Management Discussion and Analysis of Results of Operations and Financial Position

The Group is one of the leading high-speed, heavy-duty engine manufacturers in China, supplying its products mainly to certain major domestic truck and construction machinery manufacturers. The Company's core engine products are six-cylinder,110–266kw output, 9.7 litre displacement WD615 and WD618 diesel engines with output of 265–323kw. During the Period, the Group started the 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) using its new production lines.

Business Review

During the Period, the economy of China continued to record impressive growth. The gross domestic product ("GDP") expanded to approximately 10.7% for the year of 2006 from 9.9% for the year of 2005. In line with the strong economy growth and the rapid urbanization stimulated by the 11th Five Year Plan of China, both heavy-duty truck and construction machinery markets showed a significant recovery from the downturn in 2005. During the Period, the sales of heavy-duty trucks and construction machineries (wheel loaders with a load capacity (and above) in China increased by approximately 30.6% and 15.0% respectively compared with those in the year of 2005.

Sales of diesel engines — heavy-duty truck

The Group is the largest supplier of diesel engines to major manufacturers of heavy-duty trucks with a load capacity of 15 tons (and above) in China. The key customers of the Company are: 陝西重型汽車有限公司 (Shaanxi Heavy-duty Motor Company Limited), 重慶紅岩重型汽車有限公司 (Chongqing Hongyan Heavy Duty Motor Company Limited), 北汽福田汽車有限公司 (Beiqi Futian Motor Company Limited), 包頭北方奔馳汽車有限公司 (Baotou North-Benz Heavy-duty Truck Co., Ltd.), 安徽華菱汽車集團有限公司 (Anhui Hualing Automobile Group Co., Ltd.) and 安徽江淮汽車股份有限公司 (Anhui Jianghuai Automotive Co., Ltd.), etc. Thanks to the strict implementation of the 《收費公路試行計重收費指導意見》 (Guiding Opinion on the Trial of Charge-by-weight on Toll Roads) by the Central Government and 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 a load capacity of 15 tons (and above), the above-mentioned customers of the Group expanded their market share rapidly in China in 2006. During the Period, the Group sold approximately 145,890 units of diesel engines in total, compared to approximately 114,180 units in 2005, representing an increase of approximately 27.8%. Of the diesel engines sold in 2006, approximately 80,480 units (2005: 63,490 units) were truck engines, representing an increase of approximately 26.8% compared to that in 2005.

Sales of diesel engines — construction machinery

During the Period, China's construction machinery market also showed a very strong recovery from the depressed market in 2005 due to the GDP growth rate, which still maintained at a very high level. The Group is also the largest supplier of diesel engines to major manufacturers of construction machinery (mainly wheel loaders) with a load capacity of 5 tons (and above) in China. The key customers of the Group are: 廣西柳工機械股份有限公司 (Guangxi Liugong Machinery Co., Ltd), 龍工(上海)機械有限公司 (Longgong Shanghai Machinery Company Limited), 龍工(福建)機械有限公司 (Longgong (Fujian) Machinery Company Limited) ("Longgong Fujian"), 山東臨工工程機械有限公司 (Lingong Shandong Construction Machinery Co., Ltd) and 徐州徐工物資供應有限公司 (Xuzhou Xugong Material Supplying Co., Ltd), etc. During the Period, the Group sold approximately 145,890 units of diesel engines in total, compared to approximately 114,180 units in 2005, representing an increase of approximately 27.8%. Of the diesel engines sold in 2006, approximately 59,210 units (2005: 45,470 units) were construction machinery engines, representing an increase of approximately 30.2% compared to that in 2005.

Management Discussion and Analysis of Results of Operations and Financial Position

Sales of engine parts

Apart from the production and sale of diesel engines for trucks and construction machinery, 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 service on the parts. During the Period, the Group recorded an approximately 11.0% increase in sales of engine parts from approximately RMB683.0 million in 2005 to approximately RMB758.0 million in 2006. The surge was mainly attributable to the increase in accumulated sales volume of diesel engines in the previous years. The sales of engine parts represented approximately 11.4% (2005: 13.0%) of the Group's total turnover in the Period.

FINANCIAL REVIEW

Turnover

The Group's turnover increased by approximately 26.3% from approximately RMB5,250.7 million in 2005 to approximately RMB6,633.7 million in 2006. The increase in turnover was mainly due to a rebounce in demand in the heavy-duty truck and construction machinery industries for diesel engines. During the Period, the Group sold approximately 145,890 units of diesel engines in total, compared to approximately 114,180 units in 2005, representing an increase of approximately 27.8% while the unit average selling price of its diesel engines remained relatively stable.

Gross profit and gross profit margin

During the Period, the Group's gross profit increased by approximately 63.8% from approximately RMB1,154.3 million in 2005 to approximately RMB1,891.3 million in 2006 as a result of the increase in the sales volume of diesel engines from approximately 114,180 units in 2005 to approximately 145,890 units in 2006. Gross profit margin increased from approximately 22.0% in 2005 to approximately 28.5% in 2006, which was mainly due to the efficient cost control of the Company and the increase in the sales of heavy-duty truck diesel engines in 2006 which have a relatively higher gross profit margin than that of construction machinery diesel engines.

Other income

Other income increased by approximately 41.9% to approximately RMB99.3 million in 2006 from approximately RMB70.0 million in 2005. The increase was primarily due to the recovery of bad debts expenses and the compensation received from 中國重型汽車集團有限公司 (China Heavy Duty Track Group Co., Ltd.) in the Period.

Distribution costs

Distribution costs increased from approximately RMB404.0 million in 2005 to approximately RMB485.6 million in 2006. As a percentage of turnover, distribution costs decreased from approximately 7.7% in 2005 to approximately 7.3% in 2006, which was mainly due to the significant increase in the economy of scale of the Group.

Administrative expenses

Administrative expenses of the Group increased by approximately 52.2% from approximately RMB272.1 million in 2005 to approximately RMB414.1 million in 2006. The increase in administrative expenses was mainly due to the increase in the staff salary and professional fees paid in relation to the Merger (as hereinafter defined) with 湘火炬汽車集團股份有限公司 (Torch Automobile Group Co., Ltd) ("TAGC") during the Period. As a percentage of turnover, the administrative expenses increased from approximately 5.2% in 2005 to approximately 6.2% in 2006.

Share of results of an associate

Share of results of an associate increased by approximately 3,314.9% to approximately RMB32.1 million in 2006 from approximately RMB0.94 million in 2005, primarily due to the increase in the net profit of TAGC and the increased equity interest in 濰柴動力(濰坊)投資有限公司 (Weichai Power (Weifang) Investment Co., Ltd.) ("Weifang Investment") (which held approximately 28.12% equity interest in TAGC) held by the Company from 45% in the first half of the Period to 100% in second half of the Period.

Finance costs

Finance costs increased by approximately 47.0% to approximately RMB63.2 million in 2006 from approximately RMB43.0 million in 2005. This increase was mainly due to an increase in discounted charges on bank bills which were to fund the normal business operation of the Company.

Operating profit

As a result of better gross margin, other income and economy of scale in the running of the business in the Period, the Group's operating profit increased by approximately 109.9% to approximately RMB952.3 million in 2006 from approximately RMB453.6 million in 2005. The Group's operating margin was also widened from approximately 8.6% in 2005 to approximately 14.4% in 2006.

Income taxes

The Group's income tax expenses increased by approximately RMB87.2 million or 92.8% from approximately RMB93.9 million in 2005 to approximately RMB181.1 million in 2006, which was mainly attributable to the increased profit of the Group. In 2006, the Group's average effective rate tax was 20.4%, which decreased slightly compared to 22.9% in 2005. This decrease was mainly due to substantially all of the 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%.

Dividend

The Board has resolved that it will not propose a final dividend for the Company for 2006 until the Merger (as hereinafter defined) is completed. After the completion of the Merger (as hereinafter defined), the Board will meet again to consider proposing a final dividend (if any) for the Company for 2006 for the consideration and approval by the 2006 annual general meeting of the Company. For details concerning the agreement between the Company and TAGC on profit distribution, please refer to the section headed "I. The Merger Proposal — 3. Merger Agreement — Others" in the "Letter from the Board" contained in the circular of the Company dated 12th November, 2006.

Net profit margin

The Group's net profit for the Period increased from approximately RMB316.7 million in 2005 to approximately RMB708.0 million in 2006, whilst the net profit margin increased substantially from approximately 6.0% in 2005 to approximately 10.7% in 2006. The increase in the net profit margin was mainly due to the increase in gross profit margin from approximately 22.0% in 2005 to approximately 28.5% in 2006.

Liquidity and financial resources

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

Management Discussion and Analysis of Results of Operations and Financial Position

As at 31st December, 2006, the net cash and cash equivalents of the Group amounted to approximately RMB595.4 million (2005: RMB710.0 million).

As at 31st December, 2006, the Group's total assets were approximately RMB7,128.8 million (2005: RMB5,612.0 million), its total liabilities were approximately RMB4,076.5 million (2005: RMB3,151.0 million) and its total equity reached approximately RMB2,984.6 million (2005: RMB2,398.6 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, the Group's bank borrowings were primarily denominated in RMB while its cash and cash equivalents were held in RMB and Hong Kong dollars.

During the Period, the Group financed its liquidity requirements through a combination of cash flow as generated from normal operation bills, payables and bank loans. 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 31st December, 2006, the Group had debts of approximately RMB672.3 million (2005: RMB334.2 million) in aggregate and the gearing ratio was approximately 9.4% (2005: 6.0%) (total debt/total asset).

Business and geographical segments

During the Period, 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 31st December, 2006, bank deposits and bills receivables of approximately RMB494.0 million (2005: RMB371.7 million) were pledged to banks to secure bills payables issued and bills receivables discounted by the Group.

The pledged bank deposits carry prevailing bank interest rates of 1.65% (2005: 1.10%) per annum. 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.

Foreign exchange risk exposure

As almost all of the operations of the Group are located in China, 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 31st December, 2006.

Capital commitments

As at 31st December, 2006, the Group had approximately RMB57.2 million capital commitments contracted (2005: RMB234.9 million), principally for the capital expenditure in respect of acquisition of property, plant and equipment.

Capital expenditure, merger and acquisitions

During the Period, the Group's capital expenditure amounted to approximately RMB527.4 million (2005: RMB807.2 million). This was mainly attributable to the acquisition and installation of new production lines, modification of existing production lines, but excluding the acquisition of a 55% equity interest in Weifang Investment with an amount of approximately RMB684.8 million.

Human resources practice

As at 31st December, 2006, the Company had a total of over 8,000 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. 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.

Merger and Acquisition

Acquisition of 濰柴動力（濰坊）投資有限公司 (Weichai Power (Weifang) Investment Co., Ltd.) ("Weifang Investment")

On 12th May, 2006, the Company entered into conditional sale and purchase agreements to acquire 55% equity interest in Weifang Investment, as a result of which the Company's interest therein was increased from 45% to 100%, for a consideration of RMB684,750,000. Weifang Investment is an investment holding company whose principal asset is approximately 28.12% equity interest in 湘火炬汽車集團股份有限公司 (Torch Automobile Group Co., Ltd.). ("TAGC"), a company listed on the Shenzhen Stock Exchange. TAGC and its subsidiaries were are in the manufacture and sale of heavy trucks and related parts and components.

The acquisition of Weifang Investment was approved by the shareholders of the Company at its annual general meeting on 30th June, 2006. Details of the acquisition were set out in the circular of Company dated 14th June, 2006.

Merger with TAGC

On 12th November, 2006, the Company entered into an agreement (the "Merger Agreement") with TAGC in respect of the merger of the Company and TAGC and the issue of new A shares by the Company (which will be listed on the Shenzhen Stock Exchange upon completion of the Merger) ("Weichai A Shares") to the shareholders of TAGC (other than Weifang Investment) at the ratio of one Weichai A Share to 3.53 shares of TAGC held by such shareholders of TAGC (the "Merger"). The Merger will be accompanied by a cash alternative to the shareholders of TAGC who

Management Discussion and Analysis of Results of Operations and Financial Position

elected not to receive in whole (or in part) the Weichai A Shares at the rate of RMB5.05 per share of TAGC. The Company itself will not be a provider of such cash alternative, which shall be arranged by the sponsors to the listing of the Weichai A Shares.

After the completion of the Merger, (i) the shares of TAGC will be cancelled; (ii) TAGC's assets will be absorbed into and its liabilities assumed by the Company; (iii) TAGC will be deregistered and will cease to exist; and (iv) the Weichai A Shares will be listed on the Shenzhen Stock Exchange while the H shares of the Company will continue to be listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The Merger and the Merger Agreement were approved by the shareholders of the Company and TAGC at the extraordinary general meeting on 29th December, 2006. Further details of the Merger and the Merger Agreement were set out in the section headed "I. The Merger Proposal" in the "Letter from the Board" contained in the circular of the Company dated 12th November, 2006.