

CHINA YUCHAI INTERNATIONAL LTD

Form 20-F

January 30, 2009

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

FORM 20-F

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

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

**For the fiscal year ended December 31, 2007
OR**

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

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

Date of event requiring this shell company report _____

**For the transition period from _____ to _____
Commission file number 1-13522**

**China Yuchai International Limited
(Exact Name of Registrant as Specified in Its Charter)**

Not Applicable **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, 2007, 37,267,673 shares of common stock, par value US\$0.10 per share, and one special share, par value US\$0.10, were issued and outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued or
by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this report is an annual report, indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No

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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 US dollars, dollars, US\$ or \$ are to United States dollars; all references to Renminbi or Rmb are to Renminbi, the legal tender currency of China; all references to S\$ are to Singapore dollars, the legal tender of Singapore. Unless otherwise specified, translation of amounts for the convenience of the reader has been made in this Annual Report (i) from Renminbi to US dollars at the rate of Rmb 6.8346 = US\$1.00, the rate quoted by the People's Bank of China, or PBOC, on December 31, 2008 and (ii) from Singapore dollar to US dollars at the rate of S\$1.4377 = US\$1.00, 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 on December 31, 2008. No representation is made that the Renminbi amounts or Singapore dollar amounts could have been, or could be, converted into US dollars at rates specified herein or any other rate.

Our consolidated financial statements are reported in Renminbi and prepared in conformity with accounting principles generally accepted in the United States of America, or US GAAP. Totals presented in this Annual Report may not correctly total due to rounding of numbers. References to a particular fiscal year are to the period ended December 31 of such year.

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 subsidiaries. All references herein to Yuchai are to Guangxi Yuchai Machinery Company Limited and its subsidiaries and, prior to its incorporation in July 1992, to the machinery business of its predecessor, Guangxi Yulin Diesel Engine Factory, or 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, or the State Holding Company, which became a shareholder of Yuchai. All references to HLGE are to HL Global Enterprises Limited (formerly known as HLG Enterprise Limited); and all references to the HLGE group are to HLGE and its subsidiaries. All references to TCL are to Thakral Corporation Ltd; and all references to the TCL group are to TCL and its subsidiaries.

As of December 31, 2007, 37,267,673 shares of our common stock, par value US\$0.10 per share, or Common Stock, and one special share, par value US\$0.10, of our Common Stock were issued and outstanding. The weighted average shares of common stock outstanding during the year was 37,267,673. Unless otherwise indicated herein, all percentage share amounts with respect to the Company are based on the weighted average number of shares of 37,267,673 for 2007. As of December 31, 2008, 37,267,673 shares of our Common Stock, and one special share, par value US\$0.10, of our Common Stock were issued and outstanding.

Cautionary Statements with Respect to Forward-Looking Statements

We wish 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 our interpretation of factors affecting our business and operations. We believe that the following important factors, among others, in some cases have affected, and in the future could affect our consolidated results and could cause our consolidated results for 2008 and beyond to differ materially from those described in any forward-looking statements made by us or on our behalf:

- 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, our diesel engine customers, the demand, sales volume and sales prices for our diesel engines and our levels of accounts receivable;

- the effects of unfavourable economic and market conditions and the current volatility in stock markets around the world adversely impacting the entire financial industry and capital markets resulting in a worldwide economic slowdown, on our business, operating results and growth rates;

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

the effects of existing material weaknesses in our internal control over financial reporting and our ability to implement and maintain effective internal control over financial reporting;

our ability to collect and control our levels of accounts receivable;

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

our ability to successfully manufacture and sell our 4108, 4110, 4110Q, 4112, 4F, 4G, 6105, 6108, 6112, 6L/6M (formerly referred to as 6113) heavy-duty diesel engines and any new products;

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our ability to finance our working capital and capital expenditure requirements, including obtaining any required external debt or other financing;

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

our ability to successfully implement the Reorganization Agreement, as amended by the Cooperation Agreement (both as defined in Item 4. Information on the Company History and Development Reorganization Agreement) (See Item 4. Information on the Company History and Development Cooperation Agreement);

our ability to control Yuchai and consolidate Yuchai's financial results;

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

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

the effects of adverse economic conditions in consumer spending patterns and its impact on the demand for the TCL group's consumer electronics products;

the ability of TCL to obtain shareholders and regulatory approvals for, and successfully implement, its announced strategy of repositioning its principal business from consumer electronics distribution to real estate and related infrastructure investment in the pan-Asian region;

the effects of our disagreement with the other major shareholders of TCL over the running of TCL group's operations and its proposed change in its strategy from consumer electronics to real estate and related infrastructure investment in the pan-Asian region;

the effects of changes to the international, regional and economic climate and market conditions in countries where the HLGE group's hospitality operations are located, as well as related global economic trends that adversely impact the travel and tourism industries;

the outbreak of communicable diseases, such as the Avian flu, if not contained, and its potential effects on the operations of the HLGE group and its business in the hospitality industry; and

the impact of terrorism, terrorist events, airline strikes, hostilities between countries or increased risk of natural disasters or viral epidemics that may affect travel patterns and reduce the number of travelers and tourists to the HLGE group's hospitality operations.

Our actual results, performance, or achievement may differ from those expressed in, or implied by, the forward-looking statements contained in this Annual Report. Accordingly, we can give no assurances that any of the events anticipated by these forward-looking statements will transpire or occur or, if any of the foregoing factors or other risks and uncertainties described elsewhere in this Annual Report were to occur, what impact they will have on these forward-looking statements, including our results of operations or financial condition. In view of these uncertainties, you are cautioned not to place undue reliance on these forward-looking statements. We expressly disclaim any obligation to publicly revise any forward-looking statements contained in this Annual Report to reflect the occurrence of events after the date of this Annual Report.

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Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE.

Not Applicable.

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 our audited consolidated financial statements and the notes thereto included in this Annual Report. Our consolidated financial statements are prepared in conformity with US GAAP.

On May 30, 2008, the Company filed an amendment to its annual report on Form 20-F for the year ended December 31, 2005 containing the restated financial statements as of and for the year ended December 31, 2005 to reflect certain adjustments to correct accounting errors mainly at Yuchai for such period.

We currently own, through six of our wholly-owned subsidiaries, 76.4% of the outstanding shares of Yuchai. Our ownership interest in Yuchai is our main operating asset. As a result, our financial condition and results of operations depend primarily upon Yuchai's financial condition and results of operations, and the implementation of the Reorganization Agreement, as amended by the Cooperation Agreement.

Following an announcement in February 2005 by the Board of Directors of the Company of its approval of the implementation of our business expansion and diversification plan, we have looked for new business opportunities to seek to reduce our financial dependence on Yuchai. As of December 31, 2007, we had a 34.42% interest in the outstanding ordinary shares of TCL and a 45.39% interest in the outstanding ordinary shares of HLGE. As of December 31, 2008, our interest in the outstanding ordinary shares of TCL and HLGE remained unchanged. For further information on the Company's investments in TCL and HLGE, see Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan.

The selected consolidated balance sheet data as of December 31, 2006 and 2007 and the selected consolidated statement of operations data and selected consolidated statement of cash flows data set forth below for the years ended December 31, 2005, 2006 and 2007 are derived from our audited consolidated financial statements included in this Annual Report. Our selected consolidated balance sheet data set forth below as of December 31, 2003, 2004 and 2005 and selected consolidated statement of operations data and selected consolidated statement of cash flows data for the years ended December 31, 2003 and 2004 are derived from our audited consolidated financial statements not included in this Annual Report.

	Year ended December 31,					
	2003	2004	2005	2006	2007	2007
	Rmb	Rmb	Rmb	Rmb	Rmb	US\$(¹)

(in thousands except earnings per share)

Selected Consolidated Statement of Operations Data:

Revenues, net	4,569,950	5,582,095	5,816,740	6,920,528	9,556,303	1,398,224
Gross profit	1,377,156	1,575,209	1,143,383	1,272,121	1,944,718	284,540
Research and development costs	(94,594)	(136,960)	(123,793)	(167,653)	(153,146)	(22,407)
Provision for uncollectible loans to a			(202,950)			

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	2003	2004	As of December 31,		2007	2007
	Rmb	Rmb	2005	2006	Rmb	US\$(¹)
			Rmb	Rmb		
			(in thousands)			
Total assets	4,033,632	5,384,248	6,679,630	7,961,357	9,579,184	1,401,572
Long-term bank loans, excluding current installments		100,000	50,000	675,454	767,929	112,359
Minority interests	544,526	724,311	654,687	693,296	849,527	124,299
Total stockholders equity	1,991,687	2,483,084	2,566,263	2,728,399	3,294,465	482,027

	2003	2004	Year ended December 31,		2007	2007
	Rmb	Rmb	2005	2006	Rmb	US\$(¹)
			Rmb	Rmb		
			(in thousands)			

Selected Consolidated Statement of Cash Flows Data:

Net cash provided by operating activities	1,075,274	589,608	234,770	634,146	84,554	12,371
Capital expenditures ⁽³⁾	372,775	552,902	515,359	323,781	265,258	38,811

- (1) The Company's functional currency is the U.S. dollar and its reporting currency is Renminbi. The functional currency of Yuchai is Renminbi. Translation of amounts from Renminbi to US 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 6.8346 = US\$1.00, the rate quoted by the People's Bank of China at the close of business on December 31, 2008. No representation is made that the Renminbi amounts could have been, or could be, converted into U.S. dollars at that rate or at any other rate prevailing on December 31, 2008 or any other date. The rate quoted by the People's Bank of China at the close of business on December 31, 2007 was Rmb 7.3046 = US\$1.00. The Renminbi has appreciated against the U.S. dollar since December 31, 2007.

- (2) Current assets less current liabilities.
- (3) Purchase of property, plant and equipment and payment for construction in progress.

Dividends

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

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

Chinese laws and regulations applicable to a Sino-foreign joint stock company require that before Yuchai distributes profits, it must (i) recover losses in previous years; (ii) satisfy all tax liabilities; and (iii) make contributions to the statutory reserve fund in an amount equal to 10% of net income for the year determined in accordance with generally accepted accounting principles in the PRC, or PRC GAAP. However, the allocation of statutory reserve fund will not be further required once the accumulated amount of such fund reaches 50.0% of the registered capital of Yuchai.

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

The following table sets forth a five-year summary of dividends we have paid to our shareholders as well as dividends paid to us by Yuchai:

Period	Dividend paid by the Company to its shareholders (per share)	Dividend paid/declared by Yuchai to the Company⁽¹⁾ (in thousands)
2003	US\$2.08	Rmb 61,433 (US\$7,422)
2004	Nil	Rmb 231,309 (US\$27,906) ⁽²⁾
2005	US\$0.39	Rmb 72,282 (US\$9,039) ⁽³⁾
2006	US\$0.02 ⁽⁴⁾	Rmb 72,284 (US\$9,598) ⁽⁵⁾
2007	US\$0.10 ⁽⁶⁾	Rmb 108,313 (US\$15,811) ⁽⁷⁾
2008	US\$0.10 ⁽⁸⁾	Not yet declared

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- (1) Dividends paid by Yuchai to us, as well as to other shareholders of Yuchai, were declared in Renminbi and paid in US dollars (as shown in parentheses) based on the exchange rates at local designated foreign exchange banks on the respective payment dates. For dividends paid for 2003, 2004, 2005, 2006 and 2007, the exchange rate used was Rmb 8.2767 = US\$1.00, Rmb 8.2765 = US\$1.00, Rmb 7.9967 = US\$1.00, Rmb 7.5310 = US\$1.00 and Rmb 6.8357 = US\$1.00, respectively.
- (2) The dividend declared for 2004 by Yuchai was paid to us in 2005 following the execution of the Reorganization Agreement (as defined in Item 4. Information on the Company History and Development Reorganization Agreement).
- (3) On June 26, 2006, Yuchai declared a dividend to all shareholders in respect of the fiscal year ended December 31, 2005 and the amount attributable to the Company was Rmb 72.3 million. We received this dividend on July 28, 2006.
- (4) On December 4, 2006, we declared an interim dividend to all shareholders in respect of the fiscal year ended December 31, 2006. This dividend was paid to the shareholders on December

28, 2006.

- (5) The dividend declared for 2006 by Yuchai was paid to us on September 17, 2007.
- (6) On September 28, 2007, we declared a second interim dividend of US\$0.10 per ordinary share amounting to US\$3.7 million to all shareholders in respect of the fiscal year ended December 31, 2006. This dividend was paid to the shareholders on October 24, 2007.
- (7) The dividend declared for 2007 by Yuchai was paid to us on August 22, 2008.
- (8) On August 25, 2008, we declared an interim dividend of US\$0.10 per ordinary share amounting to US\$3.7 million to all shareholders in respect of the fiscal year ended December 31, 2007. This dividend was paid to the shareholders on September 19, 2008.

Historical Exchange Rate Information

On December 31, 2007, 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 was Rmb 7.2946 = US\$1.00. On December 31, 2008, the noon buying rate was Rmb 6.8225 = US\$1.00.

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

Period	Noon Buying Rate ⁽¹⁾ (Rmb per US\$1.00)	
	High	Low
December 2007	7.4120	7.2946
January 2008	7.2946	7.1818
February 2008	7.1973	7.1100
March 2008	7.1075	7.0105
April 2008	7.0185	6.9840
May 2008	7.0000	6.9377
June 2008	6.9633	6.8591
July 2008	6.8632	6.8104

August 2008	6.8705	6.7800
September 2008	6.8510	6.7810
October 2008	6.8521	6.8171
November 2008	6.8373	6.8220
December 2008	6.8842	6.8225

Period	Period End	Noon Buying Rate⁽¹⁾ (Rmb per US\$1.00)		
		Average⁽²⁾	High	Low
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	8.0702	8.1734	8.2765	8.0702
2006	7.8041	7.9579	8.0702	7.8041
2007	7.2946	7.5806	7.8127	7.2946
2008 (through December 31, 2008)	6.8225	6.9193	7.2946	6.7800

(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 PBOC. As

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a result, since April 1994, the noon buying rate and the PBOC rate have been substantially similar. The PBOC rate at the end of 2007 was Rmb 7.3046, compared with Rmb 7.5806 for the noon buying rate (average) for the year ended December 31, 2007. The PBOC rate at the end of 2008 was Rmb 6.8346, compared with Rmb 6.9193 for the noon buying rate (average) for the year ended December 31, 2008.

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

Risk Factors

Risks relating to our shares and share ownership

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

Our controlling shareholder, Hong Leong Asia Ltd., or Hong Leong Asia, 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. Hong Leong Asia controls us through its wholly-owned subsidiary, Hong Leong (China) Limited, or Hong Leong China, and through HL Technology Systems Pte Ltd, or HL Technology, a wholly-owned subsidiary of Hong Leong China. HL Technology owns approximately 21.0% of the outstanding shares of our Common Stock and is, and has since August 2002 been, the registered holder of the special share. Hong Leong Asia also owns, and has since

May 2005 owned, through another wholly-owned subsidiary, Well Summit Investments Limited, approximately 0.2% of the outstanding shares of our Common Stock. Hong Leong Asia is a member of the Hong Leong Investment Holdings Pte Ltd., or Hong Leong Investment, group of companies. Prior to August 2002, we were controlled by Diesel Machinery (BVI) Limited, or Diesel Machinery, which, until its dissolution, was a holding company controlled by Hong Leong China and was the prior owner of the special share. Through HL Technology's stock ownership and the rights accorded to the Special Share under our bye-laws and various agreements among shareholders, Hong Leong Asia is able to effectively approve and effect most corporate transactions. See Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Shareholders Agreement. In addition, our shareholders do not have cumulative voting rights. There can be no assurance that Hong Leong Asia's actions will be in the best interests of our other shareholders. See also Item 7. Major Shareholders and Related Party Transactions Major Shareholders. ***We may experience a change of control as a result of sale or disposal of shares of our Common Stock by our controlling shareholders.***

As described above, HL Technology, a subsidiary of Hong Leong Asia, owns 7,831,169 shares of our Common Stock, as well as the special share. If HL Technology reduces its shareholding to less than 7,290,000 shares of our Common Stock, our Bye-Laws provide that the special share held by HL Technology will cease to carry any rights, and Hong Leong Asia may as a result cease to have control over us. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders The Special Share. If HL Technology sells or disposes of all of the shares of our Common Stock, we cannot determine what control arrangements will arise as a result of such sale or disposal (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.

In addition, certain of our financing arrangements have covenants requiring Hong Leong Asia to retain ownership of the special share and that we remain a principal subsidiary (as defined in such arrangements) of Hong Leong Asia. A breach of that covenant may require us to pay all outstanding amounts under those financing arrangements. There can be no assurance that we will be able to pay such amounts or obtain alternate financing.

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 availability of raw materials used in our engine production, particularly steel and cast iron;

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

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, especially the impact of the global financial crisis on economic growth;

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

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the announcement by us or our competitors of a significant acquisition.

In recent months as a result of the worldwide financial crisis, global stock markets have 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.

Risks relating to our company and our business

The diesel engine business in China is dependent in large part on the performance of the Chinese and the global 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 and the global economy, as well as Chinese government policies affecting our business.

Our operations and performance depend significantly on worldwide economic conditions. During periods of economic expansion, the demand for trucks, construction machinery and other applications of diesel engines generally increases. Conversely, uncertainty about current global economic conditions or adverse changes in the economy could lead to a significant decline in the diesel engine industry which 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. Uncertainty and adverse changes in the economy could also increase costs associated with developing our products, increase the cost and decrease the availability of potential sources of financing, and increase our exposure to material losses from our investments, any of which could have a material adverse impact on our financial condition and operating results.

As widely reported, financial markets in the United States, Europe and Asia have been experiencing extreme disruption in recent months, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. Weak economic conditions in our target markets, or a reduction in automobile spending even if economic conditions improve, would likely adversely impact our business, operating results and financial condition in a number of ways, including longer sales cycles, lower prices for our products and reduced unit sales. Our revenues and gross margins are based on certain levels of consumer and corporate spending. The current conditions make it difficult for our customers, our vendors and us to accurately forecast and plan future business activities. If our projections of these expenditures fail to materialize due to reductions in consumer or corporate spending as a result of uncertain conditions in the macroeconomic environment, our revenues and gross margins could be adversely affected. As a result of the current tightening of credit in financial markets, our customers and suppliers may experience serious cash flow problems and as a result, may modify, delay or cancel plans to purchase our products. Any inability of current and/or potential customers to pay us for our products may adversely affect our earnings and cash flow. The global financial crisis has had an adverse impact on the economic growth outlook for China with the growth in the third quarter ended September 30, 2008 falling to its lowest level in five years. As a result, the Chinese government on November 10, 2008 announced a 4 trillion yuan stimulus package to maintain economic stability and development through spending on infrastructure projects. The measures being adopted by the Chinese government to ensure continued economic growth is in the very early stages of implementation and there is no assurance that such a stimulus package will be successful in achieving its aim. Uncertainty and adverse changes in the economy could also increase costs associated with developing our products, increase the cost and decrease the availability of potential sources of financing, and increase our exposure to material losses from our investments. Additionally, our stock price could decrease if investors have concerns that our business, financial condition and results of operations will be negatively impacted by a worldwide macroeconomic downturn. We are unable to predict the likely duration and severity of the current disruption in financial markets and adverse economic conditions in the U.S. and other countries. If these conditions deteriorate further or do not show improvement, we may experience material adverse impact to our business and operating results.

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. In 2005, however, sales for trucks and other commercial vehicles declined by approximately 1.0% due to a credit tightening policy by the Chinese government. In 2006, sales for commercial vehicles increased 14.2% due to the strong economic growth achieved and continued investment in infrastructure building by the Chinese government. (*Source: China Automotive Industry Newsletter for 2006*). In 2007, sales for commercial vehicles increased by approximately 26.0% due to the continued economic growth in China. (*Source: China Automotive Industry Newsletter for 2007*) 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 from time to time introduced measures to avoid overheating in certain sectors of the economy, including tighter 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.

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

We own 76.4% of the outstanding shares of Yuchai, and one of our primary sources 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 Investments Limited, or Coomber, entered into the Reorganization Agreement in April 2005, as amended in December 2005 and November 2006, and agreed on a restructuring plan for our company intended to be beneficial to our shareholders. In June 2007, we, along with Yuchai, Coomber and the State Holding Company, entered into the Cooperation Agreement. The Cooperation agreement amends certain terms of the Reorganization Agreement and as so amended, incorporates the terms of the Reorganization Agreement. Pursuant to the amendments to the Reorganization Agreement, the Company has agreed that the restructuring and spin-off of Yuchai will not be effected, and, recognizing the understandings that have been reached between the Company and the State Holding Company to jointly undertake efforts to expand the business of Yuchai, the Company will not seek to recover the anti-dilution fee of US\$20 million that was due from Yuchai. See

Item 4. Information on the Company History and Development Reorganization Agreement. No assurance can be given as to when the business expansion requirements relating to Yuchai as contemplated by the Reorganization Agreement and the Cooperation Agreement will be fully implemented, or that implementation of the Reorganization Agreement and the Cooperation 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 business expansion and diversification plan adopted in February 2005. One of the goals of this business expansion and diversification plan is to reduce our financial dependence on Yuchai. Thus far, we have acquired strategic stakes in TCL and HLGE. See

Item 5. Operating and Financial Review and Prospects Business Expansion and Diversification Plan. Nonetheless, no assurance can be given that we will be able to successfully expand and diversify our business. We may also not be able to continue 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 and Cooperation Agreement, including our continued expansion and diversification, could have a material adverse effect on our financial condition, results of operations, business or prospects. Additionally, although the Cooperation Agreement amends certain provisions of the Reorganization Agreement and also acknowledges the understandings that have been reached between us and the State Holding Company to jointly undertake efforts to expand and diversify the business of Yuchai, no assurance can be given that we will be able to successfully implement those efforts or as to when the transactions contemplated therein will be consummated.

We have and may continue to experience disagreements and difficulties with the Chinese shareholders in Yuchai.

Although we own 76.4% of the outstanding shares of Yuchai, 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 shareholders 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 legal protection available to foreign investors. We have in the past experienced problems from time to time in obtaining assistance and cooperation of Yuchai's Chinese shareholders 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, the Reorganization Agreement and the Cooperation 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 the Company's continued rights as majority shareholder to direct the management and policies of Yuchai through Yuchai's Board of Directors. Yuchai's Articles of Association have been amended and such amended Articles of Association entitle the Company to elect nine of Yuchai's 13 directors, thereby reaffirming the Company's right to effect all major decisions relating to Yuchai. However, Yuchai's amended Articles of Association are not yet effective pending approval of the Ministry of Commerce, PRC. While Yuchai has affirmed the Company's continue