(1,348)	(161,358)	(19,994)
Net cash used in investing activities	(372,373)	(753,367)	(677,215)	(83,915)

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

(Rmb and US$ amounts expressed in thousands)

	Years ended December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$
			Restated (Note 2A)	
Cash flow from financing activities				
Proceeds from short-term bank loans	230,000	330,000	1,188,178	147,230
Proceeds from short-term borrowing from a related party	8,000			
Proceeds from long-term bank loans		100,000	50,000	6,196
Proceeds from 2% convertible bonds			206,913	25,639
Repayment of short-term bank loans	(125,000)	(190,000)	(805,343)	(99,792)
Repayment of long-term bank loans	(130,000)			
Repayment of short-term borrowing from a related party		(8,000)		
Capital contribution from minority stockholders		31,000		
Dividend paid by subsidiaries to minority stockholders	(88,765)	(8,507)	(66,677)	(8,262)
Dividend paid to stockholders	(608,398)		(120,294)	(14,906)
Net cash (used in)/provided by financing activities	(714,163)	254,493	452,777	56,105
Effect of foreign currency exchange on cash and cash equivalents			(4,713)	(584)
Net (decrease)/increase in cash and cash equivalents	(11,262)	90,734	13,523	1,676
Cash and cash equivalents at beginning of year	643,200	631,938	722,672	89,548
Cash and cash equivalents at end of year	631,938	722,672	736,195	91,224
Supplemental disclosures of cash flow information				
Cash paid during the year for:				
Interest, net of amount capitalized	23,624	31,757	70,527	8,739
Income taxes	117,852	125,891	97,431	12,073

See accompanying notes to consolidated financial statements.

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Form 20-F/A (Amendment No. 1)

C HINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005

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

1 Background and principal activities

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

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

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

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

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

2 Basis of presentation

The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). This basis of accounting differs from that used in the statutory

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

financial statements of Yuchai, which are prepared in accordance with the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises issued by the Ministry of Finance of the PRC (PRC GAAP).

2A Restatement of previously issued 2005 consolidated financial statements

Management has identified certain accounting errors that required correction and a restatement of the Company s 2005 Consolidated Financial Statements. Following is a description of those accounting errors and the effects that the correcting adjustments had on the Company s previously issued 2005 consolidated financial statements:

Accounts Payable

At the time of preparing the financial statements of Yuchai for 2005, Yuchai management erroneously recorded adjustments in the amount of Rmb 167.8 million to the general ledger to reduce the amounts payable for goods received, but for which invoices were not yet received (referred to as GRIR). The correcting adjustments have now been made with the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005:

Trade accounts payable as of December 31, 2005 has been increased by Rmb 167.8 million (US$20.8 million),

Inventories, net as of December 31, 2005 has been increased by Rmb 45.1 million (US$5.6 million), and

Cost of goods sold for the year ended December 31, 2005 has been increased by Rmb 122.7 million (US$15.2 million).

Other Adjustments

During the course of finalizing the Rmb 167.8 million Adjustment, the Company s management identified certain other accounting errors that were not previously known. The Company s management has decided to correct these other accounting errors as well as the previously known immaterial uncorrected audit adjustments pertaining to its 2005 consolidated financial statements. Appropriate correcting adjustments have been made and are reflected in the restated 2005 consolidated financial statements of the Company. The net impact of these other adjustments and the effects on income taxes and minority interests for all correcting adjustments, including the Rmb 167.8 million Adjustment, is an increase in the Company s previously reported consolidated net income for the year ended December 31, 2005 by approximately Rmb 21.9 million (US$2.7 million).

Taxes: As a result of an audit by the local tax authority, it was determined that Yuchai had incorrectly calculated its VAT liability and that an additional Rmb 8.3 million of VAT was owed by Yuchai. It was also determined that Yuchai had under-provided for its income tax recoverable by Rmb 2.5 million for the year ended December 31, 2005. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005:

(a) Value Added Tax:

Other receivables, net as of December 31, 2005 has been reduced by Rmb 8.3 million (US$1.0 million), and

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

Cost of goods sold for the year ended December 31, 2005 has been increased by Rmb 8.3 million (US$1.0 million).

(b) Income tax:

Income taxes for the year ended December 31, 2005 has been reduced by Rmb 2.5 million (US$0.3 million), and

Income taxes recoverable as of December 31, 2005 has been increased by Rmb 2.5 million (US$0.3 million).

Provision for bonuses. In 2005, Yuchai did not reach its stated targets to trigger the payment of bonuses. However, even though stated bonus targets had not been reached, Yuchai recognized accrued bonuses in its previously issued financial statements. Subsequently, the Compensation Committee approved bonus amounts that were lower than the previously recognized amounts. Accordingly, the excess bonus in the amount of Rmb 6.2 million that Yuchai had recognized has now been reversed. In addition, it was determined that there was an over-payment of bonuses in the amount of Rmb 3.7 million. This amount represents the amount to be recovered from the recipients of the bonuses, of which Rmb 3.0 million has already been returned to the Company. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005:

Other receivables, net as of December 31, 2005 has been increased by Rmb 3.7 million (US$0.5 million),

Accrued expenses and other liabilities as of December 31, 2005 has been reduced by Rmb 2.5 million (US$0.3 million) (resulting from an increase in Wages payable of Rmb 8.4 million (US$1.0 million) and a decrease in the Management bonus payable of Rmb 10.9 million (US$1.4 million)), and

Selling, general and administrative expenses for the year ended December 31, 2005 have been reduced by Rmb 6.2 million (US$0.8 million).

Depreciation of fixed assets. The Company s management discovered that certain fixed assets of Yuchai continued to be depreciated even though their net book values had been reduced to zero. This resulted in an over-depreciation of Rmb 6.6 million. This over-depreciation has been reversed to correct the error. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005:

a. Property, plant and equipment, net, as of December 31, 2005 has been increased by Rmb 6.6 million (US$0.8 million),

b.

Selling, general and administrative expenses for the year ended December 31, 2005 have been reduced by Rmb 1.4 million (US$0.2 million), and

c. Cost of goods sold for the year ended December 31, 2005 has been reduced by Rmb 5.2 million (US$0.6 million).

Volume discounts. Yuchai provides discounts to those customers who meet previously-agreed volumes and whose accounts receivable with Yuchai at the year-end meet certain criteria. The Company s management discovered that for some of Yuchai s customers, discounts earned for 2005 in the amount of Rmb 12.7 million had not been

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

recognized in Yuchai s 2005 financial statements. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005

Accrued liabilities as of December 31, 2005 has been increased by Rmb 12.7 million (US$1.6 million), and

Revenues, net for the year ended December 31, 2005 has been reduced by Rmb 12.7 million (US$1.6 million).

Impairment of fixed assets. The Company s management discovered that certain fixed assets of Yuchai were idle or other factors existed that suggested that the recovery of their respective carrying values may have been impaired. Upon further evaluation, it was determined that a provision for impairment of Rmb 4.9 million was required. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005

Property, plant and equipment, net, as of December 31, 2005 has been reduced by Rmb 4.9 million (US$0.6 million),

Cost of goods sold for the year ended December 31, 2005 has been increased by Rmb 3.1 million (US$0.4 million), and

Selling, general and administrative expenses for the year ended December 31, 2005 have been increased by Rmb 1.8 million (US$0.2 million).

In addition, with respect to certain fixed assets of Yuchai that continued to be held and used, the Company s management corrected the residual value and remaining useful life assumptions for such fixed assets. These assumptions have been updated effective January 1, 2005, which resulted in an additional depreciation expense of Rmb 6.5 million. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005:

Accumulated depreciation as of December 31, 2005 has been increased by Rmb 6.5 million resulting in a decrease in Property, plant and equipment, net, as of December 31, 2005 by Rmb 6.5 million (US$0.8 million),

Cost of goods sold for the year ended December 31, 2005 has been increased by Rmb 5.9 million (US$0.7 million), and

Selling, general and administrative expenses for the year ended December 31, 2005 have been increased by Rmb 0.6 million (US$0.07 million).

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

Other Accounts Payable Adjustment for GRIR balance. Other adjustments have been made to the GRIR balance at December 31, 2005, which represents the amounts payable for goods received in 2005 but for which invoices had not been received at December 31, 2005, based on suppliers invoices that were subsequently received by the Company. The correcting adjustments had the following impact on the Company s Consolidated Financial Statements as of and for the year ended December 31, 2005:

Trade accounts payable as of December 31, 2005 has been decreased by Rmb 6.5 million (US$0.8 million),

Inventories, net as of December 31, 2005 has been decreased by Rmb 1.7 million (US$0.2 million), and

Cost of goods sold for the year ended December 31, 2005 has been decreased by Rmb 4.8 million (US$0.6 million).

Previously Known Unadjusted Audit Adjustments. The Company s management has also decided to correct previously known immaterial uncorrected audit adjustments pertaining to the 2005 consolidated financial statements. The net impact of these adjustments is a decrease in the Company s previously reported consolidated earnings before income taxes and minority interests for the year ended December 31, 2005 by approximately Rmb 4.6 million (US$0.6 million).

Effect on Income Taxes and Minority Interests. As a result of the above corrections, including the Rmb 167.8 million Adjustment, certain adjustments were made to reflect their impact on income taxes, which was Rmb 8.2 million (US$1 million) and minority interests, which was Rmb 30.8 million (US$3.8 million) in the Company s 2005 consolidated financial statements.

Reclassifications. The Company has also reclassified certain items in its consolidated financial statements as of and for the year ended December 31, 2005. These reclassifications did not have any impact on the Company s consolidated net loss, as restated, for the year ended December 31, 2005.

The following table presents the impact these correcting adjustments had on the Company s 2005 consolidated statement of operations and consolidated balance sheet. The effects of the above correcting adjustments have also been reflected in notes 3,4,5,8,9,10,12,13,14,15,20,22 and 28. As these correcting adjustments had no impact on the amounts previously reported for cash and cash equivalents, net cash provided by operating activities, net cash used in investing activities and net cash provided by financing activities, the impact of these correcting adjustments on the components of cash flow statement to reconcile net loss to net cash provided by operating activities has not been presented.

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

Impact on Consolidated Statement of Operations (in thousands except per share data)

	Years ended December 31, 2005			
	(As previously reported)	(Adjustments)	As Restated	
	Rmb	Rmb	Rmb	US$
Revenues, net	5,829,431	(12,691)	5,816,740	720,768
Cost of goods sold	(4,527,046)	(146,311)	(4,673,357)	(579,088)
Gross profit	1,302,385	(159,002)	1,143,383	141,680
Research and development costs	(123,876)	83	(123,793)	(15,340)
Selling, general and administrative expenses	(807,350)	14,197	(793,153)	(98,282)
Provision for uncollectible loans to a related party	(205,000)	2,050	(202,950)	(25,148)
Gain on transfer of lease prepayment to a related party	2,533		2,533	314
Operating income	168,692	(142,672)	26,020	3,224
Interest expense	(70,527)		(70,527)	(8,739)
Equity in losses of affiliates	(5,106)	(926)	(6,032)	(747)
Other (expenses)/income, net	24,183	1,266	25,449	3,153
Earnings (loss) before income taxes and minority interests	117,242	(142,332)	(25,090)	(3,109)
Income taxes	(20,875)	10,727	(10,148)	(1,257)
Income before minority interests	96,367	(131,605)	(35,238)	(4,366)
Minority interests in income (losses) of consolidated subsidiaries	(27,880)	30,827	2,947	365
Net income (loss)	68,487	(100,778)	(32,291)	(4,001)
Basic and diluted earnings (loss) per share	1.88	(2.77)	(0.89)	(0.11)

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

Impact on Consolidated Balance Sheet

	As of December 31, 2005			
	(As previously reported) Rmb	(Adjustments) Rmb	As Restated Rmb	US$
ASSETS				
Current assets				
Cash and cash equivalents	736,195		736,195	91,224
Trade accounts receivable, net	1,146,227	32,626	1,178,853	146,075
Amounts due from related parties	233,188		233,188	28,895
Loans to a related party		2,050	2,050	254
Loans to customers, net	7,904		7,904	979
Inventories, net	1,636,283	32,152	1,668,435	206,740
Prepaid expenses, net	138,322		138,322	17,140
Other receivables, net	140,203	(4,551)	135,652	16,809
Income taxes recoverable	43,526	2,528	46,054	5,706
Deferred income taxes	88,783	(3,432)	85,351	10,576
Total current assets	4,170,631	61,373	4,232,004	524,398
Property, plant and equipment, net	1,442,515	(1,803)	1,440,712	178,523
Construction in progress	459,902	(3,150)	456,752	56,597
Lease prepayments, net	70,608	(1,280)	69,328	8,591
Investments	191,974	(926)	191,048	23,673
Goodwill	212,636		212,636	26,348
Deferred income taxes	65,519	11,631	77,150	9,560
Total assets	6,613,785	65,845	6,679,630	827,690

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

	As of December 31, 2005			
	(As previously reported) Rmb	(Adjustments) Rmb	As Restated Rmb	US$
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Short-term bank loans	812,835		812,835	100,721
Current instalments of long-term bank loans	100,000		100,000	12,391
Amount due to the holding company	4,301		4,301	533
Amounts due to related parties	75,189	(3)	75,186	9,317
Trade accounts payable	1,642,980	157,463	1,800,443	223,098
Income taxes payable	4,208		4,208	521
Accrued expenses and other liabilities	571,717	39,990	611,707	75,798
Total current liabilities	3,211,230	197,450	3,408,680	422,379
Long-term bank loans, excluding current instalments	50,000		50,000	6,196
Total liabilities	3,261,230	197,450	3,458,680	428,575
Minority interests	685,514	(30,827)	654,687	81,124
Stockholders equity				
Common stock				
Ordinary shares US$0.10 par value: authorized 100,000,000 shares; issued and outstanding 37,267,673 shares at December 31, 2005 (December 31, 2004: 35,340,000 shares)	31,945		31,945	3,958
Special share US$0.10 par value: authorized 1 share; issued and outstanding 1 share at December 31, 2004 and 2005				
Contributed surplus	1,692,251		1,692,251	209,691
Statutory reserves	269,017	(2,431)	266,586	33,033
Accumulated other comprehensive income	28,851		28,851	3,575
Retained earnings	644,977	(98,347)	546,630	67,734
Total stockholders equity	2,667,041	(100,778)	2,566,263	317,991
Total liabilities and stockholders equity	6,613,785	65,845	6,679,630	827,690

3 Summary of significant accounting policies and practices

(a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company, its majority-owned subsidiaries and those entities that the Company has determined that it has a direct or indirect controlling financial interest in. All significant intercompany balances and transactions have been eliminated in consolidation. In addition, the Company evaluates its relationships with other entities to identify whether they are variable interest entities as defined by the Financial Accounting Standard Board (the FASB) Interpretation (FIN) No. 46 (R), Consolidation of Variable Interest Entities (FIN 46(R)) and to assess whether it is the

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46(R). The Company was not the primary beneficiary of any variable interest entities during the three years ended December 31, 2005.

(b) Cash and cash equivalents

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

(c) Trade accounts receivable

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

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

(d) Inventories, net

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

(e) Property, plant and equipment

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

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

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CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (Continued)

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

(f) Construction in progress

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

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

(g) Lease prepayments

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

(h) Investments

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

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

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

(i) Foreign currency transactions and translation

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

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

The Company s reporting currency is the Renminbi and its functional currency is the U.S. dollar. Assets and liabilities of the Company and foreign subsidiaries and affiliates whose functional currency is not Renminbi are translated into Renminbi using the exchange rate on the balance sheet date. Revenues and expenses are translated at average rates prevailing during the year. The gains and losses resulting from translation of financial statements

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of the Company and foreign subsidiaries and affiliates are recorded as a separate component of accumulated other comprehensive income/(loss) within stockholders equity. Cumulative translation adjustments are recognized as income or expense upon disposal or liquidation of a foreign subsidiary and affiliate.

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

(j) Income taxes

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

(k) Revenue recognition

(i) Product sales

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

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

(ii) Guarantee fee income

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

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(iii) Rental income

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

(l) Earnings (loss) per share

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

The reconciliation of the Company s EPS is as follows:

	Years ended December 31,			
	2003	2004	2005	2005
	Rmb	Rmb	Rmb	US$
			Restated (Note 2A)	
Net income (loss) attributable to common shares	438,182	491,397	(32,291)	(4,001)
Basic earnings (loss) per share				
Weighted average common shares outstanding during the year	35,340,000	35,340,000	36,459,635	36,459,635
Basic earnings (loss) per share of common shares	12.40	13.90	(0.89)	(0.11)

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

(m) Advertising, research and development costs

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

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

(n) Goodwill

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

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fair value of the reporting unit. If the implied fair value of reporting unit goodwill is lower than its carrying amount, goodwill is considered impaired and is written down to its implied fair value. The results of the impairment testing in 2003, 2004 and 2005 did not result in any impairment of goodwill.

(o) Product warranty

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

(p) Use of estimates

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

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

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

(r) Commitments and contingencies

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

(s) Sales of trade accounts receivable

The Company sells trade accounts and bills receivable to banks on an ongoing basis. The buyer is responsible for servicing the receivables upon maturity of the trade accounts receivable. Sales of the trade accounts receivable are accounted for under Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . Accordingly,

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trade accounts and bills receivable are derecognized, and the Company records a discount equal to the difference between the carrying value of the trade accounts and bills receivable and cash received. The Company has received proceeds for the sales of the trade accounts and bills receivable of Rmb1,730,627, Rmb2,380,569 and Rmb3,423,296 (US$424,190), for the years ended December 31, 2003, 2004 and 2005, respectively. The Company has recorded discounts totalled of Rmb22,042, Rmb31,709 and Rmb44,362 (US$5,497) in respect of sold trade accounts and bills receivable for the years ended December 31, 2003, 2004 and 2005, respectively, which have been included in interest expense.

(t) Recently issued accounting standards

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

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

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

In March 2005, the FASB issued FIN No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. The types of asset retirement obligations that are covered by this interpretation are those for which an entity has a legal obligation to perform an asset retirement activity, however the timing and (or) method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient

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information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ended after December 15, 2005. The initial adoption of FIN 47 did not have an impact on the Company s financial condition and consolidated statements of operations.

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

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

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

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

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

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

	Years ended December 31,			
	2003	2004	2005	2005
	Rmb	Rmb	Rmb	US$
			Restated (Note 2A)	
Cost of goods sold	88,737	84,907	90,354	11,064
Selling, general and administrative expenses	36,782	47,882	54,318	6,863
	125,519	132,789	144,672	17,927

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

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

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

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

5 Provision for uncollectible loans to a related party

The amount represents the recognition of specific doubtful debt provisions totaling Rmb202,950 (US$25,148) on the loans due from Yuchai Marketing and Logistic Company Limited (YMLC) as of December 31, 2005. YMLC is wholly owned by Coomber Investment Limited (Coomber), a shareholder of the Company and State Holding Company (collectively, the Chinese Shareholders).

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

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

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

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

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

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

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

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

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

The Company s management has ruled out any form of legal or other enforcement action against the Chinese Shareholders as management believes that Yuchai may not be the first preferred creditor entitled to receive payment of the judgment debt. Moreover, management believes that the process for enforcement of a

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

6 Interest cost

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

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

7 Other (expenses)/income, net

Other (expenses)/income, net consist of:

	Years ended December 31,			
	2003	2004	2005	2005
	Rmb	Rmb	Rmb	US$
			Restated (Note 2A)	
Interest income (see Note 5)	3,587	3,286	21,744	2,695
Foreign exchange (loss)/gain, net	(27)	(38)	607	75
Dividend income from other investments		4,591		
Rental income			6,078	753
Others, net	(4,441)	(2,157)	(2,980)	(370)
	(881)	5,682	25,449	3,153

8 Income taxes

Bermuda tax

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

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

PRC income tax

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

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

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

	Years ended December 31,			
	2003	2004	2005	2005
	Rmb	Rmb	Rmb	US$
			Restated (Note 2A)	
Current tax expense	106,671	104,049	30,198	3,742
Deferred tax expense/(benefit)	6,253	1,116	(20,050)	(2,485)
	112,924	105,165	10,148	1,257

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

	Years ended December 31,			
	2003	2004	2005	2005
	Rmb	Rmb	Rmb	US$
			Restated (Note 2A)	
Computed expected tax expense (benefit)	104,536	113,078	(3,764)	(466)
Adjustments resulting from:				
Non-deductible expenses related to errors correction			10,623	1,315
Other non-deductible expenses	1,232	471	5,703	707
Tax credits (see Note (i))		(16,184)	(43,535)	(5,395)
Change in valuation allowance			45,231	5,605
Rate differential of subsidiaries	7,156	7,800	(4,110)	(509)

Total tax expense	112,924	105,165	10,148	1,257

Notes:

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

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

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

	December 31,		
	2004 Rmb	2005 Rmb	2005 US$
		Restated (Note 2A)	
Trade accounts receivable	26,006	23,810	2,950
Inventories	6,678	8,336	1,033
Property, plant and equipment	69,247	50,734	6,286
Accrued expenses and other liabilities	37,020	39,259	4,865
Tax losses carried forward	3,500	11,615	1,439
Tax credits		43,535	5,395
Loans to a related party		30,443	3,773
Total gross deferred tax assets	142,451	207,732	25,741
Less: Valuation allowance		45,231	5,605
Net deferred tax assets	142,451	162,501	20,136

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

	December 31		
	2004 Rmb	2005 Rmb	2005 US$
		Restated (Note 2A)	
Net deferred tax assets comprise of:			
Current portion	69,704	85,351	10,576
Non-current portion	72,747	77,150	9,560
	142,451	162,501	20,136

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

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

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The management considered that it is more likely than not that tax credits totalling Rmb33,834 (US$4,193) relating to the purchase of domestic equipment cannot be fully utilized as the amount entitled for deduction each year is limited to the incremental current

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income tax expense of the subsidiary compared to the current tax of the subsidiary for the years 2003 and 2004, when the related domestic equipment was purchased and the management forecasted future taxable income of the subsidiary will not be sufficient to fully utilize the tax credits. In addition, one of the subsidiaries has been loss making since its commencement of operations in 2004 and based on this, management has determined that it is more likely than not that the benefit of deferred tax assets in this entity totalling Rmb11,397 (US$1,412) will not be realized.

9 Trade accounts receivable, net

Trade accounts receivable, net comprise:

	December 31,		
	2004 Rmb	2005 Rmb	2005 US$
		Restated (Note 2A)	
Trade accounts receivable	504,429	606,644	75,171
Less: Allowance for doubtful accounts	107,457	69,047	8,556
	396,972	537,597	66,615
Bills receivable	478,593	641,256	79,460
	875,565	1,178,853	146,075

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

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

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

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

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10 Amounts due from/to related parties

Amounts due from related parties comprise:

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

Amounts due to related parties comprise:

	December 31,		
	2004 Rmb	2005 Rmb	2005 US$
		Restated (Note 2A)	
Due within one year	42,686	75,186	9,317

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

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

11 Loans to customers, net

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

12 Inventories, net

Inventories comprise:

	December 31		
	2004	2005	2005
	Rmb	Rmb	US$
		Restated (Note 2A)	
Raw materials	699,132	1,029,023	127,509
Work in progress	141,659	66,326	8,218
Finished goods	505,754	573,086	71,013
	1,346,545	1,668,435	206,740

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13 Other receivables, net

Other receivables, net comprise:

	December 31,		
	2004	**2005**	**2005**
	Rmb	**Rmb**	**US$**
		Restated (Note 2A)	
VAT recoverable (see Note (i))	91,977	87,891	10,891
Staff loans	8,476	18,075	2,240
Staff advances	3,306	5,434	673
Receivable for factoring (see Note (ii))	6,845		
Others	4,810	24,252	3,005
	115,414	135,652	16,809

Notes:

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

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

14 Property, plant and equipment, net

Property, plant and equipment, net comprise:

	December 31,		
	2004	**2005**	**2005**
	Rmb	**Rmb**	**US$**
		Restated (Note 2A)	

Buildings	634,544	709,643	87,934
Machinery and equipment	1,547,112	1,836,949	227,621
	2,181,656	2,546,592	315,555
Less: Accumulated depreciation	1,022,725	1,105,880	137,032
Net property, plant and equipment	1,158,931	1,440,712	178,523

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

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

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

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

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

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

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

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

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

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

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15 Construction in progress

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

	December 31,		
	2004 Rmb	2005 Rmb Restated	2005 US$ (Note 2A)
Diesel engine production line and facilities projects	211,418	282,900	35,055
Factories auxiliary facilities	86,134	95,230	11,800
Second foundry	29,570	26,047	3,228
Others	51,913	52,575	6,514
	379,035	456,752	56,597

16 Lease prepayments, net

	December 31,		
	2004 Rmb	2005 Rmb Restated	2005 US$ (Note 2A)
Lease prepayments	99,111	96,877	12,005
Less: Accumulated amortization	24,344	27,549	3,414
Lease prepayments, net	74,767	69,328	8,591

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

17 Investments

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

	December 31,		
	2004	2005	2005

	Rmb	Rmb Restated	US$ (Note 2A)
Available-for-sale equity securities (see Note)	6,405	6,355	787
Investments in affiliated companies	648	184,693	22,886
	7,053	191,048	23,673

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

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

	December 31,		
	2004 Rmb	2005 Rmb Restated	2005 US$ (Note 2A)
Listed:			
TCL (see Note (i))		184,095	22,812
Unlisted:			
Others (see Note (ii))	648	598	74
	648	184,693	22,886

Notes:

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

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

The fair value, based on the quoted market price, of the TCL shares held by the Company was Rmb109,434 (US$13,560) as of December 31, 2005. Management considers the decline in fair value below the carrying value to be not other than temporary as the

Company has the ability and intent to hold its investment in TCL for a period that should allow it to recover its carrying value.

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

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

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

	Period from March 23, 2005 to December 31, 2005 Rmb	Period from March 23, 2005 to December 31, 2005 US$
Results of operations		
Net sales		
Supply chain management	1,531,913	189,823
Others	109,526	13,572
	1,641,439	203,395
Cost of goods sold	(1,508,247)	(186,890)
Gross profit	133,192	16,505
Selling, general and administrative expenses	(191,161)	(23,688)

Operating loss	(57,969)	(7,183)
Finance cost	(9,338)	(1,157)
Other income	34,906	4,325
Equity in profit of affiliates	281	35
Loss before income taxes and minority interests	(32,120)	(3,980)
Income tax expense	(6,086)	(754)
Loss before minority interests	(38,206)	(4,734)
Minority interests in income of consolidated subsidiaries	6,232	772
Net loss	(31,974)	(3,962)

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	Period from March 23, 2005 to December 31, 2005 Rmb	Period from March 23, 2005 to December 31, 2005 US$
Other financial information:		
Interest revenue	5,703	707
Interest expenses	9,338	1,157
Depreciation and amortisation	10,576	1,311
Significant non-cash transactions:		
Bad debt expense	11,629	1,441
Provision for inventory write-down	33,493	4,150
Impairment loss to property, plant and equipment	16,031	1,986

18 Debt

(a) Short-term bank loans

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

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

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

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

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

(b) Long-term bank loans

Yuchai s long-term bank loans comprise:

	Interest rate at December 31,	December 31,		
	2005	2004	2005	2005

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

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

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19 Convertible debt

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

20 Accrued expenses and other liabilities

Accrued expenses and other liabilities comprise:

	December 31,		
	2004	2005	2005
	Rmb	Rmb	US$
		Restated (Note 2A)	
Deposits from customers	54,165	96,936	12,012
Staff welfare payable (see Note)	15,041	15,041	1,864
Accrued product warranty (see Note 21)	126,114	142,126	17,611
Wages payable	110,577	107,130	13,275
Management bonus payable	36,574	8,158	1,011
Payable for construction in progress	39,139	39,330	4,873
Accrued research and development expenses	16,472	24,952	3,092
Accrued advertising expense	7,225	3,817	473
Accrued legal fee and other professional fees	2,762	5,050	626
Accrued expenses for litigation and guarantees (see Notes 24(c) and (d))	15,268	18,921	2,344
Individual income tax withholding	8,161	10,250	1,270
Accrued sales discount		45,741	5,668
Other accruals and liabilities	53,422	94,255	11,679
	484,920	611,707	75,798

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

21 Accrued product warranty

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

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

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22 Statutory reserves

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

	December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb Restated	2005 US$ (Note 2A)
Statutory general reserve (see Note (ii))				
Balance at January 1	116,702	156,111	170,041	21,070
Transfer from consolidated statements of operations	39,409	13,930	239	30
Balance at December 31	156,111	170,041	170,280	21,100
Statutory public welfare fund (see Note (iii))				
Balance at January 1	28,398	48,103	70,482	8,733
Transfer from consolidated statements of operations	19,705	22,379	118	15
Balance at December 31	48,103	70,482	70,600	8,748
General surplus reserve				
Balance at January 1 and December 31	25,706	25,706	25,706	3,185
Total	229,920	266,229	266,586	33,033

Notes:

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

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

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

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23 Commitments

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

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

24 Contingencies

(a) Product liability

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

(b) Environmental liability

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

(c) Dispute with Bank of China

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

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

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

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

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(d) Guarantees

YEGCL guaranteed borrowings of Rmb7,605 and Rmb178,480 (US$22,116) granted by commercial banks to unrelated parties in 2004 and 2005, respectively. The borrowings are due in equal monthly or quarterly instalments through one to two years. The guarantees were made to individual persons who applied for mortgage loans from commercial banks to purchase automobiles equipped with diesel engines produced by Yuchai. The guarantees are for the entire amount and term of the borrowings. In return, YEGCL receives a premium fee amounted to 2% to 8% of the amount of borrowings. All guarantees are secured by automobiles at a net book value totalling Rmb11,693 and Rmb242,216 (US$30,014) at December 31, 2004 and 2005, respectively. If the individual defaults on payment, YEGCL would have to perform under the guarantees. It is reasonably possible that YEGCL would be required to make payment under its guarantees. As of December 31, 2004 and 2005, the maximum amount of undiscounted payments that YEGCL would have to make in the event of default is Rmb7,422 and Rmb134,235 (US$16,633). Pursuant to the requirements of FIN 45, the Company accrued Rmb220 and Rmb16,811 (US$2,083) related to its stand ready obligation under the guarantee arrangement in 2004 and 2005, respectively. The amount recognized during the year ended December 31, 2004 and 2005 includes premium received or receivable, which is amortized on a straight line basis over the terms of the guarantees, of Rmb220 and Rmb4,493 (US$557), respectively. The amount of premium being amortized, which were recorded as revenue, for the year ended December 31, 2004 and 2005 were amounted to Rmb 14 and Rmb1,167 (US$145), respectively. The remaining balance of Rmb 12,318 (US$1,526) as of December 31, 2005 represents the provision for loss contingency related to the guarantees where payment by the Company was probable.

(e) Outstanding bills discounted

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

(f) Outstanding letters of credit

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

(g) Other outstanding litigation

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

25 Dispute with State Holding Company

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

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Chinese shareholder of Yuchai with effect from October 28, 2005. The new Chairman and legal representative of these companies is Mr Yan Ping whose appointment was confirmed on December 2, 2005.

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

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

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

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

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

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

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

Up to the date of this report:

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

the proposed capitalization of YMLC was varied by the board of directors of Yuchai at its meeting on April 21, 2005 and approved by its shareholders. Coomber has assumed the obligation to return Rmb165,400 (US$20,495) of the authorized Rmb205,000 (US$25,402) loan that was made by Yuchai to YMLC and which had been guaranteed by Coomber to Yuchai by December 6, 2005.

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The remaining Rmb39,600 (US$4,907) loan would remain as a loan by Yuchai to YMLC and would only be injected as share capital of YMLC after the successful spin-off of Yuchai in line with the terms of the Reorganisation Agreement;

a dividend payment for the financial years ended December 31, 2003 and 2004 in the amount of Rmb302,713;

the establishment and appointment of members of three sub-committees under the board, comprising the nominations committee, the remuneration committee and the audit committee;

the establishment of a financial committee to approve all borrowings, guarantees, loans issuance of company debt and investment;

the termination of the sales of the spare parts business of one of its subsidiaries;

the payment of US$20,000 to the Company pursuant to the Reorganisation Agreement;

the acceptance of the appointment of two independent directors of Yuchai and confirmation of the appointment of three directors appointed by holders of States Shares of Yuchai and six directors appointed by holders of Foreign Shares of Yuchai; and

the appointment of one independent director nominated by the holders of State Shares of Yuchai, and three independent directors nominated by the holders of Foreign Shares of Yuchai.

(ii) an internationally reputable financial adviser had been engaged by Yuchai to assist Newco (as defined below) to apply for the listing of its shares on the NYSE and assist the Company with the implementation of spin-off. Pursuant to the Reorganization Agreement, a Bermuda corporation (Newco) will be formed where (a) the Company will contribute its 76.4% indirect interest in Yuchai to in exchange for a number of Newco shares equal to the number of outstanding shares of the Company as of April 7, 2005; (b) its board of directors would comprise of nominees from the Company and Yuchai in the same respective proportions to the nominees of the holders of Foreign Shares of Yuchai and the holders of State Shares of Yuchai on the Yuchai board of directors; and (c) its charter documents and officers would be mutually agreeable to the Company and Yuchai and on the completion date of the Restructuring Exercise (as described in the Reorganization Agreement) the Company shall have no appointees to its board of directors. The appointment of the financial adviser was subsequently terminated pending Yuchai s ongoing review of the implementation of the corporate reorganization contemplated in the Reorganization Agreement;

(iii) the Yuchai board of directors subsequently directed a review of YMLC s financial position and the implementation of the recapitalization plans for YMLC has been deferred pending the successful spin-off of Yuchai in line with the terms of the Reorganisation Agreement;

(iv) the Company has received payment of an advisory fee in the amount Rmb12,105 (US$1,500) from Yuchai as provided for under the Reorganisation Agreement; and

(v) the Company has received its share of the dividend declared and paid by Yuchai in respect of the financial years ended December 31, 2003 and 2004 on May 24, 2005 for amount of Rmb225,207 (US$27,906).

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The principal terms of the Reorganisation Agreement Amendment No.1 are as follows:

(1) Clause 1.8 of the Reorganization Agreement was previously stated as:

In consideration of CYI s agreement to ensure that Coomber will under the terms of the share exchange described in clause 2.4 receive no less than 6,354,911 Newco shares, Yuchai shall, within 5 business days from the date that an unqualified audit report is issued on CYI s financial statements in the form substantially similar to that of the unaudited financial statements filed by CYI in its Form 6K dated February 28, 2005, pay CYI an amount of US$20.0 million in cash into such bank account as CYI shall notify Yuchai in writing.

was deleted and replaced with the following text:

In consideration of CYI s agreement to ensure that Coomber will under the terms of the share exchange in Clause 2.4 receive no less that 6,354,911 Newco shares, Yuchai shall on the earlier of (i) the date of the completion of the transactions described in Clause 2.6 and (ii) December 31, 2006 pay CYI an amount of US$20.0 million in cash to such bank account as CYI shall notify Yuchai in writing.

(2) Clause 2.10 of the Reorganization Agreement, which was stated as:

The parties acknowledge and accept that the CYI Group, as majority shareholders of Yuchai and with majority control of the Board of Directors of Yuchai, may cause the employment of Yuchai s current Chief Executive Officer to be terminated in accordance with the terms of his employment agreement. CYI acknowledges and accepts, however, that the successful implementation of the Restructuring Exercise will require the continued uninterrupted involvement and participation of Yuchai s current Chief Executive Officer on and subject to the terms (including remuneration) of his employment agreement. Accordingly, CYI agrees that it will not, and will procure that its appointees to the Board of Directors of Yuchai do not, take any action prior to the completion of the Restructuring Exercise that will interfere with, or cause the termination of, the employment of Yuchai s current Chief Executive Officer except if he were to be prosecuted or convicted for any activities of a criminal nature.

was deleted in its entirety with effect from October 27, 2005.

(3) The Clause 4 of the Reorganization Agreement was previously stated as:

In the event that the parties are unable to complete the events described in each of clauses 2.1, 2.2, 2.4, 2.5 and 2.6 above (not due to the default of either party) by 5:00p.m. on December 31, 2005 (or if such day is not a business day in Hong Kong, the immediately succeeding business day) (or such other date to be mutually agreed between the parties), the provision of this Agreement shall terminate and in such event no party shall have any claim against any other party for any claims, damages, losses or other costs and expenses arising from such termination.

the date appearing in the third line of Clause 4 of the Reorganization Agreement was deleted and substituted with the words

December 31, 2006 or such other date as the parties may agree in writing

Yuchai, Coomber and the State Holding Company have at various times reaffirmed their respective intentions of working with the Company to carry out their respective obligations under the Reorganization Agreement.

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26 Retirement and other postretirement benefits

As stipulated by the regulations of the PRC, Yuchai and its subsidiaries participate in defined contribution retirement plans organized by the Guangxi Regional Government and Beijing City Government for its staff. All staff are entitled to an annual pension equal to a fixed proportion of their final basic salary amount at their retirement date. For the years ended December 31, 2003, 2004 and 2005, Yuchai and its subsidiaries were required to make contributions to the retirement plan at a rate of 20.0% of the basic salary of their staff. The Guangxi Regional Government and Beijing City Government are responsible for the entire obligations of all Yuchai and its subsidiaries retirees. Expenses incurred in connection with the plan were Rmb24,101, Rmb29,868 and Rmb33,299 (US$4,126), respectively, for the years ended December 31, 2003, 2004 and 2005.

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

27 Other related party transactions

In addition to the loans to YMLC (as discussed in Note 5), the Company has undertaken other significant business transactions with related parties during the three years ended December 31, 2005. The following is a summary of these transactions:

	Years ended December 31,			
	2003 Rmb	**2004 Rmb**	**2005 Rmb**	**2005 US$**
Sales of trucks from customers to Guangxi Yuchai Mechanical and Electronics Company (GYMEC) (see Note (i))	1,346	753		
Sales of diesel engines to State Holding Company, its subsidiaries and affiliates (see Note (ii))	23,611	3,784	7,646	947
Purchase of raw materials and supplies from subsidiaries and affiliates of State Holding Company (see Note (ii))	(93,056)	(142,829)	(235,329)	(29,160)
Purchase of raw materials and supplies from YMLC (see Note (iii))			(60,756)	(7,528)
Purchase of trucks from YMLC (see Note (iii))		(95,391)	(77,324)	(9,581)
Processing fee to YMLC (see Note (iv))		(12,329)	(44,407)	(5,503)
Delivery expense charged by a subsidiary of YMLC (see Note (iv))	(62,206)	(65,468)	(126,028)	(15,616)
General and administrative expenses				
charged by State Holding Company (see Note (v))	(30,607)	(21,180)	(25,931)	(3,213)
charged by HLA (see Note (xii))	(4,427)	(4,142)	(4,035)	(500)
charged by an affiliate of HLA (see Note (vi))			(30,765)	(3,812)
Gain on disposal of land use rights to a subsidiary of State Holding Company (See Note (vii))			2,533	314
Loan from State Holding Company (see Note (viii))	8,000			
Assignment of debt to GYMEC (see Note (ix))	3,700			
Consultancy fee paid on behalf of Coomber (see Note (x))	13,347			

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Notes:

(i) Sales of diesel trucks to GYMEC

GYMEC was formerly a subsidiary of State Holding Company. It became a subsidiary of YMLC following a share transfer from State Holding Company to YMLC in 2004. During 2003 and 2004, Yuchai received diesel trucks from certain customers as part of the settlement of their trade accounts receivable. Pursuant to an agreement between Yuchai and GYMEC, Yuchai sold such diesel trucks at cost to GYMEC, which owns a business license for selling diesel trucks in the PRC. Yuchai recorded a receivable from GYMEC in connection with the truck sales. The amount due from GYMEC is unsecured, interest free and repayable on demand.

(ii) Sale and purchase of raw materials, supplies and diesel engines to/from State Holding Company, its subsidiaries and affiliates.

Certain subsidiaries and affiliates of State Holding Company have acted as suppliers of raw materials and supplies to the Company and certain subsidiaries of State Holding Company have acted as sales agents of the Company. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.

(iii) Purchase of raw materials, supplies and trucks from YMLC
Since July 2004, subsidiaries of YMMC have engaged in the sale of trucks which were mainly supplied by and purchased from YMLC. YMLC has also become a supplier of raw materials and supplies to the Company since 2005. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.

(iv) Processing fee and delivery expense charged by YMLC and its subsidiaries
The fee is for the packaging and delivering of spare parts charged by YMLC, which was recorded in Cost of goods sold and Selling, general and administrative expenses respectively. The Company considers that these transactions were entered into in the normal course of business and expects that these transactions will continue on normal commercial terms.

(v) General and administrative expenses
State Holding Company charges Yuchai for certain general and administrative expenses in respect of rental of certain office premises, property management services rendered by State Holding Company. The expenses are charged to Yuchai and its subsidiaries by State Holding Company

on an actual incurred basis. The Company believes that the expenses charged to Yuchai by State Holding Company would not have been materially different on a stand-alone basis because Yuchai could provide these services for itself at approximately the same amount.

(vi) Service fee to an affiliate of HLA

The fee was paid to Hong Leong Management Services Pte Ltd., an affiliate of HLA. Service fee includes Rmb9,167 (US$1,136) in relation to the consultancy services performed for the acquisition of interests in TCL during 2005 and LKN-Princefield Limited (LKN) in 2006 (see Note 34(a)). The remaining amounts were mainly in relation to secure additional credit facilities and enter into the Reorganization Agreement. The transactions were approved by the Board of Directors. The Company considers that the transactions were entered into in the normal course of business.

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(vii) Gain on disposal of land use rights to a subsidiary of State Holding Company
The Company has disposed of certain land use rights with net book value of Rmb1,047 (US$130) to a subsidiary of SHC for a consideration of Rmb3,580 (US$444). The Company considers that the transaction was entered into in the normal course of business.

(viii) Loan from State Holding Company
In 2003, GYSPM has entered into an agreement with State Holding Company for a borrowing of Rmb8,000 for its operating activities as of December 31, 2003. As of December 31, 2003, GYSPM pledged certain of its assets with net book value of Rmb17,132 against bank loan of Rmb8,000 borrowed by State Holding Company. The terms set out in the loan agreement entered into between State Holding Company and the bank and the loan agreement entered into between GYSPM and State Holding Company are identical. The loan proceeds from the bank borrowed by State Holding Company were solely lent to GYSPM. State Holding Company would make repayments to the bank upon receipt of loan repayment from GYSPM. The loan was fully repaid in 2004.

(ix) Assignment of debt to GYMEC
In 2003, the Company entered into a deed of assignment (the Deed) whereby one of the Company s customers assigned all the rights and liabilities of the outstanding amount due to the Company totalling approximately Rmb15,000 to GYMEC. Pursuant to the Deed, GYMEC became one of the sales agents of this customer who is principally engaged in manufacturing and sales of motor vehicles. As of December 31, 2004, the outstanding balances due from GYMEC related to this assignment was Rmb3,700 and the amount was fully repaid in 2005.

(x) Consultancy fee paid on behalf of Coomber
In 2003, the Company entered into an agreement, totalling Rmb60,000 with a consultancy company in connection with the design of an information system for YMLC to be undertaken by Coomber pursuant to which Coomber has agreed to pay for all expenses incurred by the Company in respect of this project on or before 31 December 2004. In 2003, the Company incurred payments totalling Rmb13,347 in respect of the project, which have been recorded in amounts due from related parties. The amount was subsequently repaid in 2004.

(xi) Amounts due from/to related parties
Amounts due from/to related parties arise mainly from the transactions as stated above.

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

(xii) Amount due to the holding company

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

28 Segment information

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information , establishes standards for reporting information about operating segments in financial statements. Operating segments are

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defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company s operating segments are Yuchai and TCL for the year ended December 31, 2005. Prior to the purchase of TCL, the Company s only operating segment was Yuchai.

The segment result for Yuchai is based on income before income taxes and minority interests. The segment result for TCL is the Company s equity in the net income or losses or TCL. Segment assets for Yuchai are based on total assets of Yuchai. Segment assets for TCL are based on the Company s net investment in TCL. Substantially all of the Company s operations including TCL are in the PRC. Consequentially no geographic information is presented. Further segment information about TCL is included in Note 17(c).

Following is the segment information for the year ended December 31, 2005 (Restated See Note 2A):

	Yuchai Rmb	TCL Rmb
Segment revenue from external customers	5,816,740	
Interest revenue	21,744	
Interest expenses	70,527	
Depreciation and amortization	144,672	
Equity in losses of affiliates	50	
Segment profit / (loss)	30,179	(5,982)
Significant non-cash items:		
Provision for uncollectible loans to a related party	202,950	
Bad debt expense	25,587	
Provision for inventory write-down	15,990	
Provision for losses on guarantees	12,318	
Segment assets	6,234,659	185,021
Total expenditures for additions to long-lived assets	515,359	

Reconciliation of segment information to the consolidated financial statements for the years ended December 2003, 2004 and 2005.

	2003 Rmb	2004 Rmb	2005 Rmb
Total segment profit	722, 341	773, 571	24,197
Service fee to an affiliate of HLA (see Note 27)			(30,765)
Other corporate general and administrative expenses	(25,435)	(19,717)	(18,522)
Consolidated income/(loss) before income taxes and minority interests	696,906	753,854	(25,090)
Total assets for reportable segment	3,896,463	5,268,660	6,419,680
Corporate cash and cash equivalents	129,795	108,514	247,332

Other corporate assets	7,374	7,074	12,618
Consolidated total assets	4,033,632	5,384,248	6,679,630

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

	Years ended December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb	2005 US$
			Restated (Note 2A)	
Revenues, net				
4108 Light-Duty Diesel Engines	174,173	325,242	634,532	78,627
4110 Light-Duty Diesel Engines	328,993	544,297	595,239	73,757
4112 Light-Duty Diesel Engines	266,639	314,453	321,548	39,844
6105 Medium-Duty Diesel Engines	911,190	1,143,535	1,744,953	216,222
6108 Medium-Duty Diesel Engines	1,504,140	1,372,073	809,054	100,252
6112 Heavy-Duty Diesel Engines	1,003,791	1,203,558	785,236	97,300
6113 Heavy-Duty Diesel Engines	3,697	97,368	192,850	23,897
Diesel Engine Parts	228,500	446,135	488,414	60,521
Others*	148,827	135,434	244,914	30,348
	4,569,950	5,582,095	5,816,740	720,768

* Others mainly represent the revenues earned through sales of motor vehicle chassis and power generators.

29 Foreign currency exchange

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

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

30 Distribution of profits

The Company s sources of cash flow are its share of the dividends, if any, paid by Yuchai and TCL to the Company. With respect to dividends by Yuchai, applicable PRC laws and regulations require that, before it can distribute profit to its stockholders it must satisfy all tax liabilities, recover losses in previous years and make contributions to certain statutory reserves as discussed in Note 22. Such dividends may be paid partly in Renminbi and partly in foreign currency. In the event that dividends are distributed in Renminbi, the dividends may be converted into foreign currency and remitted in accordance with relevant PRC laws, regulations and policies and to the extent permitted by PRC market conditions. Dividends of Yuchai are determined based on distributable profit reported in its PRC GAAP financial statements, after appropriation to statutory reserves. Such distributable profits differ from the amounts reported under U.S. GAAP. No similar provisions were imposed with respect to dividends by TCL.

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

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31 Derivative instrument and hedging activities

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

32 Fair value of financial instruments

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

Cash and cash equivalents of Yuchai and its subsidiaries denominated in foreign currencies have been translated at the balance sheet date into Renminbi at rates quoted by the PBOC. Yuchai does not have and does not believe it will have any difficulty in exchanging its foreign currency cash for Renminbi.

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

33 Significant concentrations and risks

(a) Customer concentration

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

	Years ended December 31,			
	2003 Rmb	**2004 Rmb**	**2005 Rmb**	**2005 US$**
Liuzhou Dongfeng Automobile (see Note (i))	391,086	830,018	385,049	47,712
Hubei Dongfeng Automobile (see Note (ii))	613,448	344,910	333,452	41,319

Notes:

(i): Sales to Liuzhou Dongfeng Automobile for the year ended December 31, 2003, 2004 and 2005 was approximately 8.6%, 14.9% and 6.6% of total sales.

(ii): Sales to Hubei Dongfeng Automobile for the year ended December 31, 2003, 2004 and 2005 was approximately 13.4%, 6.2% and 5.7% of total sales.

All the above customers are controlled by or affiliated with Dongfeng Automobile Company. At December 31, 2004 and 2005, approximately 29% and 13% of gross trade accounts receivable, respectively, were due from these customers. The Company considers its relationships with these major customers to be good; however, the loss of one or more of the Company s major customers would have a material adverse effect on the Company s results of operations.

(b) Nature of operations

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

(c) Transactions involving Yuchai s Chinese shareholders

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

34 Subsequent events

(a) Acquisition of debt and equity in an investment-holding company

In February 2006, the Company acquired S$129 million (equivalent to Rmb 626 million) in principal amount of secured bonds (the Bonds), 123,010,555 redeemable convertible preference shares (the Preference Shares), and 191,413,465 ordinary shares (the Ordinary Shares) (collectively, the Sale Securities) issued by LKN for an aggregate purchase consideration of approximately S$132 million (equivalent to approximately Rmb639 million) (the Aggregate Purchase Consideration) from certain banks, financial institutions, corporations and individuals (collectively the Sellers). Immediately following the purchase, the Company hold 29.13% of the Ordinary Shares based on LKN s total issued and outstanding Ordinary Shares or approximately 40.30% of the Ordinary Shares of LKN assuming full conversion of the 123,010,555 Preference Shares.

LKN is a company listed on the Main Board of the Singapore Exchange and is primarily engaged in the business of investment holding, including investing in rental property and hospitality business in Asia.

The Company initially intends to account for the Ordinary Shares of LKN using equity method and the Bonds and Preference Shares as available-for-sale securities.

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(b) Right issue of LKN

On February 28, 2006, LKN announced a proposed renounceable rights issue of zero coupon unsecured non-convertible bonds due 2009 (the New Bonds) and non-redeemable convertible cumulative preference shares in the capital of LKN (the New NCCPS) (the Rights Issue). The purpose of the Rights Issue of LKN is to raise funds for redeeming the existing Bonds and for working capital purpose. The Company has provided LKN an irrevocable undertaking to subscribe in full and by way of excess application, all New Bonds and New NCCPS not taken up by other stockholders of LKN.

On July 4, 2006, the Company was allotted 196,201,374 of New NCCPS and S$130,800,917 of New Bonds at a consideration of S$135 million (equivalent to approximately Rmb655 million). Assuming full conversion of the existing Preference Shares and New NCCPS, the Company s equity interest in LKN would increase from 40.3% to 51.7%. In the event the Company obtains a controlling financial interest in LKN, then LKN would become a subsidiary of the Company and its financial statement would be included in the consolidated financial statements of the Company from that point forward.

(c) Rights issue of TCL

In January 2006, TCL conducted a renounceable non-underwritten rights issue of new shares (Rights Shares) at an issue price of S$0.08 (equivalent to approximately Rmb0.39) for each Rights Share; and a renounceable non-underwritten rights issue of unsecured 2% convertible bonds due 2009 (Convertible Bonds) in the denomination of S$0.8 (equivalent to approximately Rmb3.9) for each Convertible Bond.

On February 16, 2006, the Company was allotted 87,860,288 Rights Shares and 52,933,440 Convertible Bonds in TCL for an aggregate cash consideration of S$49,400,000 (equivalent to approximately Rmb239,758).

As a result of the rights issues, the Company s equity interest in TCL increase from 15.99% to 19.36%, and would increase to 36.85% assuming full conversion of the Convertible Bonds held by the Company.

(d) New bank facility

In January to March 2006, the Company entered into additional unsecured credit facilities with certain banks for approximately S$170 million (equivalent to approximately Rmb825 million). The facilities may only be utilized by the Company in connection with certain limited circumstances relating to its business expansion activities. The terms of the facilities require, among other things, that HLA retains ownership of the Company s special share and that the Company remains a consolidated subsidiary of HLA. The terms of the facilities also include certain financial covenants with respect to the Company s tangible net worth and net gearing ratio throughout the tenor of the facility, as well as negative pledge provisions and customary drawdown requirements and events of default.

(e) Issuance of corporate bonds by Yuchai

In March 2006, Yuchai applied to the PBOC to issue short term bonds up to Rmb1,000,000 (US$123,912). The application was approved by PBOC on May 30, 2006 and the first tranche of bonds of Rmb500,000 (US$61,956) was issued on June 12, 2006. The bonds were issued at a discount and an amount totalling Rmb488 million was received by Yuchai. The bonds mature on March 9, 2007 and the funds will be used to pay off existing bank loans.