

CHINA YUCHAI INTERNATIONAL LTD  
Form 20-F/A  
May 30, 2008  
Table of Contents

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 20-F/A**

(Amendment No. 1)

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

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2005**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from            to**

**OR**

**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**

# China Yuchai International Limited

(Exact Name of Registrant as Specified in Its Charter)

**Not Applicable**  
(Translation of Registrant's Name Into English)

**Bermuda**  
(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, 2005, 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.

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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 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

**Table of Contents**

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

**EXPLANATORY NOTE**

China Yuchai International Limited (the Company) is filing this Amendment No. 1 on Form 20-F/A to its Annual Report on Form 20-F for the fiscal year ended December 31, 2005, which was originally filed with the Securities and Exchange Commission on August 8, 2006, to reflect the restatement of its consolidated financial statements for the year ended December 31, 2005. The Company's consolidated financial statements for the year ended December 31, 2005 have been restated to reflect certain adjustments to correct accounting errors mainly at the Company's majority-owned subsidiary, Guangxi Yuchai Machinery Company Limited, or Yuchai, for such period. See Note 2A to the consolidated financial statements of the Company for a complete description and quantification of these adjustments and their impact on the Company's 2005 consolidated financial statements.

The most significant adjustment is to correct accounting errors for the understatement of accounts payable of Rmb 167.8 million (approximately US\$20.8 million) by Yuchai at December 31, 2005, which we refer to in this Form 20-F/A as the Rmb 167.8 million Adjustment. A review of the understatement of accounts payable by Yuchai was conducted by the Company's Audit Committee, assisted by independent counsel and independent forensic consultants. As a result of this process, the Company's management and the Audit Committee identified errors in Yuchai's manual adjustments of its accounts payable in its attempts to reconcile with Yuchai's then-new accounting systems. In connection with their review, the Audit Committee found no evidence of fraud or intentional wrongdoing by any employee of the Company or Yuchai or any plan to intentionally inflate the profits by the management of Yuchai. The Rmb 167.8 million Adjustment has resulted in a decrease in the previously reported consolidated earnings before income taxes and minority interests of the Company for the year ended December 31, 2005 by approximately Rmb 122.7 million (US\$15.2 million).

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).

As a result of the above adjustments, the Company's consolidated financial results have been restated to report a net loss of Rmb 32.3 million (US\$4.0 million) instead of the previously reported net income of Rmb 68.5 million (US\$8.5 million).

The Company has also reclassified certain items in its consolidated financial statements as of and for the year ended December 31, 2005 as described in Note 2A. These reclassifications did not have any impact on the Company's consolidated net loss, as restated, for the year ended December 31, 2005.

In connection with the restatement of the 2005 consolidated financial statements, the Company has identified certain material weaknesses in its internal control over financial reporting for the period covered by this Form 20-F/A. See Item 15. Controls and Procedures.



**Table of Contents**

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

**PART I**

**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 notes thereto 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 has looked 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 approximately 14.99% of TCL, a China-focused electronics distribution company, for approximately S\$30.9 million (approximately \$18.9 million, based on an exchange rate of S\$1.637 to US\$1.00). The Company subsequently increased its minority stake in TCL, and as of December 31, 2005 the Company's shareholding in TCL was 15.99%. The Company has also recently invested in LKN, a company primarily engaged in the business of investment holding and hospitality-related businesses, pursuant to the Company's business expansion and diversification plan.

In February 2006, the Company acquired debt and equity in LKN for an aggregate consideration of approximately S\$131.6 million (approximately \$81.2 million, based on an exchange rate of S\$1.62 to US\$1.00), divided into 191,413,465 ordinary shares representing approximately 29.13% of the total number of ordinary shares in issue; 123,010,555 redeemable convertible preference shares in the capital of LKN; and approximately S\$129.4 million (approximately US\$79.9 million, based on an exchange rate of S\$1.62 to US\$1.00) in principal amount of outstanding secured non-convertible bonds issued by LKN. For further information on the TCL and LKN minority investments, see Item 4. Information on the Company History and Development Minority Investments.

**Table of Contents**

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

The selected consolidated balance sheet data as of December 31, 2004 and 2005 and the selected consolidated statement of operations data and selected consolidated statement of cash flow data of the Company set forth below for the years ended December 31, 2003, 2004 and 2005 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, and which we refer to in this Form 20-F/A as the Consolidated Financial Statements. Certain selected consolidated balance sheet data as of December 31, 2005 and certain selected consolidated statement of operations data for the year ended December 31, 2005 have been restated to reflect the adjustments to correct accounting errors described above and in Note 2A to the Consolidated Financial Statements. The selected consolidated balance sheet data of the Company set forth below as of December 31, 2001, 2002 and 2003 and the consolidated statement of operations data and consolidated statement of cash flow data for the years ended December 31, 2001 and 2002 are derived from the consolidated financial statements of the Company, which have also been audited by KPMG, but are not included in this Annual Report.

	2001	As of and for the Year Ended December 31,					2005
	Rmb	2002	2003	2004	2005	2005	
		Rmb	Rmb	Rmb	Rmb	US\$( <sup>3</sup> )	
		Restated					
		(in thousands)					
<b>Consolidated Statement of Operations Data:</b>							
Revenues, net	1,783,329	3,513,047	4,569,950	5,582,095	5,816,740	720,768	
Gross profit	599,926	1,141,967	1,377,156	1,575,209	1,143,383	141,680	
Research and development costs	(44,721)	(75,532)	(94,594)	(136,960)	(123,793)	(15,340)	
Provision for uncollectible loans to a related party					(202,950)	(25,148)	
Operating income	295,115	640,307	721,411	779,929	26,020	3,224	
Earnings / (loss) before income taxes and minority interests	269,189	625,450	696,906	753,854	(25,090)	(3,109)	
Income taxes	63,584	(83,242)	(112,924)	(105,165)	(10,148)	(1,257)	
Income / (loss) before minority interests	332,773	542,208	583,982	648,689	(35,238)	(4,366)	
Minority interests in (income) losses of consolidated subsidiaries	(82,386)	(129,775)	(145,800)	(157,292)	2,947	365	
Net income / (loss)	250,387	412,433	438,182	491,397	(32,291)	(4,001)	
Basic and diluted earnings / (loss) per common share	7.09	11.67	12.40	13.90	(0.89)	(0.11)	
Weighted average number of shares	35,340	35,340	35,340	35,340	36,460	36,460	
<b>Consolidated Balance Sheet Data (at year end):</b>							
Working capital <sup>(1)</sup>	1,100,462	1,340,832	1,031,830	1,402,226	823,324	102,019	
Goodwill	212,636	212,636	212,636	212,636	212,636	26,348	
Total assets	3,262,868	3,985,459	4,033,632	5,384,248	6,679,630	827,690	
Long-term bank loans, excluding current instalments	180,000	50,000		100,000	50,000	6,196	
Minority interests	420,545	487,491	544,526	724,311	654,687	81,124	
Common stock	30,349	30,349	30,349	30,349	31,945	3,958	
Stockholders' equity	1,805,045	2,161,903	1,991,687	2,483,084	2,566,263	317,991	
<b>Consolidated Statement of Cash Flows Data:</b>							
Net cash provided by operating activities	59,273	659,500	1,075,274	589,608	242,674	30,070	
Capital expenditures <sup>(2)</sup>	43,043	174,850	372,775	552,902	515,359	63,860	
Depreciation and amortization	113,680	118,872	125,519	132,789	144,672	17,927	

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**Table of Contents**

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

- (1) Current assets (including cash) less current liabilities.
- (2) Purchase of property, plant and equipment, lease prepayment and payment for construction in progress.
- (3) The Company's functional currency is the U.S. dollar and its reporting currency is Renminbi. In its prior filings, the Company incorrectly disclosed Renminbi, instead of the U.S. dollar, as its functional currency. The functional currency of Yuchai is the Renminbi. 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 8.0702 = US\$1.00, the rate quoted by the People's Bank of China 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 rate prevailing on December 30, 2005 or any other date. The Renminbi has appreciated against the U.S. dollar since December 30, 2005. The rate quoted by the People's Bank of China at the close of business on May 15, 2008 was Rmb 7.0000 = US\$1.00. Since the previously filed Annual Report on Form 20-F for the year ended December 31, 2005 included translation of amounts from Renminbi to U.S. dollars at the rate of Rmb 8.0702 = US\$1.00, the Company has included translation of amounts from Renminbi to U.S. dollars in this filing at the same rate so as to provide comparable information.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS.**

**Restatement Of Previously Issued 2005 Consolidated Financial Statements**

As described in Note 2A to the Consolidated Financial Statements included in this filing, the Company has restated its previously issued consolidated financial statements for the year ended December 31, 2005. See Note 2A for more detailed information. The information in this discussion and analysis reflects this restatement, but is not otherwise updated.

The Company's 2005 Consolidated Financial Statements have been restated to reflect the following correcting adjustments:

***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





**Table of Contents**

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

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).

1. *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 have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005.
2. *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 have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005.
3. *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 have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005.
4. *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 recognized in Yuchai's 2005 financial statements. The correcting adjustments have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005.
5. *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 have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005.  
 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 have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005.
6. *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 have been made to the Company's Consolidated Financial Statements as of and for the year ended December 31, 2005. This adjustment has resulted in an increase in the Company's previously reported consolidated earnings before income taxes and minority interests for 2005 by approximately

Rmb 4.8 million.

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**Table of Contents**

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

7. *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.
8. *Effect on Income Taxes and Minority Interests.* As a result of the above corrections, including the Rmb 167.8 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.

***Summary***

As a result of all these adjustments, the Company's consolidated financial results have been restated to report a net loss of Rmb 32.3 million (US\$4.0 million) instead of the previously reported net income of Rmb 68.5 million (US\$8.5 million).

**Overview**

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

During the fiscal years ended December 31, 2003, 2004 and 2005, the Company's main asset has been its 76.4% ownership interest in Yuchai. As a result, the Company's financial condition and results of operations have depended primarily upon Yuchai's financial condition and results of operations. The Company acquired its initial 51.3% interest in Yuchai effective April 1, 1993, increased its interest to 71.4% in November 1994 through the China Everbright Purchase and then to 76.4% in December 1994 by purchasing additional Yuchai Shares with the net proceeds of its initial public offering. The Company's historical results of operations differ from those of Yuchai, primarily as a result of amortization of goodwill prior to 2002 which arose in connection with the three investments in Yuchai's equity, additional operating expenses and the minority interest of other Yuchai shareholders in Yuchai's income. In future financial periods, the Company's financial condition, results of operations, business and prospects may differ significantly from Yuchai, depending upon, among other things, the implementation of the Company's new business expansion and diversification plan and the consummation of the spin-off contemplated in the Reorganization Agreement (see Item 4. Information on the Company - Recent Developments). For example, in March 2005, the Company through its wholly-owned subsidiary, VDL, acquired an approximate 14.99% interest in TCL, VDL further acquired another 1.00% interest of the total number of TCL Shares in issue. As a result, the Company held a 15.99% stake in TCL as of December 31, 2005. The Company accounts for its investment in TCL using the equity method and the Company has reflected its proportionate share of TCL's losses in its consolidated statement of income since March 2005.

The various austerity measures taken by the Chinese government over the last decade to regulate economic growth and control inflation have at times dampened demand for trucks in China. In particular, austerity measures that restricted access to credit and slowed the rate of fixed investment (including infrastructure development) adversely affected demand for, and production of, trucks and other commercial vehicles. Such market conditions, together with increased competition in the diesel engine market, resulted in various degrees of financial and marketing difficulties for diesel engine producers, including the Company. However, the Chinese government announced in 1998 a major initiative to boost consumer demand through investments in infrastructure projects, including the construction of highways and tollways, and also through increased availability of bank credit. As a result, demand for trucks and other commercial vehicles, and thus demand for diesel engines has been increasing annually since 1999 to 2004.

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**Table of Contents**

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

Although demand for commercial vehicles in China declined by approximately 1.0% in 2005, the Company's net revenues in 2005 increased by 4.2% to Rmb 5,816.7 million (US\$720.8 million) compared to Rmb 5,582.1 million in 2004. This increase was primarily a result of higher unit sales of the 4-Series light-duty diesel and industrial engines. The Company had a loss before minority interests of Rmb 35.2 million (US\$4.4 million) in 2005 compared to income before minority interests of Rmb 648.7 million in 2004. The decrease in income before minority interests was primarily due to reduced gross margins, higher selling, general and administrative expenses, and compounded by the specific provision made of Rmb 203.0 million (US\$25.1 million) for non-trade loans to a related party (see also Note 5 to the Company's Consolidated Financial Statements). Sales of the 6108 medium-duty and 6112 heavy-duty engines accounted for 13.9% and 13.5%, respectively, of the Company's net revenues in 2005. Sales of the 6L and 6M heavy-duty diesel engines accounted for 0.8% and 2.5%, respectively, of the Company's net revenues in 2005. Due mainly to the credit tightening by banks in China, there are more customers buying the light-duty diesel engines and industrial engines because the coverage selling price of these light-duty diesel and industrial engines are lower than the medium and heavy-duty engines.

In 2005, the Company continued its efforts to control production costs and operating expenses. However, a large portion of the Company's costs and expenses relate to fixed costs incurred in connection with the production of its diesel engines, which limits the Company's ability to significantly reduce its costs and expenses. The Company's cost of goods sold mainly includes cost of materials consumed, factory overhead, direct labor and depreciation. The Company analyzes its cost of goods sold based on its cost of manufacturing for each period. Cost of manufacturing for each period equals cost of goods sold for the period plus or minus the change in period end finished goods inventory. In 2005, cost of materials consumed accounted for approximately 84.4% of the cost of manufacturing. The Company's selling, general and administrative, or SG&A, expenses include advertising expenses, provision for doubtful accounts, salaries and wages, freight charges, sales commission expenses and a large number of smaller expenses.

The Company had effective income tax rates of 16.2% and 14.0% in 2003 and 2004, respectively. In 2005, the Company had income tax expense of Rmb 10.1 million (US\$1.3 million) comprising current tax expense of Rmb 30.2 million (US\$3.7 million), offset by a deferred tax credit of Rmb 20.1 million (US\$2.5 million). Yuchai was subject to PRC income tax at a rate of 24.0% of its income determined in accordance with PRC GAAP in 1993 prior to the restructuring. After becoming a Sino-foreign joint stock company, it was exempt from PRC income tax in 1994 and 1995. Under current laws, Yuchai is subject to PRC income tax at a rate of 7.5% for each of the three years from 1996 to 1998 and a rate of 10.0% for each of the three years from 1999 to 2001. Since January 1, 2002, Yuchai is subject to tax at a rate of 15.0% so long as it continues to qualify as a foreign-invested enterprise eligible for tax reductions under PRC income tax law. In addition to the PRC income tax, Yuchai has been subject to value-added taxes on its sales since January 1, 1994. Dividends received by the Company from Yuchai can be remitted from China without any PRC taxation under current Chinese law. See Item 10. Additional Information Taxation People's Republic of China Taxation .

The Company commenced trial marketing of its 6112 heavy-duty engine in early 1999, and began commercial production of these engines during the second half of 1999. Due to the delay in commercial production of the 6112 engine until 1999, however, the Company was not able to benefit from the competitive advantages of an early entry into the domestic market for heavy-duty engines. Moreover, the market for heavy-duty diesel engines in China is relatively price sensitive. With increasing customer acceptance of the 6112 engine in late 2001 through 2003, the sales volume of the 6112 engine improved significantly. Yuchai intends to continue to manufacture its 6112 heavy-duty diesel engines although there has been a decline in unit sales in 2005 mainly due to changes in customers' demand to light-duty diesel engines. In 2005, the sales volume of the 6112 engine was 14,788 units, which was lower than 24,073 units in 2004, due to shrinking demand arising from the Chinese government's measures to tighten the credit supply within the banking sector in China as part of its efforts to minimize overheating of the economy. This situation has led to Yuchai's customers buying more of the

## **Table of Contents**

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

cheaper light-duty diesel engines as compared to the more expensive heavy-duty diesel engines. There can be no assurance that Yuchai will be able to compete successfully in the heavy-duty diesel engine market in China with the existing producers (such as Weichei Power Co., Ltd.) or any new entrants.

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

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

### **Critical Accounting Policies**

The preparation of financial statements in accordance with US GAAP require the Company's management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of the Company's assets and liabilities, disclosures of contingent liabilities and the reported amounts of revenues and expenses. These judgments, assumptions and estimates are reflected in the Company's accounting policies, which are more fully described in Note 3 to the Company's Consolidated Financial Statements appearing elsewhere herein.

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

**Table of Contents**

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

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

Allowances for doubtful accounts;

Realization of the carrying value of inventories;

Product warranty obligations;

Realization of deferred tax assets;

Impairment of long-lived assets other than goodwill;

Provision for loss contingency for guarantee granted by YEGCL; and

Recoverability of carrying value of investment in TCL.

**Allowances for doubtful accounts**

Allowance for doubtful accounts is management's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience by industry and national economic data. The Company reviews its allowance for doubtful accounts monthly. In 2005, the Company has examined the debtors ageing report and noted that there was a significant change in the amounts owing by one of its major customers, Dongfeng Group. For the year ended December 31, 2004, the Dongfeng Group accounted for about 28% of the trade debtors outstanding as compared to approximately 12% of the amount owing as of December 31, 2005. Likewise, the top 20 non-Dongfeng Group customers had increased its significance in our sales and accounted for about 44% of the gross debts outstanding at the end of 2005 from 38% at the end of 2004. The Company has noted the customer's trends, repayment patterns and ageing analysis in 2005 which confirmed that the provision policy for doubtful accounts for the year ended December 31, 2004 is no longer appropriate. Therefore, the Company has changed its accounting estimates on allowances for doubtful accounts, taking into account the changes in customers' mix. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by aging of such balances. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Changes in the allowances for doubtful accounts for each of the years in the three-year period ended December 31, 2005 are summarized as follows:

	2003	December 31,		2005
	Rmb	2004	2005	US\$
		Rmb	Rmb	
		(in thousands)		
Balance at beginning of year	158,075	94,423	107,457	13,315

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Add: Charged 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)
<b>Balance at end of year</b>		<b>94,423</b>	<b>107,457</b>	<b>69,047</b>
			<b>8,556</b>	

The Company believes that the present level of its allowance for doubtful debts adequately reflects probable losses related to impaired accounts receivable. However, changes in the assumptions used to assess the frequency and severity of doubtful accounts would have an impact on the Company's allowance for doubtful debts. If economic or specific industry trends change, the Company would adjust its allowances for doubtful accounts by



**Table of Contents**

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

recording additional expense or benefit. Management studies show that a decrease or increase of 5% in historical write-off experience would increase or decrease the provision for doubtful accounts by approximately Rmb 13.9 million (US\$1.7 million).

**Realization of the carrying value of inventories**

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

If market conditions or future product enhancements and developments change, the Company would adjust its provision for inventories by recording additional expense or benefit. In the preceding three years, there were no significant differences or adjustments between the book cost and the net realizable or market value. Management studies show that a decrease or increase of 5.0% in historical charge experience would increase or decrease the provision for inventories by approximately Rmb 5.9 million (US\$0.7 million).

**Product warranty obligations**

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

Changes in the accrued product warranty liability for each of the years in the three-year period ended December 31, 2005 are summarized as follows:

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

The Company's estimate of its warranty obligations is evaluated on an annual basis. In previous years, warranty claims have typically not been higher than the relevant provisions made in the Company's balance sheet. If the nature, frequency and average cost of warranty claims change, the Company would adjust its allowances for product warranty by recording additional expense or benefit so as to seek to ensure that accruals will be adequate to meet expected future obligations. Management studies show that a decrease or increase of 5.0% in historical utilization experience would increase or decrease the provision for product warranty by approximately Rmb 8.2 million (US\$1.0 million).

**Realization of deferred tax assets**

Deferred tax assets are reduced by a valuation allowance to the extent the Company concludes it is more likely than not that the assets will not be realized. This valuation allowance is an estimate of the difference between the actual existing and future realizable deferred tax assets. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary

**Table of Contents**

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

differences become deductible, tax credits and tax losses carried forward utilized. Management considers the scheduled reversal of deferred tax assets, projected future taxable income, and tax planning strategies in making this assessment. Forecasted taxable income may significantly differ from actual taxable income in future years, which may result in material revisions to the valuation allowance of deferred tax assets. Differences in actual results from available evidence used in determining the valuation allowances could result in future adjustments to the allowance. The realization of the deferred tax assets is subject to specific PRC tax regulations and not solely dependent on generating future taxable income. For example, tax credits relating to the purchase of domestic equipment may not be fully utilized as the amount entitled for deduction each year is limited to the incremental current income tax expense of the subsidiary compared to the income tax of the subsidiary for the year before the domestic equipment was purchased. Tax credit may also have a validity period. It is therefore possible that a subsidiary has a taxable income but unable to utilize the deferred tax benefit brought forward, if any. Tax losses incurred by certain subsidiaries are not likely to be realized in the future in connection with the assessment for valuation allowance. Based on management's forecast of future taxable income, the Company views the recoverability of the deferred tax assets, net of existing valuation allowances, as more likely than not to be realizable. In addition, based upon the results of prior years' taxable income and projections for future taxable income over the next five years in which the deferred tax assets are deductible and tax losses carried forward, management believes the Company will realize the benefits of these deductible differences and tax losses carried forward as of December 31, 2005. Deferred tax assets which were not probable to be realized had been subjected to valuation allowance. For the years ended December 31, 2003 and 2004, no deferred tax asset valuation allowance was provided. For the year ended December 31, 2005, management concluded that a deferred tax asset valuation allowance of Rmb 45.2 million (US\$5.6 million) was necessary. This valuation allowance is primarily for tax credits that management believes will expire unused.

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

**Impairment of long-lived assets, other than goodwill**

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

The Company has conducted a review on the conditions of the property, plant and equipment. In 2003, management identified that certain property, plant and equipment would no longer be used in production due to the introduction of new environmental regulations in 2003. These changes required an impairment analysis to be performed. The estimated undiscounted future cash flows generated from such property, plant and equipment were less than their carrying value. The carrying value of such assets was therefore reduced to estimated fair value. Since there was no active second hand resale market for these items relating to property, plant and equipment, management has adopted the discounted cash flow model to determine their fair value. An impairment loss of Rmb 12.4 million has been charged to the consolidated statement of operations in 2003 under selling, general and administrative expense. In 2004, the Company did not identify any circumstances indicating that the carrying value of the property, plant and equipment may not be recoverable, and hence no impairment loss was recognized. In 2005, it was determined 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. An impairment loss of Rmb 4.9 million (US\$0.6 million) has been charged to the consolidated statement of operations in 2005 under selling, general and administrative expense.

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**Table of Contents**

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

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

**Provision for loss contingency for guarantee granted by YEGCL**

YEGCL guaranteed borrowings of Rmb 7.6 million and Rmb 178.5 million (US\$22.1 million) 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 totaling Rmb 11.7 million and Rmb 242.2 million (US\$30.0 million) as of 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 Rmb 7.4 million and Rmb 134.2 million (US\$16.6 million). Pursuant to the requirements of FIN 45, the Company accrued Rmb 0.2 million and Rmb 16.8 million (US\$2.1 million) related to its stand ready obligation under the guarantee arrangement in 2004 and 2005, respectively. In assessing the contingent liability, management considered the probable recoverable amount of the secured automobiles and the customers' deposits against its obligations to the banks for the defaulted payments from the customers. The Company has assessed that there is a risk exposure relating to default by customers on the expected future payments and therefore such a provision for loss contingency is required. 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 Rmb 220.0 million and Rmb 4.5 million (US\$0.6 million), 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 0.01 million and Rmb 1.2 million (US\$0.1 million), respectively. The remaining balance of Rmb 12.3 million (US\$1.5 million) as of December 31, 2005 represents the provision for loss contingency related to the guarantees where payment by the Company was probable.

**Recoverability of carrying amount of investment in TCL**

The Company acquired a 15.99% equity ownership interest in TCL in 2005 as part of its diversification plan to include new businesses, other than Yuchai. The total purchase consideration was S\$32.3 million, which approximates S\$0.12 per share. The market price of TCL shares traded on the Singapore Exchange has fallen to S\$0.08 on December 31, 2005 and was S\$0.085 per share on July 31, 2006. Management of the Company has assessed and deemed the impairment to be temporary in nature and 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. Accordingly, no provision for impairment is required.

Using the quoted market price at December 31, 2005, the TCL investment was valued at S\$22.5 million (Rmb 109.0 million based on an exchange rate of S\$1.00 to Rmb 4.83), compared to our carrying value of S\$38.3 million (Rmb 185.0 million based on an exchange rate of S\$1.00 to Rmb 4.83). If the Company's management considered such impairment to be other than temporary, an impairment provision would have been recognized and income before income taxes and minority interest would have been reduced by Rmb 76.0 million (US\$9.4 million based on an exchange rate of Rmb 8.0957 to US\$1.00) for the year ended December 31, 2005.

**Table of Contents**

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

**Results of Operations**

The following table sets forth the percentages of net revenues of certain income and expense items of the Company for the last three fiscal years ended December 31, 2003, 2004 and 2005, respectively:

	Percentage of Net Revenues Year Ended December 31,		
	2003	2004	2005 Restated
Revenues, net	100.0%	100.0%	100.0%
Cost of goods sold	69.9%	71.8%	80.3%
Gross profit	30.1%	28.2%	19.7%
Research and development costs	2.1%	2.5%	2.1%
Selling, general and administrative expenses	12.3%	11.8%	13.6%
Provision for uncollectible loans to a related party			3.5%
Operating income	15.8%	14.0%	0.4%
Interest expense	0.5%	0.6%	1.2%
Other (expenses)/income, net	0.0%	0.1%	0.4%
Earnings / (loss) before income taxes and minority interests	15.2%	13.5%	(0.4)%
Income taxes	2.5%	1.9%	(0.2)%
Income / (loss) before minority interests	12.8%	11.6%	(0.6)%
Minority interests in income of consolidated subsidiaries	3.2%	2.8%	0.1%
Net income / (loss)	9.6%	8.8%	(0.6)%

**2005 Compared to 2004**

Net revenue increased by 4.2% to Rmb 5,816.7 million (US\$720.8 million) in 2005 compared to Rmb 5,582.1 million in 2004. The increase in net revenue was primarily due to higher sales volume arising from more aggressive marketing programs. Unit sales of diesel engines increased by 11.4% to 230,228 units in 2005 from 206,628 units in 2004 and this unit sales increase came mainly from higher sales of the 4-Series light-duty diesel engines and 6105 medium-duty diesel engines. In 2005, net revenues of the 4-Series light-duty diesel engines increased by approximately 31.0% and net revenues of the 6105 medium-duty engines increased by approximately 52.6% as compared to 2004.

Cost of goods sold increased by 16.6% to Rmb 4,673.4 million (US\$579.1 million) in 2005 from Rmb 4,006.9 million in 2004, and increased as a percentage of net revenues to 80.3% in 2005 from 71.8% in 2004. Cost of manufacturing increased by 18.4% to Rmb 4,517.0 million (US\$559.8 million) in 2005 from Rmb 3,816.7 million in 2004, and increased as a percentage of net revenue to 77.7% in 2005 from 68.4% in 2004. Cost of materials consumed included in costs of manufacturing increased by 20.6% to Rmb 3,812.4 million (US\$472.4 million) in 2005 from Rmb 3,159.9 million in 2004 (due to higher production during 2005, while cost of materials consumed as a percentage of net revenue increased to 65.5% in 2005 from 56.6% in 2004. Factory overhead (which does not include depreciation and salaries) included in cost of manufacturing decreased by 2.4% to Rmb 409.0 million (US\$50.7 million) in 2005 from Rmb 419.2 million in 2004, due to lower variable factory expenses. The factory overhead as a percentage of net revenue decreased to 7.0% in 2005 from 7.5% in 2004. Depreciation included in cost of manufacturing increased to Rmb 90.4 million (US\$13.7 million) from Rmb 84.9 million in 2004. Depreciation as a percentage of net revenue increased to 1.6% in 2005 from 1.5% in 2004.

Gross profit decreased by 27.4% to Rmb 1,143.4 million (US\$141.7 million) in 2005 from Rmb 1,575.2 million in 2004. Gross profit margin (gross profit divided by net revenue) decreased to 19.7% in 2005 compared to 28.2% in 2004, reflecting a shift in the sales mix whereby the gross margin for the 4-Series and industrial engines were lower than margins historically achieved for both medium and heavy-duty engines.

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**Table of Contents**

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

SG&A expenses (excluding research and development) increased by 20.5% to Rmb 793.2 million (US\$98.3 million) in 2005 from Rmb 658.3 million in 2004 and increased as a percentage of net revenue from 11.8% in 2004 to 13.6% in 2005. This increase in SG&A was primarily due to the increase in sales, legal and professional costs and allowance for doubtful accounts on trade accounts receivable. Research and development expenses decreased to Rmb 123.8 million (US\$15.3 million) in 2005 from Rmb 137.0 million in 2004. Advertising expenses included in SG&A decreased by 7.0% to Rmb 45.3 million (US\$5.6 million) in 2005 from Rmb 48.7 million in 2004. Advertising expenses as a percentage of net revenue decreased to 0.8% in 2005 from 0.9% in 2004. Sales commission expenses included in SG&A expenses increased by 239.7% to Rmb 39.4 million (US\$4.9 million) in 2005 from Rmb 11.6 million in 2004. Sales commission expenses as a percentage of net revenues increased to 0.7% in 2005 from 0.2% in 2004. The decrease in advertising is mainly due to lower spending on television and road signboard advertising. The increase in sales commissions is mainly due to higher commission given to promote the sales of new products such as 6L and 6M heavy duty diesel engines.

Included in the 2005 income statement is a provision for non-trade loans to a related party of Rmb 203.0 million (US\$25.1 million). See Note 5 to the Company's Consolidated Financial Statements. Salaries and wages as a percentage of net revenues was 7.9% in 2005 and 7.4% in 2004. As a result of the foregoing, profits from operations decreased to Rmb 26.0 million (US\$3.2 million) in 2005 compared to Rmb 779.9 million in 2004.

Interest expenses increased by 122.1% to Rmb 70.5 million (US\$8.7 million) in 2005 from Rmb 31.8 million in 2004, primarily due to increase in bank borrowings.

Loss before income taxes and minority interests in 2005 was Rmb 25.1 million (US\$3.1 million), as compared to a profit of Rmb 753.9 million in 2004. Income tax expense in 2005 was Rmb 10.1 million (US\$1.3 million) compared to income tax expense of Rmb 105.2 million in 2004. Yuchai was subject to PRC income tax at a rate of 15.0% in both 2004 and 2005. The effective tax rates of Yuchai were 14.0% and 40% for 2004 and 2005 respectively. The increase in the effective tax rate for 2005 was primarily due to additional non-deductible expenses for tax purposes.

As a result of the foregoing factors, the Company had a loss before minority interests of Rmb 35.2 million (US\$4.4 million) in 2005 compared to income before minority interests of Rmb 648.7 million in 2004, and a net loss of Rmb 32.3 million (US\$4.0 million) in 2005 compared to a net income of Rmb 491.4 million in 2004.

As described above, a provision of Rmb 203.0 million (US\$25.1 million) has been made for non-trade loans to a related party. Excluding the impact of this provision, the Company's net income for the year ended December 31, 2005 would be Rmb 170.7 million (US\$21.1 million).

**2004 Compared to 2003**

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

Cost of goods sold increased by 25.5% to Rmb 4,006.9 million in 2004 from Rmb 3,192.8 million in 2003, and increased as a percentage of net revenues to 71.8% in 2004 from 69.9% in 2003. Cost of manufacturing increased by 27.5% to Rmb 3,816.7 million in 2004 from Rmb 2,993.7 million in 2003, and increased as a

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**Table of Contents**

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

percentage of net revenue to 68.4% from 65.5% in 2003. Cost of materials consumed in costs of manufacturing increased by 27.4% to Rmb 3,159.9 million in 2004 from Rmb 2,479.9 million in 2003 (due to higher production throughput during 2004), while cost of materials consumed as a percentage of net revenue increased to 56.6% in 2004 from 54.3% in 2003. Factory overhead (which does not include depreciation and salaries) included in cost of manufacturing increased by 118.4% to Rmb 419.2 million in 2004 from Rmb 191.9 million in 2003, due to higher variable factory expenses (such as utilities) arising from higher diesel engine production in 2004. The factory overhead as a percentage of net revenue similarly increased to 7.5% for 2004 and 4.2% for 2003. Depreciation included in cost of manufacturing decreased to Rmb 84.9 million from Rmb 88.7 million in 2003. Depreciation as a percentage of net revenue decreased to 1.5% in 2004 from 1.9% in 2003.

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

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

Interest expenses increased by 34.7% to Rmb 31.8 million in 2004 from Rmb 23.6 million in 2003, primarily due to increase in bank borrowings.

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

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

**Table of Contents**

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

**Inflation**

The general annual inflation rate in China was approximately 1.2%, 3.9% and 1.8% in 2003, 2004 and 2005, respectively. The Company's results of operations may be affected by inflation, particularly rising prices for parts and components, labor costs and other operating costs.

**Liquidity and Capital Resources**

The Company's primary sources of cash are funds from operations generated by Yuchai, as well as debt financing incurred by the Company. The Company's operations provided cash in 2003, 2004 and 2005. The acquisitions of TCL in 2005 and LKN in 2006 were funded from internal cash and external bank borrowings. In 2005, the Company's primary cash requirements were for working capital and capital expenditures to complete the expansion of production capacity. The Company believes that its sources of liquidity are sufficient for its requirements over the next year. Factors which may affect the Company's ability to generate funds from operations include increased competition (including as a result of China's admission to the WTO), fluctuations in customer demand for the Company's products, the Company's ability to collect and control its level of accounts receivable, the status of the Company's investment in Yuchai under Chinese law and the implementation of the Reorganization Agreement (see Item 4. Information on the Company - Recent Developments).

As of December 31, 2005, the Company had approximately Rmb 736.2 million (US\$91.2 million) in cash on a consolidated basis. The Company believes that if the Company is considered on a stand alone basis without its investment in Yuchai, the Company would find it difficult to raise new capital (either debt or equity) on its own.

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

	2003	December 31,		2005
	Rmb	2004	2005	2005
		Rmb	Rmb	US\$
		(in thousands)		
Net cash provided by operating activities	1,075,274	589,608	242,674	30,070
Net cash used in investing activities	(372,373)	(753,367)	(677,215)	(83,915)
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

Net cash flow provided by operating activities decreased by Rmb 346.9 millions between 2004 and 2005. The decrease was principally caused by an increase in inventories, net of Rmb 321.9 million, due to stocking up at the end 2005 to meet expected higher sales in 2006. In addition, the decrease in net cash from operating activities was also partly attributed to increase in trade accounts receivables, net of Rmb 303.3 million and increase in amount due from related companies of Rmb 115.1 million. In addition, there was an increase in trade accounts payable in 2005 of Rmb 710.7 million arising from increased business activities from higher production. Net cash used in investing activities decreased by Rmb 76.2 million in 2005, principally due to repayment of Rmb 205.0 million of loans from a related company and increased in purchased of investments of Rmb 161.4 million. The Rmb 205.0 million loan repaid by the related company (YMLC) was subsequently re-loaned to the same company (see also Note 5 to the Company's Consolidated Financial Statements appearing elsewhere herein). Net cash provided by financing activities increased by Rmb 198.3 million in 2005, mainly due to net increase in net proceeds from bank terms loans of Rmb 1,238.2 million, proceeds from 2% convertible bonds of Rmb 206.9 million and offset by the dividend payment of Rmb 120.3 million made in 2005.

**Table of Contents**

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

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

The Company expects that cash generated from operations and credit collection arrangements should provide the Company with sufficient financial flexibility to satisfy future bank obligations, capital expenditures and projected working capital requirements. However, at certain times cash generated from operations is subject to seasonal fluctuations. As a result, the Company may use periodic borrowings to supplement its working capital requirements. Yuchai has established banking relationships with a number of domestic Chinese banks, each of which will review Yuchai's loan applications on a case by case basis with reference to the loan limit approved by Yuchai's Board of Directors. Yuchai had outstanding borrowings of Rmb 962.8 million as of December 31, 2005. The interest rate applicable to the amounts borrowed ranges from 4.94% and 5.85% per annum. During its April 2006 board meeting, the Yuchai board of directors approved an increase in this borrowing limit to Rmb 2,000 million. As of June 30, 2006, Yuchai had outstanding borrowings of Rmb 920 million. The Company believes that should there be a need for further loans from banks, Yuchai could seek to drawdown additional amounts up to such limit from the Chinese domestic banks; however, no assurance can be given that such additional borrowings would be approved by such banks.

The Company's working capital as of December 31, 2005 was Rmb 823.3 million compared to Rmb 1,402.2 million as of December 31, 2004. The decrease in working capital was primarily due to the increase of accounts payable by 65.2% to Rmb 1,800.4 million, with higher volume of raw materials and components purchased to meet expected higher sales in 2006. In addition, the increase in total current liabilities was also partly due to increase in borrowings of Rmb 482.8 million. As of December 31, 2005, the Company had long-term debt, including current installments, totaling Rmb 150.0 million, of which Rmb 100.0 million will mature in 2006. The Company had current debt totaling Rmb 812.8 million as of December 31, 2005.

The Company's capital expenditures were Rmb 515.4 million in 2005, Rmb 552.9 million in 2004 and Rmb 372.8 million in 2003. As of December 31, 2005, the Company had authorized and contracted for capital expenditures for improvement to existing production facilities in the amount of Rmb 214.1 million. As the Company's business continues to grow, it will also require additional funds for increased working capital requirements, including to finance increased accounts receivable. The Company expects to fund its capital expenditures and working capital requirements primarily from funds from operations generated by Yuchai and, to the extent that is insufficient, from bank loans incurred by Yuchai and the Company. Yuchai's ability to obtain financing is limited by government regulation and a general shortage of debt and equity financing in China. Any additional capital contribution by the Company to Yuchai would require, among other things, the approval of the MOC, which has broad discretion with respect to such approval.

In February 2005, the Company issued \$25.0 million in principal amount of convertible bonds due 2012 in a private placement. The convertible bonds carried interest at 2.0% per annum and matured in 2012, unless redeemed earlier in accordance with their terms. The bonds were convertible by their holders into newly issued ordinary shares of the Company at a conversion price of \$12.969 per share, subject to customary adjustments. The bonds were fully converted by their holders in June 2005. Upon conversion, the Company issued 1,927,673 ordinary shares, representing approximately 5.45% and 5.17% of the then existing and enlarged issued share capital of the Company, respectively. The Company received approximately \$24.9 million in proceeds from the convertible bond placement after deducting costs and expenses. The proceeds of the offering had been fully utilized to finance the TCL share acquisitions described above.

As an additional source of funding for the Company's business expansion and diversification related activities, the Company had in March 2005, September 2005, January 2006 and March 2006 entered into credit facilities for \$25.0 million, \$50.0 million, S\$60.0 million (approximately US\$37.0 million, based on an exchange



**Table of Contents**

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

rate of S\$1.62 to US\$1.00) and S\$110.0 million (approximately US\$69.2 million, based on an exchange rate of S\$1.59 to US\$1.00), respectively, with various banks in Singapore. The Company has drawn down the first three facilities as of June 30, 2006 in connection with its acquisition of shares and bonds in TCL and LKN described above. The purpose of the fourth credit facility is to enable the Company to make further new acquisitions as part of its diversification plans. These facilities aggregate approximately \$181.2 million of which \$112 million had been drawn down as of June 30, 2006. The terms of these facilities require, among other things, that HLA retains ownership of CYI's Special Share and that CYI remains a consolidated subsidiary of HLA. The terms of these facilities also include certain financial covenants with respect to CYI'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.

As part of its business strategy, Yuchai seeks from time to time opportunities to invest in domestic manufacturers of diesel engine parts and components, as well as in other related automotive businesses, including truck manufacturers, and insurance, warranty servicing and credit support for diesel engine customers. Yuchai may make such investments and acquisitions with funds provided by operations, future debt or equity financings or a combination thereof. Subsequent to December 31, 2005, Yuchai has lodged an application to the People's Bank of China for short-term bonds issuing limit amounting to Rmb 1,000 million (US\$124.5 million). The application was approved on May 30, 2006 and is valid until the end of June 2007. Yuchai can issue the bonds in multiple tranches at various dates during the validity period of the approval. Yuchai intends to use these short-term bonds principally to refinance existing indebtedness relating to its working capital requirements.

Yuchai issued the first tranche of Rmb 500 million short-term bonds on June 13, 2006 with a maturity date on March 9, 2007.

The following table sets forth information on the Company's material contractual obligation payments for the periods indicated as of December 31, 2005:

Contractual Obligations	Total	Payments Due by Period		
		Less than 1 Year	1-3 Years	4-5 Years More than 5 Years
Short-term debt	913	913		
Long-term debt	50		50	
Purchase Obligations regarding capital expenditure	214	214		
Lease Commitments	6	3	3	
<b>Total</b>	<b>1,183</b>	<b>1,130</b>	<b>53</b>	

Subsequent to December 31, 2005, the Company entered into a number of contractual arrangements that result in additional cash obligations or contingent cash obligations (see Note 34 to the Consolidated Financial Statements).

**Off-Balance Sheet Arrangements**

The Company currently does not engage in any off-balance sheet arrangements.

**Guarantee by YEGCL**

YEGCL guaranteed borrowings of Rmb 7.6 million and Rmb 178.5 million (US\$22.1 million) 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

**Table of Contents**

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

premium fee amounted to 2% to 8% of the amount of borrowings. All guarantees are secured by automobiles at a net book value totaling Rmb 11.7 million and Rmb 242.2 million (US\$30.0 million) 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 Rmb 7.4 million and Rmb 134.2 million (US\$16.6 million). Pursuant to the requirements of FIN 45, the Company accrued Rmb 0.2 million and Rmb 16.8 million (US\$2.1 million) 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 Rmb 0.2 million and Rmb 4.5 million (US\$0.6 million), 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 0.01 million and Rmb 1.2 million (US\$0.1 million), respectively. The remaining balance of Rmb 12.3 million (US\$1.5 million) as of December 31, 2005 represents the provision for loss contingency related to the guarantees where payment by the Company was probable.

***Outstanding bills discounted***

As of December 31, 2004 and 2005, outstanding bills discounted with banks for which the Company has retained a recourse obligation totaled Rmb 1,117.8 million and Rmb 1,373.7 million (US\$170.2 million), respectively.

***Outstanding letter of credits***

As of December 31, 2004 and 2005, the Company had issued irrevocable letter of credits of Rmb 165.9 million and Rmb 110.3 million (US\$13.7 million), respectively.

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

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

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 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.

**FIN No. 48**

In June 2005, 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.

## **Table of Contents**

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

### **Emerging Issues Task Force ( EITF ) 04-13**

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.

### **SFAS No. 151**

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.

### **SFAS No. 153**

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, which eliminates an exception in Accounting Principles Board ( 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.

### **SFAS No. 155**

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 and 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.

### **SFAS No. 156**

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.

**Table of Contents**

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

**SFAS No. 123 (revised 2004)**

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 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 adopted 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.

**Research and Development**

The Company has committed substantial resources to continually improve the technology of its products. The Company's internal development effort focuses primarily on improving manufacturing processes and adapting foreign technology to the Chinese market. In addition, the Company plans to continue to acquire advanced technology from Chinese research institutes, foreign engine design consulting firms and foreign diesel engine and engine parts manufacturers. As of December 31, 2005, the Company employed over 1,445 engineers, approximately 267 of whom were devoted to research and development, product enhancement and new designs. In 2003, 2004 and 2005, the Company spent approximately Rmb 94.6 million, Rmb 137.0 million and Rmb 123.8 million (US\$15.3 million), respectively, on research and development. The Company believes that it has been able to control to some extent the increase of research and development expenses due to the relatively low salary levels of engineers in China.

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**Table of Contents**

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

**PART II**

**ITEM 15. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

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

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Group Financial Controller\*, of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Group Financial Controller concluded that as a result of the restatement described in this Form 20-F/A and below, as of the end of the period covered by this Form 20-F/A, the Company's disclosure controls and procedures were not effective.

The Company has restated its previously issued consolidated financial statements for the year ended December 31, 2005. The restatement was the result of errors relating to the accounts of Yuchai, relating primarily to an understatement of accounts payable of approximately Rmb 167.8 million (approximately US\$20.8 million) by Yuchai for the year ended December 31, 2005. The review of the accounting error pertaining to accounts payable was conducted by the Company's Audit Committee, assisted by independent counsel and independent forensic consultants. As a result of this process, the Company's management and the Audit Committee identified errors in Yuchai's adjustments of its accounts payable in its attempts to reconcile with Yuchai's then-new accounting systems. In connection with their review, the Audit Committee made the following key conclusions:

1. The adjustment of accounts payable in the amount of approximately Rmb 167.8 million was made in error but was not the result of: (a) any fraud or intentional wrongdoing on the part of any employee of the Company or Yuchai; or (b) any plan to intentionally inflate the profits. There was evidence that lower level Yuchai employees became aware that the adjustment was made in error but either did not understand the significance of the error or did not elevate their concerns to a higher level at Yuchai, where the issue could have been properly addressed. There was a similar lack of communication between employees at Yuchai and the Company regarding this adjustment. Finally, there was a failure among employees of the Company to communicate properly with respect to the filing of the Company's Form 12b-25 for the year ended December 31, 2006 on July 2, 2007. The Company and Yuchai are addressing each of the problems associated with the failures of communication regarding important accounting and other issues.
2. The Audit Committee, based on the investigation, made recommendations to the Board of Directors of the Company in order to prevent such an occurrence again. The recommendations include changes to be made to the Company's controls and procedures to improve their effectiveness, improve communication flow, clarifying the roles and responsibilities of Yuchai's finance staff, training for Yuchai finance staff, and increase resources at the Company and Yuchai.

In the previously filed Annual Report on Form 20-F for the year ended December 31, 2005, the Company had disclosed the following:

In connection with the Company's recent business expansion and diversification plan, the Company has made minority equity investments in TCL and LKN, as described elsewhere in this Annual Report.



## **Table of Contents**

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

With respect to TCL, the Company has experienced delays in the timely collating and integration of financial information from TCL management for use by the Company in preparing its consolidated financial statements and related disclosures. This situation has primarily arisen from TCL management's lack of familiarity with US GAAP and SEC financial reporting requirements, as TCL maintains its financial statements in accordance with Singapore Financial Reporting Standards. Further, the Company did not have sufficient controls in place to detect timely all deficiencies in the US GAAP information provided by TCL in order for the Company to properly apply the equity method of accounting. The Company is pro-actively taking steps to assist TCL management to develop improved systems and procedures to enhance the quality and timeliness of the US GAAP information provided to the Company. The Company has specifically informed TCL management the importance that all significant matters must be communicated to the Company on a timely basis. The Company will continue to hold regular meetings with TCL management and review closely with the TCL management to record and disclose information received on a timely basis as appropriate. The Company will perform analytical review on the balance sheet and profit and loss statements received on a monthly basis to assess compliance with US GAAP requirements.

### **Internal Control over Financial Reporting**

In connection with the audit of the restated 2005 consolidated financial statements, the Company's management and audit committee were informed of the following material weaknesses\* in its internal control over financial reporting for the period covered by this Form 20-F/A. Based on the existence of the material weaknesses in internal control over financial reporting described below, the Company's management has concluded that as of the end of the period covered by this Form 20-F/A, the Company's internal control over financial reporting was not effective.

#### *GRIR balance*

Yuchai and the Company failed to timely identify and reconcile the original difference between the GRIR balance, which represents the amount payable for goods received but for which invoices have not been received, based on the SAP system and the GRIR balance based on manual compilation of the Goods Received Notes, which are internal documents prepared by Yuchai upon the receipt of goods for which invoices have not been received evidencing that the goods have been received in good condition and accurate quantity. In addition, management did not address the issue in a timely manner once the error became known.

#### *Sales Discounts Calculations*

Yuchai provides sales discounts to those customers who meet previously-agreed volumes and whose accounts receivable with the Company at the year-end meet certain criteria. Yuchai's management incorrectly calculated the sales discounts. The employees calculating the sales discounts did not have adequate knowledge of the sales contracts' terms and the Yuchai's policy on granting sales discounts. In addition, there was a lack of detailed review of the sales discounts' calculation by a person with adequate knowledge of US GAAP and a lack of supporting documents for departures from previously-agreed volumes and criteria.

### **Remediation Measures**

To remediate the above mentioned weaknesses, the Company and Yuchai have implemented some of the recommendations of the Audit Committee, namely:

Increase resources: The Company has, since late 2007, appointed its own dedicated Chief Financial Officer, General Counsel and Group Financial Controller, each of whose sole responsibilities relate to the Company. In addition, Yuchai has effected changes in personnel in its finance department as a measure to prevent such an occurrence again; and

\*

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A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.



## **Table of Contents**

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

Clarifying roles and responsibilities and training for the members of the staff The Chairman of Yuchai has agreed to improve professional training of all its employees, provide training courses on the SAP system as well as provide clarity on the role and responsibility of each member of the staff.

The Company is in the process of implementing the other recommendations of the Audit Committee to improve the overall effectiveness of its disclosure controls and procedures.

The Company has put in place procedures to ensure that sales discounts calculations are properly computed and recorded, and Yuchai is in the process of formalizing and documenting such procedures.

The Company's management performed analysis and procedures to ensure that the consolidated financial statements included in this Form 20-F/A were prepared in accordance with generally accepted accounting principles. Accordingly, the Company's management believes that the consolidated financial statements included in this Form 20-F/A fairly present in all material respects the Company's consolidated financial position, results of operations and cash flows for the periods presented.

For future financial periods and to enhance the Company's internal control over financial reporting, management plans to review and make necessary changes to the overall design of the Company's internal control environment, as well as policies and procedures to improve the overall effectiveness of internal control over financial reporting. If unremediated, these material weaknesses have the potential to result in the Company's failure to prevent or detect misstatements in its financial statements in future financial periods.

With respect to TCL, since the filing of the previously filed Annual Report on Form 20-F for the year ended December 31, 2005, as a result of the measures described above, the situation has been remedied and the Company has not experienced any significant delays in timely collating the integration of financial information from TCL management for any period since December 31, 2005.

### **Management's Assessment on Internal Control over Financial Reporting for 2006**

While not required as of December 31, 2005, Section 404 of the Sarbanes-Oxley Act of 2002 requires the Company's management to assess the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 and to include management's report on internal control over financial reporting in the Company's annual report on Form 20-F for the fiscal year ended December 31, 2006. Although such assessment by the Company's management is continuing, the Company's management currently expects to disclose one or more material weaknesses in its internal control over financial reporting and conclude that the Company's internal control over financial reporting was not effective as of December 31, 2006. If any additional material weaknesses are identified, the Company will make public disclosure at the appropriate time and take action to remediate them as soon as practicable.

### **Changes in internal control over financial reporting**

Except as described in this Form 20-F/A, there were no adverse changes in the Company's internal control over financial reporting that occurred during the period covered by this Form 20-F/A that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

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

**PART III**

**ITEM 18. FINANCIAL STATEMENTS.**

**Index to Financial Statements**

**China Yuchai International Limited**

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Statements of Operations for Years Ended December 31, 2003, 2004 and 2005</u>	F-3
<u>Consolidated Balance Sheets as of December 31, 2004 and 2005</u>	F-5
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for Years Ended December 31, 2003, 2004 and 2005</u>	F-7
<u>Consolidated Statements of Cash Flows for Years Ended December 31, 2003, 2004 and 2005</u>	F-8
<u>Notes to Consolidated Financial Statements</u>	F-12

**ITEM 19. EXHIBITS.**

Exhibits to this Annual Report:

- 1.1 Memorandum of Association of China Yuchai International Limited or the Registrant (incorporated herein by reference to Amendment No. 1 to the Registration Statement on Form F-1, filed by the Registrant on December 8, 1994 (File No. 33-86162), or the Form F-1).
- 1.2 Bye-laws of the Registrant (incorporated herein by reference to the Form F-1).
- 3.1 Subscription and Shareholders Agreement of Diesel Machinery (BVI) Limited, dated November 9, 1994, among Diesel Machinery (BVI) Limited, Hong Leong Asia Ltd., or Hong Leong Asia, and China Everbright Holdings Company Limited, or China Everbright Holdings (incorporated herein by reference to Amendment no. 2 to the Registration Statement on Form F-1, filed by the Registrant on December 14, 1994 (File No. 33-86162)).
- 3.2 Supplemental Subscription and Shareholders Agreement, dated January 21, 2002, between China Everbright Holdings and Hong Leong Asia (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2001, filed by the Registrant on June 25, 2002 (File No. 001-013522), or Form 20-F FY2001).
- 3.3 Second Supplemental Subscription and Shareholders Agreement, dated May 17, 2002, between China Everbright Holdings and Hong Leong Asia (incorporated herein by reference to the Form 20-F FY2001).
- 4.1 Contract for the Subscription of Foreign Common shares in Guangxi Yuchai Machinery Company Limited, or Yuchai, and Conversion from a Joint Stock Limited Company into a Sino-Foreign Joint Stock Limited Company, dated April 1, 1993, among Yuchai, Guangxi Yuchai Machinery Holdings Company, Hong Leong Technology Systems (BVI) Ltd., Cathay Clemente Diesel Holdings Limited, Goldman Sachs Guangxi Holdings (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd. and Youngstar Holdings Limited with amendments, dated May 27, 1994 and October 10, 1994 (incorporated herein by reference to the Form F-1).
- 4.2 Subscription and Transfer Agreement (with Shareholders' Agreement), dated April 1993, among Cathay Clemente (Holdings) Limited, GS Capital Partners L.P., Sun Yuan Overseas Pte Ltd., HL Technology Systems Pte Ltd and Coomber Investments Limited (incorporated herein by reference to the Registration Statement on Form F-1, filed by the Registrant on November 9, 1994 (File No. 33-86162)).



**Table of Contents**

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

- 4.3 Amended and Restated Shareholders Agreement, dated as of November 9, 1994 among The Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte Ltd, Hong Leong Asia Ltd., Coomber Investments Limited, China Everbright Holdings Company Limited, Diesel Machinery (BVI) Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd. and the Registrant (incorporated herein by reference to the Form F-1).
- 4.4 Form of Amended and Restated Registration Right Agreement, dated as of November 9, 1994, among The Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte Ltd, Coomber Investments Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd. and the Registrant (incorporated herein by reference to Amendment No. 3 to the Registration Statement on Form F-1, filed by the Registrant on December 15, 1994 (File No. 33-86162)).
- 4.5 Form of Subscription Agreement between the Registrant and its wholly-owned subsidiaries named therein and Yuchai (incorporated herein by reference to Amendment No. 2 to the Registration Statement on Form F-1, filed by the Registrant on December 14, 1994 (File no. 33-86162)).
- 4.6 Form of Term Loan Agreement between the Registrant and Yuchai (incorporated herein by reference to Amendment No. 2 to the Registration Statement on Form F-1, filed by the Registrant on December 14, 1994 (File No. 33-86162)).
- 4.7 Share Purchase and Subscription Agreement, dated as of November 9, 1994, between (i) the Registrant, (ii) China Everbright Holdings Company Limited and (iii) Coomber Investments Limited (incorporated herein by reference to the Form F-1).
- 4.8 Investment and Shareholders Agreement between CACG Limited IV and Guangxi Yuchai Machinery Company Limited, dated July 14, 1994 with a First Amendment dated September 5, 1994 (incorporated herein by reference to the Form F-1).
- 4.9 Employment Agreement, dated September 5, 2003, between Yuchai and Wang Jianming (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2003, filed by the Registrant on June 29, 2004 (the Form 20-F FY2003 )).
- 4.10 Form of indemnification agreement entered into by the Company with each of Wrixon Frank Gasteen, Gao Jia Lin, Gan Khai Choon, Raymond C. K. Ho, Kwek Leng Peck, Liu Chee Ming, Wong Hong Ren, Philip Ting Sii Tien, Lim Poh Lea, Sheila Murugasu, Teo Tong Kooi, Neo Poh Kiat and Tan Aik-Leang (incorporated herein by reference to the Form 20-F FY2003).
- 4.11 Agreement between the Registrant and Yuchai, dated July 19, 2003 (incorporated herein by reference to the Form 20-F FY2003).
- 4.12 Reorganization Agreement between the Company, Coomber and Yuchai, dated April 7, 2005 (incorporated herein by reference to the Current Report on Form 6-K filed by the Registrant on April 7, 2005 (File No. 001-13522)).
- 4.13 Reorganization Agreement Amendment (No. 1) between the Registrant, Coomber and Yuchai, dated December 2, 2005 (incorporated herein by reference to the Current Report on Form 6-K filed by the Registrant on December 6, 2005 (File No. 001-13522)).
- 8.1 Subsidiaries of the Registrant (incorporated herein by reference to the Annual Report on Form 20-F for the fiscal year ended December 31, 2005, filed by the Registrant on August 8, 2006).
- 12.1\* Certifications furnished pursuant to Section 302 of the Sarbanes-Oxley Act. (Filed herewith)
- 13.1\* Certifications furnished pursuant to Section 906 of the Sarbanes-Oxley Act. (Filed herewith)
- 15.1 Consent of Independent Registered Public Accounting Firm. (Filed herewith)

**Table of Contents**

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

\* As announced on March 20, 2008, Mr. Hoh Weng Ming was appointed Chief Financial Officer of the Company with effect from May 1, 2008 in place of Mr. Ho Tuck Chuen who resigned due to health reasons. Mr. Lai Seng Fatt, who was appointed to the position of Group Financial Controller of the Company in January 2008 from his position of finance manager at GPac Technology (S) Pte Ltd, a subsidiary of Hong Leong Asia, worked closely with Mr. Ho Tuck Chuen on, and has been performing the function of senior financial officer responsible for, the matters described in this Form 20-F/A. It is therefore believed by the Company that the Section 302 and Section 906 certifications required to be signed by the Chief Financial Officer should accordingly be signed by Mr. Lai Seng Fatt.

The Company has not included as exhibits certain instruments with respect to its long-term debt, the total amount of debt authorized under each of which does not exceed 10% of its total consolidated assets. The Company agrees to furnish a copy of any such instrument to the SEC upon request.

**Table of Contents**

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

**SIGNATURES**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F/A and has duly caused this Amendment No. 1 to the Annual Report on Form 20-F/A for the year ended December 31, 2005 to be signed on its behalf by the undersigned, thereunto duly authorized.

**CHINA YUCHAI INTERNATIONAL LIMITED**

By: /s/ TEO TONG KOOI  
Name: **Teo Tong Kooi**  
Title: **President and Director**

Date: May 30, 2008

**Table of Contents**

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

**Exhibit Index**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
1.1	Memorandum of Association of China Yuchai International Limited, or the Registrant (incorporated herein by reference to Amendment No. 1 to the Registration Statement on Form F-1, filed by the Registrant on December 8, 1994 (File No. 33-86162), or the Form F-1).
1.2	Bye-laws of the Registrant (incorporated herein by reference to the Form F-1).
3.1	Subscription and Shareholders Agreement of Diesel Machinery (BVI) Limited, dated November 9, 1994, among Diesel Machinery (BVI) Limited, Hong Leong Asia Ltd., or Hong Leong Asia, and China Everbright Holdings Company Limited, or China Everbright Holdings (incorporated herein by reference to Amendment No. 2 to the Registration Statement on Form F-1, filed by the Registrant on December 14, 1994 (File No. 33-86162)).
3.2	Supplemental Subscription and Shareholders Agreement, dated January 21, 2002, between China Everbright Holdings and Hong Leong Asia (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2001, filed by the Registrant on June 25, 2002 (File No. 001-13522), or Form 20-F FY2001).
3.3	Second Supplemental Subscription and Shareholders Agreement, dated May 17, 2002, between China Everbright Holdings and Hong Leong Asia (incorporated herein by reference to the Form 20-F FY2001).
4.1	Contract for the Subscription of Foreign Common shares in Guangxi Yuchai Machinery Company Limited, or Yuchai, and Conversion from a Joint Stock Limited Company into a Sino-Foreign Joint Stock Limited Company, dated April 1, 1993, among Yuchai, Guangxi Yuchai Machinery Holdings Company, Hong Leong Technology Systems (BVI) Ltd., Cathay Clemente Diesel Holdings Limited, Goldman Sachs Guangxi Holdings (BVI) Ltd., Tsang & Ong Nominees (BVI) Ltd. and Youngstar Holdings Limited with amendments, dated May 27, 1994 and October 10, 1994 (incorporated herein by reference to the Form F-1).
4.2	Subscription and Transfer Agreement (with Shareholders Agreement), dated April 1993, among Cathay Clemente (Holdings) Limited, GS Capital Partners L.P., Sun Yuan Overseas Pte Ltd., HL Technology Systems Pte Ltd and Coomber Investments Limited (incorporated herein by reference to the Registration Statement on Form F-1, filed by the Registrant on November 9, 1994 (File No. 33-86162)).
4.3	Amended and Restated Shareholders Agreement, dated as of November 9, 1994 among The Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte Ltd, Hong Leong Asia Ltd., Coomber Investments Limited, China Everbright Holdings Company Limited, Diesel Machinery (BVI) Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd. and the Registrant (incorporated herein by reference to the Form F-1).
4.4	Form of Amended and Restated Registration Right Agreement, dated as of November 9, 1994, among The Cathay Investment Fund, Limited, GS Capital Partners L.P., HL Technology Systems Pte. Ltd., Coomber Investments Limited, owners of shares formerly held by Sun Yuan Overseas (BVI) Ltd. and the Registrant (incorporated herein by reference to Amendment No. 3 to the Registration Statement on Form F-1, filed by the Registrant on December 15, 1995 (File No. 33-86162)).
4.5	Form of Subscription Agreement between the Registrant and its wholly-owned subsidiaries named therein and Yuchai (incorporated herein by reference to Amendment No. 2 to the Registration Statement on Form F-1, filed by the Registrant on December 14, 1994 (File No. 33-86162)).
4.6	Form of Term Loan Agreement between the Registrant and Yuchai (incorporated herein by reference to Amendment No. 2 to the Registration Statement on Form F-1, filed by the Registrant on December 14, 1994 (File No. 33-86162)).

**Table of Contents**

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

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
4.7	Share Purchase and Subscription Agreement, dated as of November 9, 1994, between (i) the Registrant, (ii) China Everbright Holdings Company Limited and (iii) Coomber Investments Limited (incorporated herein by reference to the Form F-1).
4.8	Investment and Shareholders Agreement between CACG Limited IV and Guangxi Yuchai Machinery Company Limited, dated July 14, 1994 with a First Amendment dated September 5, 1994 (incorporated herein by reference to the Form F-1).
4.9	Employment Agreement, dated September 5, 2003, between Yuchai and Wang Jianming (incorporated herein by reference to the Annual Report on Form 20-F for fiscal year ended December 31, 2003, filed by the Registrant on June 29, 2004 (the Form 20-F FY2003)).
4.10	Form of indemnification agreement entered into by the Registrant with each of Wrixon Frank Gasteen, Gao Jia Lin, Gan Khai Choon, Raymond C. K. Ho, Kwek Leng Peck, Liu Chee Ming, Wong Hong Ren, Philip Ting Sii Tien, Lim Poh Lea, Sheila Murugasu, Teo Tong Kooi, Neo Poh Kiat and Tan Aik-Leang (incorporated herein by reference to the Form 20-F FY2003).
4.11	Agreement between the Company and Yuchai, dated July 19, 2003 (incorporated herein by reference to the Form 20-F FY2003).
4.12	Reorganization Agreement between the Company, Coomber and Yuchai, dated April 7, 2005 (incorporated herein by reference to the Current Report on Form 6-K filed by the Registrant on April 7, 2005 (File No. 001-13522)).
4.13	Reorganization Agreement Amendment (No. 1) between the Registrant, Coomber and Yuchai, dated December 2, 2005 (incorporated herein by reference to the Current Report on Form 6-K filed by the Registrant on December 6, 2005 (File No. 001-13522)).
8.1	Subsidiaries of the Registrant (incorporated herein by reference to the Annual Report on Form 20-F for the fiscal year ended December 31, 2005, filed by the Registrant on August 8, 2006).
12.1*	Certifications furnished pursuant to Section 302 of the Sarbanes-Oxley Act. (Filed herewith)
13.1*	Certifications furnished pursuant to Section 906 of the Sarbanes-Oxley Act. (Filed herewith)
15.1	Consent of Independent Registered Public Accounting Firm. (Filed herewith)

\* As announced on March 20, 2008, Mr. Hoh Weng Ming was appointed Chief Financial Officer of the Company with effect from May 1, 2008 in place of Mr. Ho Tuck Chuen who resigned due to health reasons. Mr. Lai Seng Fatt, who was appointed to the position of Group Financial Controller of the Company in January 2008 from his position of finance manager at GPac Technology (S) Pte Ltd, a subsidiary of Hong Leong Asia, worked closely with Mr. Ho Tuck Chuen on, and has been performing the function of senior financial officer responsible for, the matters described in this Form 20-F/A. It is therefore believed by the Company that the Section 302 and Section 906 certifications required to be signed by the Chief Financial Officer should accordingly be signed by Mr. Lai Seng Fatt.

The Company has not included as exhibits certain instruments with respect to its long-term debt, the total amount of debt authorized under each of which does not exceed 10% of its total consolidated assets. We agree to furnish a copy of any such instrument to the SEC upon request.



**Table of Contents**

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

**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2003, 2004 AND 2005**

**(With Report of Independent Registered Public Accounting Firm)**

**Index to Financial Statements**

**China Yuchai International Limited**

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Statements of Operations for Years Ended December 31, 2003, 2004 and 2005</u>	F-3
<u>Consolidated Balance Sheets as of December 31, 2004 and 2005</u>	F-5
<u>Consolidated Statements of Stockholders' Equity for Years Ended December 31, 2003, 2004 and 2005</u>	F-7
<u>Consolidated Statements of Cash Flows for Years Ended December 31, 2003, 2004 and 2005</u>	F-8
<u>Notes to Consolidated Financial Statements</u>	F-12

F-1

**Table of Contents**

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

**R E P O R T O F I N D E P E N D E N T R E G I S T E R E D P U B L I C A C C O U N T I N G F I R M**

To the Board of Directors and Stockholders

China Yuchai International Limited

We have audited the accompanying consolidated balance sheets of China Yuchai International Limited (the Company) and subsidiaries as of December 31, 2004 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2005, all expressed in Renminbi. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Yuchai International Limited and subsidiaries as of December 31, 2004 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005 in conformity with U.S. generally accepted accounting principles.

As further described in Note 2A to the consolidated financial statements, the consolidated financial statements of the Company as of and for the year ended December 31, 2005 have been restated for the correction of certain accounting errors.

As described in Note 5 to the consolidated financial statements, the Company recognized a provision for uncollectible loans to a related party in the amount of Rmb 203 million as of December 31, 2005. Further, as described in Note 34 to the consolidated financial statements, the Company entered into certain material transactions subsequent to December 31, 2005.

The accompanying consolidated financial statements as of and for the year ended December 31, 2005 have been translated into U.S. dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Renminbi have been translated into U.S. dollars on the basis set forth in Note 3(i) to the consolidated financial statements.

/s/ KPMG

*Certified Public Accountants*

Hong Kong,

August 4, 2006, except as to Note 2A which is as of May 15, 2008

**Table of Contents**

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

**C HINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005***(Rmb and US\$ amounts expressed in thousands, except per share data)*

	Note	2003 Rmb	Years ended December 31, 2004 Rmb	2005 Rmb	2005 US\$
				Restated (Note 2A)	
Revenues, net <sup>(a), (1)</sup>	3(k), 27, 28, 33, 2A	4,569,950	5,582,095	5,816,740	720,768
Cost of goods sold <sup>(a)</sup>	4, 27, 2A	(3,192,794)	(4,006,886)	(4,673,357)	(579,088)
<b>Gross profit</b>		1,377,156	1,575,209	1,143,383	141,680
Research and development costs	3(m), 2A	(94,594)	(136,960)	(123,793)	(15,340)
Selling, general and administrative expenses <sup>(a)</sup>	3(m), 4, 14, 27, 2A	(561,151)	(658,320)	(793,153)	(98,282)
Provision for uncollectible loans to a related party	5, 2A			(202,950)	(25,148)
Gain on transfer of lease prepayment to a related party	27			2,533	314
<b>Operating income</b>		721,411	779,929	26,020	3,224
Interest expense	3(s), 6, 28	(23,624)	(31,757)	(70,527)	(8,739)
Equity in losses of affiliates	2A			(6,032)	(747)
Other (expenses)/income, net <sup>(a)</sup>	7, 2A	(881)	5,682	25,449	3,153
<b>Earnings/(loss) before income taxes and minority interests</b>		696,906	753,854	(25,090)	(3,109)
Income taxes	8, 2A	(112,924)	(105,165)	(10,148)	(1,257)
<b>Income/(loss) before minority interests</b>		583,982	648,689	(35,238)	(4,366)
Minority interests in income (loss) of consolidated subsidiaries	2A	(145,800)	(157,292)	2,947	365
<b>Net income/(loss)</b>		438,182	491,397	(32,291)	(4,001)

**Table of Contents**

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

**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR YEARS ENDED DECEMBER 31, 2003, 2004 AND 2005 (CONTINUED)***(Rmb and US\$ amounts expressed in thousands, except per share data)*

	Note	2003 Rmb	Years ended December 31, 2004 Rmb	2005 Rmb Restated (Note 2A)	2005 US\$
<b>Net earnings (loss) per common share</b>					
Basic	3(1), 2A	12.40	13.90	(0.89)	(0.11)
Diluted	3(1), 2A	12.40	13.90	(0.89)	(0.11)
<b>Weighted average number of shares</b>					
Basic	3(1)	35,340,000	35,340,000	36,459,635	36,459,635
Diluted	3(1)	35,340,000	35,340,000	36,459,635	36,459,635

See accompanying notes to consolidated financial statements.

- (a) Includes the following income and expenses resulting from transactions with related parties in addition to those indicated above (see Note 5 and 27)

	2003 Rmb	2004 Rmb	2005 Rmb Restated (Note 2A)	2005 US\$
<b>Revenues, net</b>	24,957	4,537	7,646	947
<b>Cost of goods sold</b>	(93,056)	(250,549)	(425,141)	(52,680)
<b>Selling, general and administrative expenses</b>	(97,240)	(90,790)	(186,759)	(23,141)
<b>Other (expenses)/income, net</b>			11,922	1,477

**Table of Contents**

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

**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2004 AND 2005***(Rmb and US\$ amounts expressed in thousands, except per share data)*

	Note	As of December 31,		
		2004 Rmb	2005 Rmb Restated (Note 2A)	2005 US\$
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		722,672	736,195	91,224
Trade accounts receivable, net	9, 18(a), 2A	875,565	1,178,853	146,075
Amounts due from related parties	10, 27	85,614	233,188	28,895
Loans to a related party	5, 2A	205,000	2,050	254
Loans to customers, net	11		7,904	979
Inventories, net	12, 2A	1,346,545	1,668,435	206,740
Prepaid expenses, net		58,565	138,322	17,140
Other receivables, net	13, 2A	115,414	135,652	16,809
Income taxes recoverable	2A		46,054	5,706
Deferred income taxes	8, 2A	69,704	85,351	10,576
<b>Total current assets</b>		<b>3,479,079</b>	<b>4,232,004</b>	<b>524,398</b>
Property, plant and equipment, net	14, 18(a), 2A	1,158,931	1,440,712	178,523
Construction in progress	15, 2A	379,035	456,752	56,597
Lease prepayments, net	16, 2A	74,767	69,328	8,591
Investments	17, 2A	7,053	191,048	23,673
Goodwill		212,636	212,636	26,348
Deferred income taxes	8, 2A	72,747	77,150	9,560
<b>Total assets</b>		<b>5,384,248</b>	<b>6,679,630</b>	<b>827,690</b>

**Table of Contents**

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

**CHINA YUCHAI INTERNATIONAL LIMITED AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2004 AND 2005 (Continued)***(Rmb and US\$ amounts expressed in thousands, except per share data)*

	Note	As of December 31,		
		2004 Rmb	2005 Rmb Restated (Note 2A)	2005 US\$
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>				
<b>Current liabilities</b>				
Short-term bank loans	18(a)	430,000	812,835	100,721
Current installments of long-term bank loans	18(b)		100,000	12,391
Amount due to the holding company	27	4,143	4,301	533
Amounts due to related parties	10, 27, 2A	42,686	75,186	9,317
Trade accounts payable	2A	1,089,717	1,800,443	223,098
Income taxes payable		25,387	4,208	521
Accrued expenses and other liabilities	20, 2A	484,920	611,707	75,798
<b>Total current liabilities</b>		2,076,853	3,408,680	422,379
Long-term bank loans, excluding current installments	18(b)	100,000	50,000	6,196
<b>Total liabilities</b>		2,176,853	3,458,680	428,575
<b>Minority interests</b>		724,311	654,687	81,124
<b>Stockholders equity</b>				
<b>Common stock</b>				
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)		30,349	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		1,486,934	1,692,251	209,691
Statutory reserves	22, 2A	266,229	266,586	33,033
Accumulated other comprehensive income			28,851	3,575
Retained earnings		699,572	546,630	67,734
<b>Total stockholders equity</b>		2,483,084	2,566,263	317,991
Commitments and contingencies	23, 24			
<b>Total liabilities and stockholders equity</b>		5,384,248	6,679,630	827,690

See accompanying notes to consolidated financial statements.

**Table of Contents**

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
<b>2003</b>							
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
<b>2004</b>							
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
<b>2005 (Restated Note 2A)</b>							
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.

**Table of Contents**

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 Restated (Note 2A)	2005 US\$
<b>Cash provided by operating activities</b>				
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
<b>Net cash provided by operating activities</b>	<b>1,075,274</b>	<b>589,608</b>	<b>242,674</b>	<b>30,070</b>
<b>Cash flow from investing activities</b>				
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)
<b>Net cash used in investing activities</b>	<b>(372,373)</b>	<b>(753,367)</b>	<b>(677,215)</b>	<b>(83,915)</b>





**Table of Contents**

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

**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 Restated (Note 2A)	2005 US\$
<b>Cash flow from financing activities</b>				
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)
<b>Net cash (used in)/provided by financing activities</b>	<b>(714,163)</b>	<b>254,493</b>	<b>452,777</b>	<b>56,105</b>
<b>Effect of foreign currency exchange on cash and cash equivalents</b>			<b>(4,713)</b>	<b>(584)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(11,262)</b>	<b>90,734</b>	<b>13,523</b>	<b>1,676</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>643,200</b>	<b>631,938</b>	<b>722,672</b>	<b>89,548</b>
<b>Cash and cash equivalents at end of year</b>	<b>631,938</b>	<b>722,672</b>	<b>736,195</b>	<b>91,224</b>
<b>Supplemental disclosures of cash flow information</b>				
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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**Table of Contents**

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

**CHINA 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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**Table of Contents**

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

**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

F-11

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**Table of Contents**

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

**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.

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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

**Table of Contents**

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

**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).





**Table of Contents**

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

**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.

**Table of Contents**

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

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

**Table of Contents**

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

**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 previously reported) Rmb	As of December 31, 2005		
		(Adjustments) Rmb	As Restated Rmb	US\$
<b>ASSETS</b>				
<b>Current assets</b>				
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
<b>Total current assets</b>	<b>4,170,631</b>	<b>61,373</b>	<b>4,232,004</b>	<b>524,398</b>
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
<b>Total assets</b>	<b>6,613,785</b>	<b>65,845</b>	<b>6,679,630</b>	<b>827,690</b>

**Table of Contents**

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

**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 previously reported) Rmb	As of December 31, 2005		
		(Adjustments) Rmb	As Restated Rmb	US\$
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>				
<b>Current liabilities</b>				
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
<b>Total current liabilities</b>	<b>3,211,230</b>	<b>197,450</b>	<b>3,408,680</b>	<b>422,379</b>
Long-term bank loans, excluding current instalments	50,000		50,000	6,196
<b>Total liabilities</b>	<b>3,261,230</b>	<b>197,450</b>	<b>3,458,680</b>	<b>428,575</b>
<b>Minority interests</b>	<b>685,514</b>	<b>(30,827)</b>	<b>654,687</b>	<b>81,124</b>
<b>Stockholders equity</b>				
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
<b>Total stockholders equity</b>	<b>2,667,041</b>	<b>(100,778)</b>	<b>2,566,263</b>	<b>317,991</b>
<b>Total liabilities and stockholders equity</b>	<b>6,613,785</b>	<b>65,845</b>	<b>6,679,630</b>	<b>827,690</b>

**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

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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

F-17

**Table of Contents**

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

**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

**Table of Contents**

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

**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

F-19

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**Table of Contents**

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

**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)*

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.



**Table of Contents**

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

**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)***(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 Rmb	2004 Rmb	2005 Rmb Restated (Note 2A)	2005 US\$
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

**Table of Contents**

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

**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)*

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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**Table of Contents**

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

**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)*

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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**Table of Contents**

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

**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)*

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.

**Table of Contents**

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

**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)***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 Rmb	2004 Rmb	2005 Rmb	2005 US\$
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 Rmb	2004 Rmb	2005 Rmb	2005 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 Rmb	2004 Rmb	2005 Rmb	2005 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.

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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).

F-25

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**Table of Contents**

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

**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)*

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.

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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

F-26

**Table of Contents**

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

**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)*

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
<b>Total interest cost incurred</b>	<b>35,770</b>	<b>51,458</b>	<b>91,518</b>	<b>11,340</b>

**7 Other (expenses)/income, net**

Other (expenses)/income, net consist of:

	Years ended December 31,			
	2003	2004	2005	2005
	Rmb	Rmb	Rmb	US\$
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.

**Table of Contents**

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

**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)*

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 Rmb	2004 Rmb	2005 Rmb	2005 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 Rmb	2004 Rmb	2005 Rmb	2005 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
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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.

F-28

**Table of Contents**

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

**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)*

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.

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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

F-29

**Table of Contents**

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

**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)*

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:

	<b>2004</b>	<b>December 31,</b>	
	<b>Rmb</b>	<b>2005</b>	<b>2005</b>
		<b>Rmb</b>	<b>US\$</b>
		<b>Restated (Note 2A)</b>	
Trade accounts receivable	504,429	606,644	75,171
Less: Allowance for doubtful accounts	107,457	69,047	8,556
		396,972	537,597
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:

	<b>2003</b>	<b>December 31,</b>		
	<b>Rmb</b>	<b>2004</b>	<b>2005</b>	<b>2005</b>
		<b>Rmb</b>	<b>Rmb</b>	<b>US\$</b>
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)).

F-30

**Table of Contents**

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

**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)***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\$
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:

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	<b>2004</b>	<b>December 31</b>	
	<b>Rmb</b>	<b>2005</b>	<b>2005</b>
		<b>Rmb</b>	<b>US\$</b>
		<b>Restated (Note 2A)</b>	
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

F-31

**Table of Contents**

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

**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)***13 Other receivables, net**

Other receivables, net comprise:

	December 31,		
	2004 Rmb	2005 Rmb	2005 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:

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



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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.

**Table of Contents**

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

**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)*

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



**Table of Contents**

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

**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)***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	2005 US\$
			Restated (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	2005 US\$
			Restated (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

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	Rmb	Rmb Restated (Note 2A)	US\$
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.

F-34

**Table of Contents**

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

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

	December 31,		
	2004	2005	2005
	Rmb	Rmb	US\$
		Restated (Note 2A)	
<i>Listed:</i>			
TCL (see Note (i))		184,095	22,812
<i>Unlisted:</i>			
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

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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.

F-35

**Table of Contents**

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

**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)**(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:*

	<b>December 31, 2005 Rmb</b>	<b>December 31, 2005 US\$</b>
<i>Financial position</i>		
Current assets	932,008	115,488
Property, plant and equipment, net	173,266	21,470
Other assets	453,327	56,173
<b>Total assets</b>	<b>1,558,601</b>	<b>193,131</b>
Current liabilities	337,971	41,879
Non-current liabilities	1,034	128
Long term debts	32,076	3,975
<b>Total liabilities</b>	<b>371,081</b>	<b>45,982</b>
Minority interests	30,416	3,769
Stockholders' equity	1,157,104	143,380
<b>Total liabilities and stockholders' equity</b>	<b>1,558,601</b>	<b>193,131</b>
	<b>Period from March 23, 2005 to December 31, 2005 Rmb</b>	<b>Period from March 23, 2005 to December 31, 2005 US\$</b>
<i>Results of operations</i>		
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)
<b>Gross profit</b>	<b>133,192</b>	<b>16,505</b>
Selling, general and administrative expenses	(191,161)	(23,688)



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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)

F-36

**Table of Contents**

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

**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)*

	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, 2005	December 31,		
		2004	2005	2005

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	(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.

F-37

**Table of Contents**

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

**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)***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 Rmb	2005 Rmb	2005 US\$
		<b>Restated (Note 2A)</b>	
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:

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	2003	December 31,		2005
	Rmb	2004	2005	US\$
		Rmb	Rmb	
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	17,611

F-38

**Table of Contents**

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

**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)***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:

	2003 Rmb	December 31, 2004 Rmb	2005 Rmb	2005 US\$
			Restated (Note 2A)	
<b><i>Statutory general reserve (see Note (ii))</i></b>				
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
<b><i>Statutory public welfare fund (see Note (iii))</i></b>				
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
<b><i>General surplus reserve</i></b>				
Balance at January 1 and December 31	25,706	25,706	25,706	3,185
<b><i>Total</i></b>	<b>229,920</b>	<b>266,229</b>	<b>266,586</b>	<b>33,033</b>

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

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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.

F-39

**Table of Contents**

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

**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)***23 Commitments**

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

	December 31,	
	2005	2005
	Rmb	US\$
<i>Authorized and contracted for:</i>		
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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**Table of Contents**

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

**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)*

**(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

**Table of Contents**

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

**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)*

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.



**Table of Contents**

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

**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)*

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;

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- (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).

F-43

**Table of Contents**

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

**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)*

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 than 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:

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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.

F-44



**Table of Contents**

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

**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)***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			



**Table of Contents**

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

**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)*

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

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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.

F-46

**Table of Contents**

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

**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)*

(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

**Table of Contents**

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

**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)*

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 of 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):

	<b>Yuchai Rmb</b>	<b>TCL Rmb</b>
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.		

	<b>2003 Rmb</b>	<b>2004 Rmb</b>	<b>2005 Rmb</b>
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

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

F-48



**Table of Contents**

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

**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)*

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

	Years ended December 31,			
	2003 Rmb	2004 Rmb	2005 Rmb Restated (Note 2A)	2005 US\$
<b>Revenues, net</b>				
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.

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

F-49

**Table of Contents**

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

**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)***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	2004	2005	2005
	Rmb	Rmb	Rmb	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

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**Table of Contents**

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

**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)*

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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**Table of Contents**

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

**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)*

***(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.

