INDUSTRY REVIEW

Heavy-duty trucks industry

The development of road system, especially highway system, and the strong GDP growth of 9.5% in the Reporting Period in the PRC have stimulated the sales of trucks, especially heavy-duty trucks in China. A sizable proportion of the unit sales of heavy-duty trucks with a load capacity of 15 tones (and above) in China is concentrated in few manufacturers, which are the major customers of the Company, such as: CHDTGL, Chongqing Hongyan Heavy Duty Motor Company Limited ("Chongqing Hongyan"), Shaanxi Heavy-duty Company Limited ("Shaanxi Motor"), Beijing Futian Motor Company Limited ("Beijing Futian"), Baotou North-Benz Heavy-duty Truck Co., Ltd ("North-Benz"), etc. During the Reporting Period, the PRC central government implemented a series of austerity measures to cool down the investment in infrastructures. With effect from 1st April, 2005, the central government has implemented a new policy of Vehicles' Maximum Measurement On Size, Weight and Loading Capacity《道路車輛外廓尺寸，軸荷及質量限值》, which required all truck manufacturers to redesign their trucks so as to meet certain design standards with specific length, height and chassis structure standards. As a result of which, the nationwide crackdown on truck overloading has been easing off since the second quarter of 2005. The implementation of the above-mentioned measures had certain negative impacts on the heavy-duty trucks, which in turn substantially slowed down the increase in sales of the Company of diesel engines which were used in the said industry as compared to the previous year. In China, during the Reporting Period, the total sales of heavy-duty trucks decreased by approximately 4.9% as compared with the same period in 2004.

Construction machineries — Wheel loaders industry

During the Reporting Period, the sale of the wheel loaders with a load capacity of 5 tones (and above), being the second-most important market of the Company, slowed down as a result of the implementation of series of austerity measures with credit-tightening policies by the PRC central government. A sizeable proportion of the sales of construction machines with a load capacity of 5 tonnes (and above) in the PRC is concentrated in a few manufacturers which are the major customers of the Company, such as: Guangxi Liugong Machinery Co., Ltd ("Guangxi Liugong"), Shanghai Longgong Machinery Company Limited ("Shanghai Longgong"), Fujian Longyan Construction (Group) Company Limited ("Fujian Longyan"), Shandong Lingong Construction Machinery Co., Ltd ("Shandong Lingong"), etc.

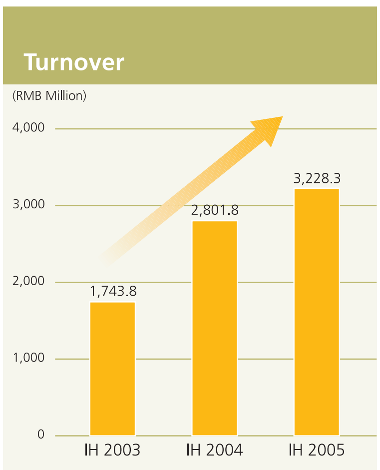
Business Review

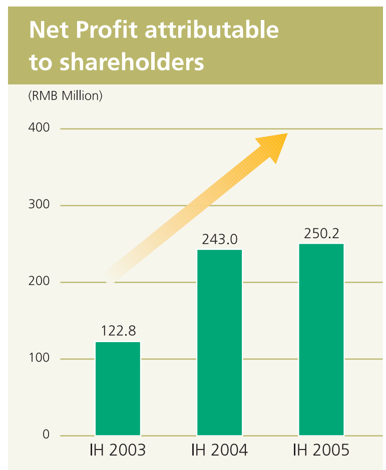
The Company is one of China's leading high-speed, heavy-duty diesel engine manufacturers, supplying mainly to certain major domestic truck and construction machine makers. The Company's core products are six-cylinder, 110–266kw output, 9.7 litre displacement WD615 diesel engines and WD618 diesel engines with output of 265–323kw. During the Reporting Period, the Company started a trial production of its newly invented Euro III diesel engines, with 10–12 liter displacement and higher horsepower up to 480 horsepower, on a market testing basis by using the new production lines.

Management Discussion and Analysis

The Company still has a very stable customers base which includes certain well-known market leaders in their industries including: CHDTGL, Shaanxi Motor, Guangxi Liugong, Shanghai Longgong, Shandong Lingong, North-Benz and Chongqing Hongyan, etc. During Reporting Period, sales to our top five and top ten customers accounted for approximately 50.1% and 67.6% of our total turnover respectively.

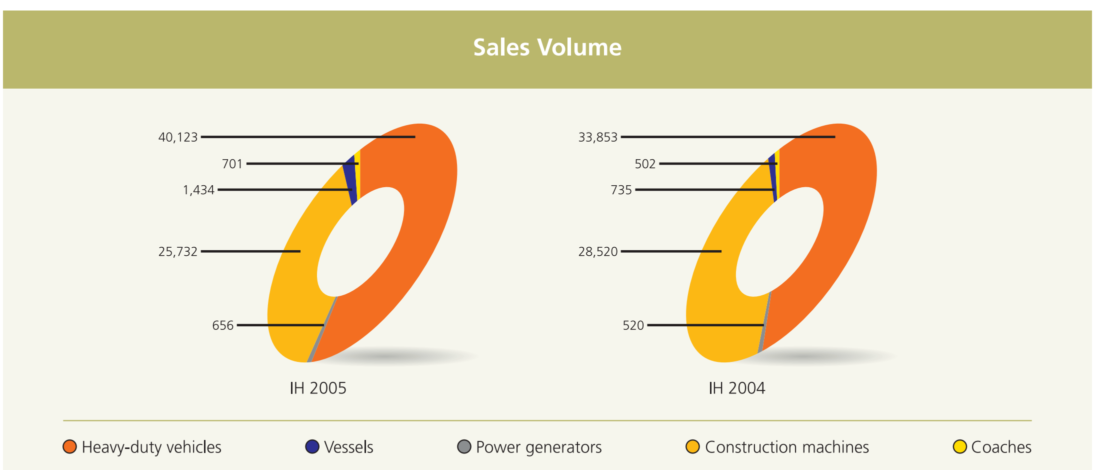
During the Reporting Period, the Company recorded growth in both turnover and net profit attributable to shareholders.



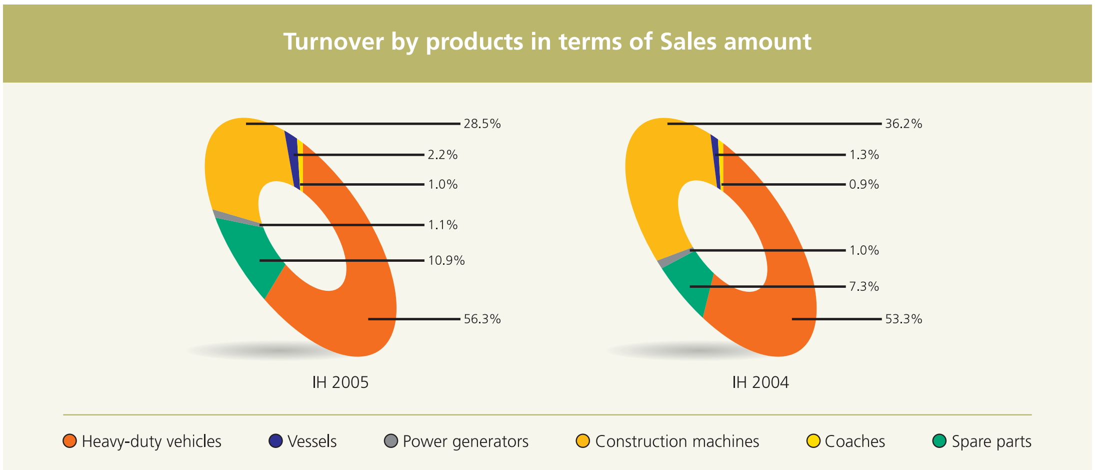


The pie charts below set out the Company's turnover by key product categories in terms of sales volume and amount.

Turnover by products in terms of sales volume of diesel engines



Turnover by products in terms of Sales amount



Sales of WD615 and WD618 series engines

During the Reporting Period, the Company's turnover increased by approximately 15.2% from RMB2,801.8 million in 2004 to approximately RMB3,228.3 million in 2005. The turnover was derived mainly from the sale of diesel engines used in heavy-duty trucks and construction machines, which in total accounted for approximately 84.9% and also represented approximately 56.3% and 28.6% of the total turnover, respectively. The growth in sales was mainly the result of a growing demand in the heavy-duty truck industries for the Company's products due to the strong economic growth in the PRC. During the Reporting Period, the Company sold approximately 68,646 units of diesel engines in 2005, compared to 64,130 units in 2004, representing an increase of approximately 7.0%, while the average unit selling price of the Company remained stable. Of these diesel engines sold in the Reporting Period, approximately 40,123 units (2004: 33,853 units) are trucks engines, representing an increase of approximately 18.5% when compared to that for the same period in 2004.

Sales of diesel engine parts

Apart from the production and sales of whole set of diesel engine, the Company also engages in the production and sales of engine parts. The production and sales of engine parts not only contributed to the sales revenue of the Company, but also ensured the generation of revenue from the provision of after-sales service on the parts. During the Reporting Period, the Company recorded an approximately 74.0% increase in sales of engine parts from RMB203.0 million in 2004 to approximately RMB353.3 million in 2005. The surge was mainly attributable to the increase in sales volume of diesel engines. The sales of diesel engine parts represented approximately 10.9% (2004: 7.3%) of the Company's turnover during the Reporting Period.

Management Discussion and Analysis

Financial Review

Gross profit and gross profit margin

During the Reporting Period, the Company's gross profit increased by approximately 21.1% to approximately RMB747.6 million (2004: RMB617.2 million) as a result of increase in the sales volume from 64,130 units in 2004 to approximately 68,646 units of diesel engines in 2005. The Company's gross profit margin slightly increased from 22.0% in 2004 to approximately 23.2% in 2005. The increase in gross profit margin was mainly due to the increase in sale of heavy-duty trucks diesel engines which have relatively higher gross profit margin than that of construction machineries' diesel engines in 2005.

Distribution expenses

During the Reporting Period, the Company's distribution expenses increased from RMB131.9 million in 2004 to approximately RMB175.5 million in 2005. As a percentage of turnover, distribution expenses increased from 4.7% in 2004 to approximately 5.4% in 2005, which was mainly due to the increase in repair and maintenance expense resulting from the substantial increase in the number of after-sales service centers from 756 at 30th June, 2004 to approximately 1,281 at 30th June, 2005.

Net profit margin

The Company's net profit margin decreased from 8.7% in 2004 to approximately 7.8% in 2005. The decrease was mainly due to the increase in expenses which were not tax deductible for PRC income tax purpose and the fact that no income tax credit was granted for the Reporting Period.

Liquidity and Financial Position

As at 30th June, 2005, the cash and cash equivalent of the Company amounted to approximately RMB941.6 million, representing a decrease of approximately 46.9% from RMB1,774.2 million as at 31st December, 2004. Such decrease was primarily due to the increase in capital expenditure of approximately RMB666.2 million on property, plants and equipments for updating the production capacity for the Reporting Period.

Earnings Per Share — Basic

The calculation of basic earnings per share is based on the net profit for the period of approximately RMB250,223,000 (six months ended 30th June, 2004: RMB242,973,000 as restated) and on the weighted average number of 330,000,000 (six months ended 30th June, 2004: 285,769,231) ordinary shares in issue during the Reporting Period.

The adjustment to comparative earnings per share, arising from adoption of new HKFRSs shown in note 2 to the interim financial statement of 2005, is as follows:

	RMB
Reconciliation of 2004 basic earnings per share	
Reported figure before adjustment	0.87
Adjustment arising from the adoption of HKAS 32	(0.02)
Restated	0.85

The earnings per share for the Reporting Period was approximately RMB0.76 (2004: RMB0.85) per share. The decrease in earnings per share was mainly due to the increase in the weighted number of shares in 2005 as compared to the same period in 2004, when the Company commenced the trading of its H Shares on the Stock Exchange on 11th March, 2004.

The effects of the adoption of new HKFRSs on the results for the Reporting Period and prior period are as follows:

	Six months ended	
	30.6.2005	30.6.2004
	RMB'000	*RMB'000*
Net profit after tax before taken up the effects	**256,291**	248,599
Increase in administrative expenses:		
Listing expenses	—	(5,626)
Increase in finance costs:		
Interest on amount due to a related party	**(6,068)**	—
Net profit for the period	**250,223**	242,973

Capital structure and capital expenditure

During the Reporting Period, the Company's bank borrowings were primarily denominated in RMB while its cash and cash equivalents were held in RMB and Hong Kong dollars.

It is the intention of the Company to maintain an appropriate mix of equity and debt to ensure an efficient capital structure from time to time. As at 30th, June, 2005, the Company had debts of RMB20 million and its gearing ratio (total debt/total asset) was only a mere of 0.42% (2004: 0.41%).

Management Discussion and Analysis

During the Reporting Period, the capital expenditure of approximately RMB666.2 million (2004: 303.4 million) was spent on the purchase of property, plant and equipment for upgrading the production capacity to approximately 200,000 units of diesel engines per annum in 2005.

Subsequent Event After Balance Sheet Date

濰柴動力(濰坊)投資有限公司 ("濰柴投資") is an equity joint venture company established in the PRC on 2nd August, 2005 with a registered capital of RMB1,638 million, of which the Company holds 45% interest in it. The registered capital of 濰柴投資 was fully paid up on 5th August, 2005.

On 11th August, 2005, 濰柴投資 entered into an agreement with independent vendors for the acquisition of an approximately 28.12% interest in 湘火炬汽車集團股份有限公司 Torch Automobile Group Co., Ltd., a company listed on The Shenzhen Stock Exchange in the PRC, at a consideration of approximately RMB622 million. On the same date, 濰柴投資 also enter into another agreement for the purchase of certain loans receivables from Torch Automobile at a consideration of approximately RMB401 million.

For any further detailed information, please refer to the announcement of the Company dated 11th August, 2005.

Foreign exchange risk exposure

As almost all of the income and expenditure of the Company were denominated in RMB and Hong Kong dollars for the Reporting Period, the Company did not experience any material difficulties or effects on its operations or liquidity as a result of fluctuations in currency exchange during the Reporting Period. The Directors believe that the Company will have sufficient foreign exchange to meet its foreign exchange requirements.

Segment Information

The Company was solely engaged in the business of manufacture and sale of diesel engines and substantially all of the Company's turnover and operating results were derived from the PRC and accordingly, no analysis of business and geographical segment is presented.

Contingent liabilities

The Company had no material contingent liabilities as at 30th June, 2005.

Human resources practice

As at 30th June, 2005, the Company had a total of over 5,400 employees. Employees are remunerated based on their performance, experience and the prevailing industry practices, with compensation policies and packages being reviewed on a yearly basis. Bonus and commission may also be awarded to employees based on internal performance evaluation.

The Company has established an incentive scheme for its senior management. Under this scheme, up to 5% of the audited annual profit after tax of the Company will be paid as bonus to the Directors and senior management staff each year.