MANAGEMENT DISCUSSION AND ANALYSIS

The Company is one of the leading high-speed, heavy-duty diesel engine manufacturers in China, supplying mainly to certain major domestic truck and construction machinery manufacturers. The Company's core products are six-cylinder, 110–266kw output, 9.7 litre displacement WD615 diesel engines and WD618 diesel engines with an output of 265–323kw. During the Period under review, the Company continued its trial production of its newly invented Euro III diesel engines WP10 and WP12, with a 10–12 litre displacement and higher power up to 480 horsepower, on a market testing basis by using our new production lines.

Industry Review

During the Period under review, the economy of the People's Republic of China (the "PRC") continued to record impressive growth. The gross domestic product ("GDP") expanded by approximately 9.9% for the year of 2005 and 10.9% for the Period. In line with the strong economy growth and the rapid urbanization stimulated by 11th Five Year Plan of the PRC, both the heavy-duty truck and construction machinery markets showed a significant recovery after the downturn caused by the promulgation of certain industry policies in 2005, as discussed in our 2005 annual report. During the Period under review, sales of heavy-duty trucks and construction machines (wheel loaders) in China increased by approximately 9% and 13% respectively compared with the same period 2005.

Heavy-duty trucks industry

Thanks to the rapid shift in focus and demand in the market in China from light and medium sized heavy-duty trucks to heavy-duty trucks with the load capacity of 15 tones (and above), the total units of diesel engine sold for heavy-duty truck increased by approximately 10.2% from 40,123 (in the six months ended 30th June, 2005) units to approximately 44,197 units for the Period. A sizable proportion of the unit sales of heavy-duty trucks with a load capacity of 15 tones (and above) in the PRC market was concentrated in a few manufacturers, which also included the major customers of the Company, such as: 陝西重型汽車有限公司 (Shaanxi Heavy-duty Company Limited) ("Shaanxi Motor"), 重慶紅岩重型汽車有限公司 (Chongqing Hongyan Heavy Duty Motor Company Limited) ("Chongqing Hongyan"), 北京福田汽車有限公司 (Beijing Foton Motor Company Limited) ("Beijing Foton"), 包頭北方奔馳重型汽車有限責任公司 (Baotou North-Benz Heavy-duty Truck Co., Ltd) ("North-Benz") and 安徽華菱汽車集團有限公司 (Anhui Huling Automobile Group Co., Ltd).

Construction machinery — Wheel loaders industry

During the Period under review, China's construction machinery market also showed a very strong recovery following a depressed market in 2005 due to the implementation of a series of micro-economy tightening measures by the PRC central government. The total units of diesel engine sold for construction machinery with a load capacity of 5 tones (and above) increased by approximately 41.6% from approximately 25,732 units (in the six months ended 30th June, 2005) to approximately 36,425 units for the Period. A sizeable proportion of the sales of construction machinery with a load capacity of 5 tonnes (and above) in the PRC was concentrated in a few manufacturers, which also included the major customers of the Company, such as: 廣西柳工機械股份有限公司 (Guangxi Liugong Machinery Co., Ltd) ("Guangxi Liugong"), 上海龍工機械有限公司 (Shanghai Longgong Machinery Company Limited)

MANAGEMENT DISCUSSION AND ANALYSIS

("Shanghai Longgong"), 福建龍岩工程機械(集團)有限公司 (Fujian Longyan Construction (Group) Company Limited) ("Fujian Longyan") and 山東臨工工程機械股份有限公司 (Shandong Lingong Construction Machinery Co., Ltd) ("Shandong Lingong").

Sales of WD615 and WD618 series engines

During the Period under review, the Group's turnover increased by approximately 8.2% from RMB3,228.3 million in the corresponding period in 2005 to approximately RMB3,493.6 million in 2006. The turnover of the Group was derived mainly from the sale of diesel engines used in heavy-duty trucks and construction machinery, which in total accounted for approximately 83.3% and also represented approximately 49.9% and 33.4% of all kinds of the total turnover of the Group, respectively. During the Period under review, the Group sold approximately 83,027 units of all kinds of diesel engines, compared to 68,646 units in the corresponding period in 2005, representing an increase of approximately 20.9%, while the average unit selling price of the Group remained relatively stable. Of the diesel engines sold for the Period, approximately 44,197 units (2005: 40,123 units) were truck engines, representing an increase of approximately 10.2% when compared to that for the same period in 2005. During the Period under review, approximately 36,425 units (2005: 25,732 units) of diesel engines for construction machinery were sold, representing an increase of approximately 41.6%, when compared to that for the same period in 2005.

Sales of engine parts

Apart from the production and sale of diesel engines, the Group is also engaged in the production and sale of engine parts. The production and sale of engine parts not only contributed to the revenue of the Group, but also ensured the generation of revenue from the provision of after-sales services on the parts. During the Period under review, the Group recorded an approximately 31.0% increase in sales of engine parts from RMB353.3 million in the corresponding period in 2005 to approximately RMB462.7 million in 2006. The surge was mainly attributable to the increase in accumulated sales volume of diesel engines in previous years. The sales of engine parts represented approximately 13.2% (2005: 10.9%) of the Group's total turnover in the Period.

OVERSEAS MARKET

On 24th July, 2006, the Group signed an agreement with a major heavy-duty truck maker in Europe. Under this agreement, the Group is expected to supply 17,500 units of new generation of diesel engines within next three years. This move signifies a significant step of the Group in diversifying its business and revenue geographically into the international market.

Financial Review

Turnover

The Group's turnover increased by approximately 8.2% from RMB3,228.3 million (first six months of 2005) to approximately RMB3,493.6 million for the Period in 2006. The increase in turnover was the result of a rebounce in demand in the heavy-duty trucks and construction machinery industries for diesel

MANAGEMENT DISCUSSION AND ANALYSIS

engines. During the Period under review, the Company sold approximately 83,027 units of diesel engines in total, compared to 68,646 units in the same period in 2005, representing a increase of approximately 20.9% while the unit average selling price of its diesel engines remained relatively stable.

Gross profit and gross profit margin

During the Period under review, the Group's gross profit increased by approximately 18.4% from RMB747.6 million (first six months of 2005) to approximately RMB885.0 million for the Period in 2006 as a result of increase in the sales volume from 68,646 units (first six months of 2005) to approximately 83,027 units of diesel engines for the Period in 2006. Gross profit margin increased from 23.2% to approximately 25.3%, which was mainly due to the increase in the sale of heavy-duty trucks diesel engines in 2006 which have a relatively higher gross profit margin and cost control efficiency.

Selling and distribution costs

Selling and distribution costs increased from RMB175.5 million (first six months of 2005) to approximately RMB289.0 million for the Period in 2006. As a percentage of turnover, selling and distribution costs increased from 5.4% (first six months of 2005) to approximately 8.3% for the Period in 2006, which was mainly due to the increase in repair and maintenance expenses and after-sales services charges resulting from the extension of warranty period for certain major customs from an average of 180 days starting from the second half of 2005 to one year and substantial increase in the number of after-sales services centers from an average of 1,281 in the first half of 2005 to 1,354 in the Period.

Administrative expenses

Administrative expenses of the Group increased by approximately 0.8% from RMB148.6 million in the first half of 2005 to approximately RMB149.8 million for the Period in 2006. The increase in administrative expenses was mainly due to the increase in the depreciation charged during the Period. As a percentage of turnover, the administrative expenses decreased from 4.6% in the first half of 2005 to approximately 4.3% for the Period in 2006. The decrease in administrative expenses was mainly due to the increase in the economy scale of the Group with most of administration expenses are relatively fixed to some extent.

Net profit margin

The Group's profit for the Period increased from RMB250.2 million in the first half of 2005 to approximately RMB320.7 million for the Period in 2006, whilst the net profit margin increased substantially from approximately 7.8% in the first half of 2005 to approximately 9.2% for the Period in 2006. The increase in the net profit margin was mainly due to the gross profit margin increase and the substantial decrease of income tax expense due to the decrease of the effective income tax rate from approximately 36.4% in 2005 to approximately 18.0% in 2006 due to substantially all of Group's production and sales were derived from the State high technology development zone, in which its assessable profit is taxed at a preferential rate of 15% compared to the statutory income tax rate of 33%.

MANAGEMENT DISCUSSION AND ANALYSIS

Liquidity and financial resources

During the Period under review, the Group maintained a relatively healthy cash flow and capital resources, which were reasonably allocated to appropriate use.

As at 30th June, 2006, the net cash and cash equivalents of the Group amounted to approximately RMB403.5 million (30th June, 2005: RMB941.6 million).

As at 30th June, 2006, the Group's total assets were RMB6,602.6 million (30th June, 2005: RMB4,784.7 million) and total liabilities were RMB3,875.4 million (30th June, 2005: RMB2,396.7 million) and the total equity reached RMB2,727.2 million (30th June, 2005: RMB2,388.0 million).

The Group will have sufficient financial resources to fund its operations, as well as its current investment needs and development plans, in its ordinary course of business.

Capital structure

During the Period under review, the Group'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 Group to maintain an appropriate mix of equity and debt to ensure an efficient capital structure from time to time. As at 30th June, 2006, the Group had debts of approximately RMB522.5 million in aggregate and the gearing ratio was approximately 7.9% (30th June, 2005: 0.42%) (total debt/total asset).

Business and geographical segments

During the Period under review, the Group was principally engaged in the business of manufacture and sale of diesel engines and related parts and substantially all of the Group's turnover and operating results were derived from the PRC and accordingly, no analysis of business and geographical segment is presented.

Pledge of assets

At 30th June, 2006, bank deposits and bills receivable of approximately RMB358.6 million (30th June, 2005: RMB242.1 million) were pledged to banks to secure bills payable issued and bills receivables discounted by the Group.

The pledged bank deposits carry prevailing bank interest rates. The pledge will be released upon the settlement of the relevant bank borrowings. The fair value of the bank deposits at the balance sheet dates approximates the carrying amount.

MANAGEMENT DISCUSSION AND ANALYSIS

Foreign exchange risk exposure

As almost all of the operations of the Group are located in the PRC. Its operating expenses as well as most of capital expenditure of the Group were denominated in RMB for the Period. Therefore, the Group did not experience any material difficulties or effects on its operations or liquidity as a result of fluctuations in currency exchange during the Period. The Directors believe that the Group will have sufficient foreign exchange currency to meet its foreign exchange requirements.

Contingent liabilities

The Group had no material contingent liabilities as at 30th June, 2006.

Capital commitments

As at 30th June, 2006, the Group had approximately RMB340.5 million capital commitments contracted (30th June, 2005: RMB128.7 million), principally for the capital expenditure in respect of purchase of property, machinery and equipment.

Capital expenditure, significant investment and material acquisitions

During the Period under review, the Group's capital expenditure amounted to approximately RMB96.2 million (30th June, 2005: RMB666.2 million). This was mainly attributable to the acquisition and installation of new production lines, modification of existing production lines, research and development of Euro III diesel engines, but excluding the acquisition of a 55% equity interest in 濰柴動力(濰坊)投資有限公司 (Weichai Power (Weifang) Investment Co., Ltd.) ("InvestCo").

In May 2006, the Company entered into agreement to purchase 55% of the equity interest in InvestCo. The said purchase was approved at the annual general meeting of the Company on 30th June, 2006 and has been completed. InvestCo is now a wholly owned subsidiary of the Company and the sole business and asset of InvestCo is an approximately 28.12% shareholding in TAGC. Further information relating to InvestCo was set out in the major transaction circular of the Company dated 14th June, 2006.

Post balance sheet event

Trading in the H shares of the Company has been suspended since 21st August, 2006 pending the release of an announcement. As at the date of this results announcement, the said announcement has not been finalised. Shareholders of the Company should take note of such announcement and the event concerning the said suspension of trading in the H shares of the Company.

Human resources practice

As at 30th June, 2006, the Company had a total of over 7,700 employees. As the Company believes that a loyal and motivated work force is key to its success, the Company has long been investing in employees' development efforts by organizing various training courses to broaden their horizon.

MANAGEMENT DISCUSSION AND ANALYSIS

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 are also awarded to employees based on internal performance evaluation.

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