

## **Directors' Report**

The Directors present their annual report and the audited consolidated financial statements for the year ended 31st December, 2005.

### **PRINCIPAL ACTIVITIES**

The principal activities of the Company are the manufacture and sales of diesel engines and related parts. The principal activities of its associate and subsidiaries are set out in notes 20 and 37 to the financial statements respectively.

### **RESULTS AND APPROPRIATIONS**

The results of the Group for the year ended 31st December, 2005 are set out in the consolidated income statement on page 42.

An interim dividend of RMB0.165 per share amounting to RMB54,450,000 was paid to shareholders during the year.

The Directors now recommend, subject to approval of the shareholders of the Company at the forthcoming annual general meeting, the payment of a final dividend of RMB0.165 per share to the shareholders on the register of members on 29th May, 2006, amounting to RMB54,450,000.

### **SHARE CAPITAL**

Details of the share capital of the Company are set out in note 30 to the financial statements.

### **PROPERTY, PLANT AND EQUIPMENT**

Details of movements during the year in the property, plant and equipment of the Group are set out in note 16 to the financial statements.

### **DISTRIBUTABLE RESERVES**

The amount of the Company's reserves available for distribution to shareholders as at 31st December, 2005, calculated in accordance with the profit as reported under the relevant accounting principles and financial regulations applicable to companies established in the People's Republic of China or Hong Kong Financial Reporting Standards, whichever is less, was RMB755,141,000.

## Directors' Report

### DIRECTORS AND SUPERVISORS

The Directors and Supervisors of the Company during the year and up to the date of this annual report were:

#### Executive Directors

Tan Xuguang (*Chairman and CEO*)  
Xu Xinyu  
Sun Shaojun  
Zhang Quan

#### Non-Executive Directors

Yeung Sai Hong  
Chen Xue Jian  
Yao Yu  
Li San Yim  
Tong Jingen  
Zhang Fusheng  
Julius G. Kiss  
Han Xiaoqun  
Feng Gang

(appointed on 5th December, 2005 for a term of three years as from 18th December, 2005)  
(resigned with effect from 17th December, 2005)

#### Independent Non-Executive Directors

Koo Fook Sun, Louis  
Zhang Xiaoyu  
Fang Zhong Chang

#### Supervisors

Sun Chengping  
Wang Yong  
Jiang Jianfang

### DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

Each of the Executive Directors has entered into a service contract with the Company commenced 24th November, 2003 and ended on 17th December, 2005. At the extraordinary general meeting of the Company held on 5th December, 2005, the terms of appointment for each of the Executive Directors were further extended to 17th December, 2008.

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The term of appointment of each of the Non-Executive Directors and Supervisors was from 18th December, 2002 to 17th December, 2005, save and except that the term of appointment of Chen Xue Jian (a Non-Executive Director) was from 29th June, 2004 to 17th December, 2005. At the extraordinary general meeting of the Company held on 5th December, 2005, the terms of appointment for each of the Non-Executive Directors and Supervisors, except Feng Gang (a Non-Executive Director) who resigned with effect from 17th December, 2005 and Wang Yong who was subject to re-appointment by employees of the Company, were further extended to 17th December, 2008. Mr. Wang Yong was re-appointed as a Supervisor of the Company on 18th December, 2005 by employees of the Company for a term of three years up to 17th December, 2008.

Each of the Independent Non-Executive Directors has a fixed term of appointment commencing from the date of the last annual general meeting of the Company and ending (i) on the next annual general meeting of the Company ("Next AGM"); or (ii) on the conclusion of the extraordinary general meeting (if any) of the Company convened prior to the Next AGM at which he is re-appointed as Independent Non-Executive Director for a term beyond the conclusion of the Next AGM (whichever is the earlier). At the extraordinary general meeting of the Company held on 5th December, 2005, each of the Independent Non-Executive Directors of the Company was re-appointed for a term of three years as from 18th December, 2005 to 17th December, 2008 (both days inclusive).

The Company has received, from each of the Independent Non-Executive Directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"). The Company considers all of the Independent Non-Executive Directors are independent.

## Directors' Report

### DIRECTORS' AND SUPERVISORS' INTERESTS IN SHARES, UNDERLYING SHARES AND CONVERTIBLE BONDS

As at 31st December, 2005, the interests of the Directors, Supervisors and their associates in the shares, underlying shares and convertible bonds of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance ("SFO"), or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code"), were as follows:

Name of Director	Capacity	Number of domestic shares or foreign shares held	Percentage of the issued share capital of the Company
Tan Xuguang	Beneficial owner	4,300,000 (Note 1)	1.3%
Xu Xinyu	Beneficial owner	1,000,000 (Note 1)	0.3%
Sun Shaojun	Beneficial owner	1,000,000 (Note 1)	0.3%
Zhang Quan	Beneficial owner	1,000,000 (Note 1)	0.3%
Yeung Sai Hong (Note 3)	Held by controlled corporation	23,500,000 (Note 2)	7.1%
Li San Yim (Note 4)	Held by spouse and controlled corporation	21,500,000 (Note 1)	6.5%
Julius G. Kiss (Note 5)	Held by controlled corporation	10,750,000 (Note 2)	3.3%
<b>Name of Supervisor</b>			
Wang Yong	Beneficial owner	350,000 (Note 1)	0.1%

Notes:

1. These are domestic shares of the Company. Domestic shares are ordinary shares issued by the Company, with a Renminbi-denominated par value of RMB1.00 each, which are subscribed for and paid up in Renminbi or credited as fully paid up.
2. These are foreign shares of the Company. Foreign shares are ordinary shares issued by the Company, with a Renminbi-denominated par value of RMB1.00 each, which are subscribed for and paid up in a currency other than Renminbi. As at 31st December, 2005, these foreign shares are included in the domestic shares of the Company.

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3. Yeung Sai Hong, a Non-Executive Director, was directly and indirectly interested in 90% of the issued share capital of Peterson Holdings Company Limited ("Peterson"), which in turn held 23,500,000 foreign shares of the Company.
4. Li San Yim, a Non-Executive Director, and his spouse, Ni Yinying, were interested in 69.16% and 30.84%, respectively in the registered capital of 福建龍岩工程機械(集團)有限公司 (Fujian Longgong Construction Machinery (Group) Company Limited ("Fujian Longgong")), which in turn held 21,500,000 domestic shares of the Company, and therefore Li San Yim was deemed to be interested in these shares of the Company.
5. Julius G. Kiss, a Non-Executive Director, was indirectly interested in the entire issued share capital of IVM Technical Consultants Wien Gesellschaft m.b.H. ("IVM"), which in turn held 10,750,000 foreign shares of the Company.

Save as disclosed above, none of the Directors, Supervisors, chief executives, nor their associates had any interests or short positions in any shares, underlying shares or convertible bonds of the Company or any of its associated corporations as at 31st December, 2005.

### ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

At no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the Directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

### PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

## Directors' Report

### SUBSTANTIAL SHAREHOLDERS

The register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that as at 31st December, 2005, the following shareholders had notified the Company of their relevant interests in the issued share capital of the Company.

Name	Capacity	Number of domestic shares (Note 7) or foreign shares (Note 8) held	Percentage of share capital comprising only domestic shares and foreign shares	Number of H shares held (Note 9)	Percentage of share capital comprising only H shares	Percentage of total issued share capital
濰坊柴油機廠 (Weifang Diesel Engine Works) ("Weichai Factory")	Beneficial owner	77,647,900	38.16%	Nil	—	23.53%
中國重型汽車集團有限公司 (China Heavy Duty Truck Group Co., Ltd.) ("CHDTGL") (Note 1)	Held by controlled corporation	77,647,900	38.16%	Nil	—	23.53%
Peterson (Note 2)	Beneficial owner	23,500,000	11.55%	Nil	—	7.12%
Yeung Sai Hong (Note 2)	Held by controlled corporation	23,500,000	11.55%	Nil	—	7.12%
Tingho Nominees Limited (Note 2)	Held by controlled corporation	23,500,000	11.55%	Nil	—	7.12%
Advantage Investment Corporation Limited (Note 2)	Held by controlled corporation	23,500,000	11.55%	Nil	—	7.12%
Fujian Longgong	Beneficial owner	21,500,000	10.57%	Nil	—	6.52%
Li San Yim (Note 3)	Held by controlled corporation and spouse	21,500,000	10.57%	Nil	—	6.52%
Ni Yinying (Note 3)	Held by controlled corporation and spouse	21,500,000	10.57%	Nil	—	6.52%
濰坊市投資公司 ("Weifang Investment Company") (Note 4)	Beneficial owner	19,311,550	9.49%	Nil	—	5.85%
深圳市創新投資集團有限公司 ("Shenzhen Chuangxin Investment Group Company Limited")	Beneficial owner	21,500,000	10.57%	Nil	—	6.52%
深圳市投資管理公司 ("Shenzhen Investment Management Company") (Note 5)	Held by controlled corporation	21,500,000	10.57%	Nil	—	6.52%

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Name	Capacity	Number of domestic shares (Note 7) or foreign shares (Note 8) held	Percentage of share capital comprising only domestic shares and foreign shares	Number of H shares held (Note 9)	Percentage of share capital comprising only H shares	Percentage of total issued share capital
IVM	Beneficial owner	10,750,000	5.28%	Nil	—	3.26%
ADTECH Advanced Technologies AG ("ADTECH") (Note 6)	Held by controlled corporation	10,750,000	5.28%	Nil	—	3.26%
Julius G. Kiss (Note 6)	Held by controlled corporation	10,750,000	5.28%	Nil	—	3.26%
JP Morgan Chase & Co.	Investment manager	Nil	—	13,773,969	10.89%	4.17%
Government of Singapore Investment Corporate Pte Ltd.	Investment manager	Nil	—	8,950,000	7.08%	2.71%
FMR Corp.	Investment manager	Nil	—	7,467,000	5.90%	2.26%

Notes:

1. CHDTGL, a State-owned enterprise, was the holding company of Weichai Factory and held the entire registered capital of Weichai Factory.
2. Yeung Sai Hong, a Non-Executive Director, was beneficially interested in the entire issued share capital of Tingho Nominees Limited, which in turn held 100% of Advantage Investment Corporation Limited, which was interested in 90% of the issued share capital of Peterson.
3. The registered capital of Fujian Longgong was held as to 69.16% by Li San Yim, a Non-Executive Director, and as to 30.84% by Ni Yinying, spouse of Li San Yim, and therefore Ni Yinying was deemed to be interested in these shares of the Company.
4. Weifang Investment Company was a State-owned enterprise.
5. Shenzhen Investment Management Company was interested in approximately 33.73% of the registered capital of Shenzhen Chuangxin Investment Group Company Limited.
6. ADTECH was wholly owned by Julius G. Kiss, a Non-Executive Director, and ADTECH was interested in the entire issued share capital of IVM.
7. Domestic shares are ordinary shares issued by the Company, with a Renminbi-denominated par value of RMB1.00 each, which are subscribed for and paid up in Renminbi or other currencies or credited as fully paid up.
8. Foreign shares are ordinary shares issued by the Company, with a Renminbi-denominated par value of RMB1.00 each, which are subscribed for and paid up in a currency other than Renminbi. As at 31st December, 2005, these foreign shares are included in the domestic shares of the Company.
9. H shares are overseas listed shares in the share capital of the Company, with a Renminbi-denominated par value of RMB1.00 each and are subscribed for and traded in Hong Kong dollars, and they are currently listed on the Main Board of the Stock Exchange.

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Save as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at 31st December, 2005, which were recorded in the register as required to be kept under Section 336 of the SFO.

### CONNECTED TRANSACTIONS AND DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

During the year, the Group had the following significant transactions with connected persons:

	Notes	RMB'000
China Heavy Duty Truck Group ( <i>note i</i> ):		
Sales of diesel engines and related parts	<b>(iv)</b>	1,806,798
Purchases of materials	<b>(iv)</b>	128,868
Purchases of finished diesel engines	<b>(iv)</b>	409,791
General services fee paid	<b>(v)</b>	23,571
Utility services fee paid	<b>(vi)</b>	129,172
Processing services fee	<b>(vii)</b>	60,042
Sales and warranty period repair services fee income	<b>(viii)</b>	21,025
Purchases of property, plant and equipment	<b>(ix)</b>	145
Disposal of property, plant and equipment	<b>(ix)</b>	71
Rental paid for certain premises, machinery and equipment	<b>(x)</b>	46,218
Fujian Longgong Group ( <i>note ii</i> ):		
Sales of diesel engines and related parts	<b>(iv)</b>	349,774
Guangxi Liugong Group ( <i>note iii</i> ):		
Sales of diesel engines and related parts	<b>(iv)</b>	266,338

*Notes:*

- (i) CHDTGL and its affiliates other than the Group are collectively referred as China Heavy Duty Truck Group.
- (ii) Fujian Longgong together with its affiliates are collectively referred as the "Fujian Longgong Group".
- (iii) 廣西柳工集團有限公司 ("Guangxi Liugong") is a promoter of the Company and held 1.36% interest in the Company at 31st December, 2005. Guangxi Liugong together with its affiliates are collectively referred as the "Guangxi Liugong Group".
- (iv) These transactions were carried out at market prices or, where no market prices were available, at cost plus a percentage profit mark-up.
- (v) The general services fee was based on the actual cost incurred plus not more than 20% service charge.
- (vi) The utility services fee was based on the actual usage and with reference to market prices or, where no market prices were available, at actual cost incurred plus not more than 20% service charge.
- (vii) The processing services fee was based on the actual cost incurred plus not more than 20% service charge.



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- (viii) The sales and warranty period repair service fee income was based on 3% on the sales of medium speed diesel engines on behalf of China Heavy Duty Truck Group.
- (ix) These transactions were carried out on terms mutually agreed by the relevant parties.
- (x) Rental for certain land and buildings, machinery and equipment were charged based on a fixed monthly charge.

Save as disclosed above, no contracts of significance to which the Company or its subsidiaries was a party and in which a Director or a Supervisor of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

The Independent Non-Executive Directors have reviewed the continuing connected transactions and have confirmed that the transactions have been entered into by the Company in the ordinary course of its business, on normal commercial terms, and in accordance with the terms of the agreement governing such transactions that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

## CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from 30th May, 2006 to 30th June, 2006 (both days inclusive) during which no transfer of shares will be registered. In order to qualify for the attendance and voting at the forthcoming annual general meeting and for the final dividend, all documents on transfer of H Shares of the Company, accompanied by the relevant share certificates, must be lodged with the Company's Hong Kong H-Share Registrar and Transfer Office, Computershare Hong Kong Investor Services Limited at 46/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not later than 4:00 p.m. on 29th May, 2006.

## ARRANGEMENT TO PURCHASE SHARES OR DEBENTURES

At no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the Directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association or the laws of the People's Republic of China, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

## PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

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### MAJOR SUPPLIERS AND CUSTOMERS

The aggregate sales attributable to the Group's largest customer and the five largest customers taken together accounted for approximately 23% and 47% respectively of the Group's total sales for the year.

At 31st December, 2005, CHDTGL and Fujian Longgong were shareholders holding indirectly more than 5% of the Company's share capital. CHDTGL, together with companies under its control other than the Group, was the Group's largest customer. Fujian Longgong Group was one of the Group's five largest customers. All transactions between the Group and the customers concerned were carried out on normal commercial terms.

Save as disclosed above, at no time during the year did a Director, an associate of a Director or a shareholder of the Company, which to the knowledge of the Directors, owns more than 5% of the Company's share capital, have an interest in any of the Group's five largest suppliers or customers.

### AUDIT COMMITTEE

The Audit Committee comprises all three independent non-executive directors. The Chairman of the Audit Committee is Mr. Koo Fook Sun, Louis, an independent non-executive director. Mr. Koo is an experienced investment banker with appropriate professional qualifications or accounting or related financial management expertise as required under Rule 3.10(2) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") for the purpose of such appointment.

Meetings of the Audit Committee generally held not less than twice a year to review and discuss the interim and annual financial statements respectively. Additional meetings may also be held by the Committee from time to time to discuss special projects or other issues which the Committee considers necessary. The external auditors of the Company may request a meeting if they consider that it is necessary to do so. Throughout the year, the Audit Committee discharged its responsibilities, reviewed and discussed the financial results and internal control system of the Company. In accordance with the requirements of Appendix 16 of the Listing Rules, the Audit Committee has reviewed the consolidated financial statements for the year ended 31st December, 2005. The non-PRC auditors of the Company have audited the consolidated financial statements and have issued an unqualified auditors' report.

### COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES IN APPENDIX 14 OF THE LISTING RULES

The Company complied with the code provisions of the Code on Corporate Governance Practices in Appendix 14 to the Listing Rules throughout the year. None of the Directors is aware of any information that would reasonably indicate that the Company is not or was not for any time during the period under review in compliance with the code provisions of the Code on Corporate Governance Practices in Appendix 14 to the Listing Rules.

## **Directors' Report**

### **COMPLIANCE WITH THE MODEL CODE**

During the year, the Company has adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standard set out in the Model Code as set out in Appendix 10 to the Listing Rules (the "Code"). Having made specific enquiry of all Directors, the Directors have confirmed that they have complied with the required standard set out in the Code for the year under review.

### **SUFFICIENCY OF PUBLIC FLOAT**

The Company has maintained a sufficient public float throughout the year ended 31st December, 2005.

### **POST BALANCE SHEET EVENT**

Details of the post balance sheet event are set out in note 35 to the financial statements.

### **AUDITORS**

A resolution will be submitted to the forthcoming annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

### **APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS**

The audited consolidated financial statements for the year were approved by the Board on 19th April, 2006.

### **PUBLICATION OF THE RESULTS ON WEBSITE**

The financial information required to be disclosed under paragraphs 46 (1) to 46 (6) of Appendix 16 of the Listing Rules has been published on the website of the Stock Exchange at [www.hkex.com.hk](http://www.hkex.com.hk).

On behalf of the Board

Tan Xuguang  
*Chairman and CEO*  
Hong Kong, 19th April, 2006