CHINA YUCHAI INTERNATIONAL LTD
Form 20-F
July 15, 2005

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from __________to __________

For the fiscal year ended December 31, 2004 **Commission file number 1-13522**

China Yuchai International Limited

(Exact Name of Registrant as Specified in Its Charter)

N/A	Bermuda
(Translation of Registrant s Name Into English)	(Jurisdiction of Incorporation or Organization)

16 Raffles Quay #26-00
Hong Leong Building
Singapore 048581
65-6220-8411
(Address and Telephone Number of Principal Executive Offices)

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

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

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None
(Title of Class)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark which financial statement item the registrant has elected to follow.
Item 17 o Item 18þ

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Certain Definitions and Supplemental Information

All references to China , PRC and the State in this Annual Report are references to the People s Republic of China. Unless otherwise specified, all references in this Annual Report to U.S. dollars , dollars , US$ or $ are to United States dollars; all references to Renminbi or Rmb are to Renminbi, the legal tender currency of China. Unless otherwise specified, translation of amounts from Renminbi to U.S. dollars for the convenience of the reader has been made in this Annual Report at the rate of Rmb 8.2765 = US$1.00, the rate quoted by the People s Bank of China on December 31, 2004. No representation is made that the Renminbi amounts could have been, or could be, converted into U.S. dollars at that rate or at any other rate.

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

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

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

Cautionary Statements with Respect to Forward-Looking Statements

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

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

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

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

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

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

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

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

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

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

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

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

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

Incorporation by Reference

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

PART I

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

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE.

Not Applicable.

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ITEM 3. KEY INFORMATION.

Selected Financial Data

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

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

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

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

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

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

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

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

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

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

(4) Depreciation of property, plant and equipment and amortization of lease prepayments.

(5) The Company s functional and reporting currency is Renminbi, and the translation of amounts from Renminbi to U.S. dollars is solely for the convenience of the reader. Translation of amounts from Renminbi to U.S. dollars has been made at the rate of Rmb 8.2765 = US$1.00, the rate quoted by the People s Bank of China at the close of business on December 31, 2004. No representation is made that the Renminbi

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

Dividends

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

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

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

(2) The dividends declared for 2002 by Yuchai were paid to the Company in 2003 following execution of the July 2003 Agreement.

(3) The dividends declared for 2004 by Yuchai were paid to the Company in 2005 following execution of the Reorganization Agreement.

Historical Exchange Rate Information

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

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

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

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

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

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

Risk Factors

Risks relating to our company and our business

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

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

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

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

We may experience disagreements with the Chinese stakeholders in Yuchai.

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

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

Our sales are concentrated among the Dongfeng Group, which includes the Dongfeng Automobile Company, one of the largest state-owned automobile companies in China, and other major diesel truck manufacturers controlled by or affiliated with the Dongfeng Automobile Company. In 2004, the Dongfeng Group accounted for 21.0% of our gross sales and included our two largest customers: Liuzhou Dongfeng Automobile and Hubei Dongfeng Automobile. Although we consider our relationships with the Dongfeng Group to be good, the loss of one or more of the companies within the Dongfeng Group as a customer would have a material adverse effect on our financial condition, results of operations, business or prospects.

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

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

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

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

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

- improvements in competitors products;
- increased production capacity of competitors;
- increased utilization of unused capacity by competitors; and
- price competition.

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

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

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

In the light-duty diesel engine market, our 4108, 4110 and 4112 light-duty engines introduced in 2000 were met with weak consumer demand due to strong competition and a high pricing structure. Although there had been an increase in sales of our 4-Series engines in 2003 and 2004, we cannot assure you that we will be able to continue to improve our market share for light-duty diesel engines, and we may, in the future, decide to cease production of one or more of the models we are currently producing.

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

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

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

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

- obtaining the necessary supplies;
- hiring and training skilled production workers and management personnel;
- manufacturing and delivering products for increased orders in a timely manner;
- maintaining quality standards and prices; and
- controlling production costs.

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

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

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

The business and prospects for the diesel engine industry, and thus the business and prospects of our company, may also be adversely affected by Chinese government policy. For example, in 1998, the Chinese government announced a major initiative to boost consumer demand through investments in infrastructure projects and increased availability of bank credit. As a result, demand for trucks and other commercial vehicles, and thus demand for diesel engines, continued to increase from 2002 to 2004. However, we cannot assure you that the Chinese government will not change its policy in the future to de-emphasize the use of diesel engines, and any such change will adversely affect our financial condition, results of operations, business or prospects. For example, the Chinese government has recently announced measures to avoid overheating in certain sectors of the economy, which may include tight bank lending policies and increases in bank interest rates (see Risks relating to Mainland China Adverse changes in the economic policies of the Chinese government could have a material adverse effect on the overall economic growth of Mainland China, which could reduce the demand for our products and adversely affect our competitive position).

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

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

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

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

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

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

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

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

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

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

The value of the Renminbi is subject to changes in Chinese government policies and to international economic and political developments. Although the official exchange rate for the conversion of Renminbi to U.S. dollars has been stable, with Renminbi appreciating slightly against the U.S. dollar in recent years, the exchange rate of the Renminbi could become volatile against the U.S. dollar or other currencies. Since 1994, the conversion of Renminbi into Hong Kong and United States dollars has been based on rates set by the People s Bank of China, which are set daily based on the previous day s Chinese interbank foreign exchange market rate and current exchange rates on the world financial markets. The Chinese government has stated publicly that it intends to make the Renminbi fully convertible in the future. However, we cannot predict when the Chinese government will allow free conversion of the Renminbi into foreign currency, and we cannot assure you that the Chinese government will not take steps that will cause the Renminbi to devalue. Substantially all of our operating revenue is denominated in Renminbi, while a major portion of our capital expenditures is denominated in U.S. dollars and Euros. Since we may not be able to hedge effectively against Renminbi devaluations, future movements in the exchange rate of Renminbi and other currencies could have an adverse effect on our financial condition and results of operations.

We may be adversely affected by environmental regulations.

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

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

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

The market price for our common stock may be volatile.

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

- our interim operating results;
- the public s reaction to our press releases and announcements and our filings with the Securities and Exchange Commission (or SEC);
- changes in financial estimates or recommendations by stock market analysts regarding us, our competitors or other companies that investors may deem comparable;
- operating and stock price performance of our competitors or other companies that investors may deem comparable;
- changes in general economic conditions;
- future sales of our common stock in the public market, or the perception that such sales could occur;
- the announcement by us or our competitors of a significant acquisition; and
- increases in labor and other costs.

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

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Risks relating to Mainland China

Substantially