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Web Proof Information Pack of
XINCHEN CHINA POWER HOLDINGS LIMITED
新晨中國動力控股有限公司
(Incorporated in the Cayman Islands with limited liability)

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SUMMARY

OVERVIEW

We are one of the leading automotive engine manufacturers in the independent branded segment of the PRC passenger vehicle, or PV, and light commercial vehicle, or LCV, engine market in terms of sales volume in 2011. We develop, manufacture and sell light-duty gasoline and diesel engines used by various local and foreign-invested PV and LCV manufacturers in the PRC. We were the largest independent branded engine manufacturer of small bus engines in China in 2011 in terms of sales volume according to the Frost & Sullivan Report. According to the Frost & Sullivan Report, in terms of sales volume in 2011, we accounted for 9.4% of the independent branded segment of the PV and LCV engine market in China, and independent brands accounted for approximately 13.8% of the PV and LCV engine market in China. Our target PV and LCV engine market in China has experienced rapid growth in recent years. According to the Frost & Sullivan Report, the total sales volume of PV and LCV engines in China had grown from 7.9 million units in 2007 to 17.1 million units in 2011. We believe our brand “XCE 新晨動力” enjoys high brand recognition in the PRC automotive industry and it was named as one of the “Top 10 Brands for Diesel Engines” by the China Internal Combustion Engine Industry Association and China Automotive News in 2010. We believe that we are one of the few local light-duty gasoline and diesel engine manufacturers in China with the research and development capabilities to independently develop automotive engines. Our Directors confirm that to their best knowledge, our market position in the nine months ended September 30, 2012 has not materially deteriorated from 2011.

PRODUCTS

During the Track Record Period, our main products were light-duty gasoline and diesel engines which have displacement ranging from 1.0L to 2.7L and engine power ranging from 38.5kW to 120.0kW. As of the Latest Practicable Date, we manufacture and sell 36 models of automotive engines, installed in a wide range of PVs and LCVs, including sedans, SUVs, MPVs, small buses and minibuses, small and light-duty trucks. We focus on producing high quality and high performance/price ratio automotive engines with low fuel consumption, emissions and noise that target the mid to low end automotive markets. All vehicles installed with our engines meet the current mandatory National Emission Limits (National III and IV) and Phase II of the Fuel Consumption Limits, or the equivalent overseas standards, and some vehicles installed with our engines meet Phase III of the PV Fuel Consumption Limits. These emissions and fuel consumption limits apply to vehicles but their compliance is directly related to the performance of the engines. Our engines have received numerous awards in recognition of their quality and performance. For example, China Internal Combustion Engine Industry Association and China Automotive News awarded our D20A light-duty diesel engine with a “2011 Fuel Efficiency Award” in 2011, our 4A13 and 4A15 light-duty gasoline engines with a “2010 Efficient Fuel Consumption Gold Award” in 2010 and our ZD25TCR light-duty diesel engine as one of the “Top 10 Chinese Engines” in 2008, with the other nine engines all being gasoline engines. In addition to engine sales, we also generate a small portion of our revenue from the manufacture and sale of engine components and providing testing services to external customers. For further details of our products, see “Business — Our Products” in this document.

SUMMARY

The following table sets forth the sales volume and revenue of our engines by fuel type and displacement range for the periods indicated:

	Year ended December 31,						Nine months ended September 30, 2012	
	2009		2010		2011		Sales Volume (Unit)	Revenue (RMB million)
	Sales Volume (Unit)	Revenue (RMB million)	Sales Volume (Unit)	Revenue (RMB million)	Sales Volume (Unit)	Revenue (RMB million)		
Light-duty Gasoline Engines								
≤1.6L	32,292	265.8	74,182	589.9	80,326	622.3	86,564	650.5
1.6L — 2.0L	37,227	261.7	46,534	321.7	40,320	290.5	34,011	236.7
>2.0L — 2.5L	49,983	446.3	69,890	635.5	88,238	856.9	65,127	646.3
>2.5L — 3.0L	438	9.9	478	10.7	1,676	33.8	1,402	26.4
Sub-total	119,940	983.7	190,084	1,557.8	210,560	1,803.5	187,104	1,559.9
Light-duty Diesel Engines								
>2.0L — 2.5L	10,768	275.2	14,817	352.2	19,694	463.4	16,543	358.6
Total	130,708	1,258.9	205,901	1,910.0	230,254	2,266.9	203,647	1,918.5

The following table sets forth the gross profit and gross profit margin of our engines by fuel type and displacement range for the periods indicated:

	Year ended December 31,						Nine months ended September 30, 2012	
	2009		2010		2011		RMB million	%
	RMB million	%	RMB million	%	RMB million	%		
Light-duty Gasoline Engines								
≤1.6L	15.1	5.7	56.1	9.5	80.0	12.9	90.0	13.8
1.6L — 2.0L	32.3	12.3	38.8	12.0	65.3	22.5	49.9	21.1
>2.0L — 2.5L	74.9	16.8	123.7	19.5	182.6	21.3	141.7	21.9
>2.5L — 3.0L	2.3	23.2	5.1	47.7	14.3	42.5	10.5	40.0
Sub-total	124.6	12.7	223.7	14.4	342.2	19.1	292.1	18.7
Light-duty Diesel Engines								
>2.0L — 2.5L	39.0	14.2	70.1	19.9	118.4	25.5	89.7	25.0
Total	163.6	13.0	293.8	15.4	460.6	20.4	381.8	19.9

SUMMARY

The following table sets forth the average unit price of our engines by fuel type and displacement range for the periods indicated:

	Year ended December 31,			Nine months ended September 30, 2012
	2009	2010	2011	
	Average Unit Price (RMB)	Average Unit Price (RMB)	Average Unit Price (RMB)	Average Unit Price (RMB)
Light-duty Gasoline Engines				
≤1.6L	8,231	7,952	7,748	7,515
1.6L — 2.0L	7,030	6,913	7,206	6,961
>2.0L — 2.5L	8,929	9,093	9,712	9,924
>2.5L — 3.0L	22,603	22,447	20,145	18,789
Light-duty Diesel Engines				
>2.0L — 2.5L	25,557	23,770	23,528	21,677

As an independent branded engine supplier, generally our products are designed to fit different models of vehicles manufactured by different automotive manufacturers. We perform thorough market analysis and feasibility studies before commencing any product research and development project and focus on engines that have the potential to gain widespread market acceptance or become the best among similar classes of products on the market. We reach out to potential customers as early as their product development stage and communicate with our customers on a regular basis to understand their needs. From time to time, we design engines that are compatible with their specific vehicle models through entering into joint development contracts with our customers and third parties. This allows us to secure target customers at the research and development stage. The intellectual property resulting from such joint research and development may belong to us or our customers, and our customers may bear part or all of the development costs. However, there is no significant difference in the cost, time and effort involved in developing a new engine model independently or jointly with our customers, as in either case we need to pass a customer approval process before entering into supply contracts with them, which may take months and during which we are required to submit our sample engines and related specifications and qualifications to our potential customers, who will conduct a series of tests to determine whether the functionality, compatibility and quality of our engines are in compliance with their requirements. This approval process may be carried out in conjunction with joint product development by our customers and us. During the Track Record Period, we did not fail to pass any existing customer’s approval process for a new product or fail to maintain existing customer approvals due to our product quality. Our lead-time for development of a new engine model is typically not more than two years. The pricing and marketing strategies for independently and jointly developed engines are the same.

SALES AND CUSTOMERS

Our customers include local and foreign-invested automotive manufacturers and automotive components companies in China. Our top customers during the Track Record Period include well-known automotive manufacturers in China, such as Brilliance China Group, Huachen Group, Zhengzhou Nissan, Xiamen Golden Dragon and GAC Changfeng. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our top five customers, on an entity basis, accounted for 82.9%, 77.8%, 76.0% and 75.3% of our revenue, respectively. We have established stable and long-term relationships with our major customers through joint product development and by providing high quality products and services. As of December 31, 2009, 2010 and 2011 and September 30, 2012, apart from our Controlling Shareholders and Huachen, we had 24, 26,

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24 and 31 customers, respectively. We provide before and after-sales services to our customers through a wide sales network covering all major regions of China. Our independent branding strategy allows us to sell to multiple automotive manufacturers in the fast-growing PV and LCV segments of the automotive industry in China.

We recognize revenue from the sale of our products when the products are delivered to and accepted by our customers. We generally issue invoices upon the receipt of customers’ acceptance of the products and the corresponding invoices are recorded on or before the respective month end. At the end of each month, we will reconcile the amounts of sales with customers to ensure the revenue and the corresponding account receivables are properly recorded in that month. We generally extend a credit period of 30 to 60 days to our non-related customers and three months to our related customers, both with a further three to six months for payment by bank promissory notes. We may further extend the credit period if the customer has a good track record with us and low credit risk. We believe that the credit periods extended by us to our customers generally match the credit periods extended by our suppliers to us, which is three months with a further three to six months for payment by bank promissory notes.

We intend to continue to secure future demand for our products and strengthen our relationships with our major customers through strategic alliances. We have been a jointly controlled entity of Brilliance China and Wuliangye during the Track Record Period. During the Track Record Period, aggregate sales to Brilliance China, Huachen and Wuliangye, each on a group basis amounted to RMB663.5 million, RMB1,075.6 million, RMB1,077.8 million and RMB867.4 million, which accounted for 51.6%, 55.3%, 46.7% and 44.6% of our revenue for the same periods, respectively, and total sales to Brilliance China, on a group basis accounted for 48.8%, 41.4%, 18.0% and 19.6% of our revenue for the same periods, respectively. We believe that our close relationship with Brilliance China has provided and will continue to provide us with a competitive edge in our industry. We entered into a non-binding strategic alliance agreement with Dongfeng in January 2007 to jointly develop engines suitable for Dongfeng’s vehicles. To solidify this alliance, we entered into a binding joint venture agreement with Dongfeng in December 2011 and established the Dongfeng JV in January 2012 to manufacture the JV-branded engines for Dongfeng’s light-duty vehicles. In addition, we entered into a strategic alliance agreement with Zhengzhou Nissan in February 2007 to jointly pursue the research and development and production of engines for Zhengzhou Nissan’s SUVs and pickups. We entered into a cooperation agreement in August 2011 and a subsequent engine production line management agreement in November 2011 with FAW Jilin, pursuant to which we will manage and operate one of their engine production lines to manufacture our engines exclusively for their vehicles.

PRODUCTION, RAW MATERIAL AND ENGINE COMPONENTS AND SUPPLIERS

We carry out all our manufacturing activities at our production facilities currently located in Mianyang, Sichuan Province. As of the Latest Practicable Date, we had 15 production lines.

Our production involves one principle raw material and over 200 kinds of engine components. Our principal raw material is aluminum ingots and our engine components include cylinder casting, electronic fuel injection systems, crankshafts and other parts and components. We do not have a single raw material or engine component that accounted for more than 10% of our total costs of raw material and engine components during the Track Record Period. We mainly source aluminum ingots and engine components from various independent third-party suppliers in the PRC, and to a lesser extent, from our related companies. We procure aluminum ingots and engine components from our list of pre-approved suppliers that meet our quality standards. We normally enter into supply contracts with our suppliers on a yearly basis. Although we do not enter into long-term supply contracts with our suppliers, we believe that we are able to maintain long-term business relationships with most of our suppliers. We have on average 11 years of relationships with our top five suppliers. Our economies of

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scale helps us, in many cases, to negotiate and secure favorable pricing terms with our suppliers. We believe that these favorable pricing terms allowed us to achieve low production costs. We also enter into strategic arrangements with some of our suppliers to secure competitive pricing terms and ensure stable and quality supplies.

PRODUCTION CAPACITY

The following table sets forth the designed engine production capacity, actual engine production volume and utilization rate of our Mianyang production facilities for the periods indicated:

	Year ended December 31,			
	2009	2010	2011	2012
Designed engine production capacity ⁽¹⁾ (Units)	139,200	200,000	220,800	255,000
Actual engine production volume (Units)	140,323	212,200	220,013	257,093
Utilization rate (%) ⁽²⁾	100.8 ⁽³⁾	106.1 ⁽³⁾	99.6	100.8 ⁽³⁾

(1) Our designed engine production capacity is calculated based on 251 working days per year and two workshifts of eight hours each per day and is the weighted average of the production capacity based on the month of the year in which the production capacity was realized.

(2) Our utilization rate is calculated based on our actual engine production volume divided by our designed engine production capacity.

(3) Over 100% utilization rate is due to the addition of a third workshift during the period.

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PRODUCTION CAPACITY EXPANSION

To meet the increasing demand for our products and to increase our revenue, we plan to expand our current production capacity through the construction of new production facilities, improving our production technologies and the purchase of new production equipment. Since the end of 2010, we have begun to transition all of our production to our new production facilities that are currently under construction in the Mianyang High-Tech Development Zone in Sichuan Province. We have obtained all land use rights and construction permits necessary for this project. We expect our new production facilities to commence full commercial production by September 30, 2013. We also established the Dongfeng JV jointly-controlled by us and Dongfeng in Jiangsu Province to manufacture engines for Dongfeng’s light-duty vehicles and plan to manage an engine production line owned by FAW Jilin in Jilin Province to manufacture our engines exclusively for their vehicles. Our total capital expenditure in relation to the Dongfeng JV is RMB125 million, of which RMB50.0 million has been incurred during the nine months ended September 30, 2012. We have no capital expenditure commitment to FAW Jilin, because the production line is owned by them and managed by us. These two operations are currently in the construction and production preparation stage, respectively. Furthermore, we expect to build a new production line to manufacture engines specifically for Shenyang Jinbei. The following table sets forth a summary of our production capacity expansion plan. For further details, see “Business — Production” in this document.

Production Facilities	Production Capacity as of the Latest Practicable Date	Planned Expanded Production Capacity
New production facilities located at Mianyang, Sichuan	255,000 units/year	300,000 units/year, upon full commercial production by September 30, 2013
Dongfeng JV located at Changzhou, Jiangsu	Nil (Construction of this facility commenced in July 2012)	100,000 units/year upon completion of phase one by June 2013 and 200,000 units/year upon completion of phase two
FAW Jilin’s production facilities located at Jilin, Jilin	40,000 units/year (Operation has not commenced at this facility yet)	40,000 units/year, upon commencement of operation by September 30, 2013
Production line of engines for Shenyang Jinbei	Nil (Construction of this production line to commence in early 2014)	50,000 units/year, upon full commercial production by June 2014

RESEARCH AND DEVELOPMENT

We focus on designing and developing new models of automotive engines based on market demands and trends as well as improving the performance and functionality of our existing engine models. Our research and development team consists of over 160 personnel who have on average over 12 years of automotive engine industry experience in mechanical engineering, internal combustion and other related areas. As we undertake substantially all of our research and development activities in-house, we believe we are able to quickly respond to market demands and changes in market trends. Our research and development capabilities allow us to independently develop our products, which we believe sets us apart from our competitors in China. Our research and development center was recognized as a “state certified enterprise technology center” by the NDRC and other government authorities in 2004 and our laboratory was accredited by the China National Accreditation Service for Conformity Assessment in

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2007. As of the Latest Practicable Date, we are in the process of upgrading 11 existing engine models and developing four new engine models, which are in various stages of product development by our in-house research and development team. We plan to bring five engine models out of these 15 models to the market between 2013 and 2014. In addition, we plan to establish a new research and development center in Chengdu in Sichuan Province to further strengthen our research and development capabilities. We believe choosing Chengdu as the location of our new research and development center will help us to attract and recruit qualified research and development personnel, to have access to a convenient transportation network for dealing or working with our customers and research and development partners, and to benefit from favorable local government policies. We plan to gradually relocate our current research and development facilities and activities to the Chengdu research and development center once it is completed. For further details of our research and development activities, see “Business — Research and Development” in this document.

INDUSTRY AND COMPETITION LANDSCAPE

We target the PV and LCV engine market in China, which we consider to be fast growing yet highly competitive. The competition among existing market players is intense in terms of product quality, pricing, performance, reliability, timeliness of delivery, product development capabilities, customer service and overall management. Our key competitors consist of local automotive engine manufacturers as well as large foreign-invested automotive engine manufacturers in China. Furthermore, there is a direct correlation between our business and the automotive production and sales volumes of our customers in the PRC, which are in turn dependent on economic policies and market sentiment and demand. We have benefited from the fast-growing production of automobiles in China during the Track Record Period due to various factors, including the continued growth of China’s economy, government incentive policies, increases in consumer purchasing power and a historically low rate of automotive ownership. We expect to continue to be affected by these factors in the future. For details about and risks associated with the industry and competitive landscape that we operate in, see “Risk Factors — We operate in a competitive industry and face intense competition from our competitors”, “Industry Overview” and “Business — Competition” in this document.

TRADE AND OTHER RECEIVABLES WITH OUR RELATED AND NON-RELATED COMPANIES

Our trade and other receivables primarily consist of trade receivables, bills receivable, prepayments for the purchase of raw material and engine components and other receivables. Our trade receivables primarily consist of account receivables with our related and non-related customers in connection with the sale of our products. Our bills receivable primarily consist of bank promissory notes delivered by our related and non-related customers in lieu of cash payment for purchases. Our trade and other receivables with our related customers are accounted for on our consolidated statements of financial position as “Amounts due from related companies.”

SUMMARY

The following table sets forth our trade and bills receivables with our related and non-related companies and the amounts that were past due but not impaired as of the dates indicated:

	As of December 31,			As of	[As of	Subsequent
	2009	2010	2011	September 30,	January 31,	settlement of
	RMB'000	RMB'000	RMB'000	2012	2013]	September 30, 2012
				RMB'000	RMB'000	balance as of
					(unaudited)	[January 31, 2013] ⁽⁴⁾
						(%)
With non-related companies						
Trade receivables ⁽¹⁾ .	51,923	33,136	245,437	380,321	[●]	[●]
Bills receivable ⁽²⁾ . .	40,853	134,332	241,542	265,649	[●]	[●]
Total	92,776	167,468	486,979	645,970	[●]	[●]
Past due but not impaired	6,723	2,631	43,513	202,200	[●]	[●]
With related companies						
Trade receivables ⁽¹⁾ .	458,105	701,400	892,816	942,549	[●]	[●]
Bills receivable ⁽²⁾ . .	74,100	125,000	169,094	11,760 ⁽³⁾	[●]	[●]
Total	532,205	826,400	1,061,910	954,309	[●]	[●]
Past due but not impaired	145,660	266,131	419,471	471,550	[●]	[●]

- (1) The increases of our trade receivables with related and non-related companies during the Track Record Period were primarily due to the increase in our sales and prolonged payment cycles by some of them.
- (2) The increases of our bills receivables with related and non-related companies during the Track Record Period were primarily due to the PRC Government's tightened credit policy starting in 2010 and continuing through 2011 and 2012, which increased pressure on their cash flow.
- (3) The substantial decrease in our bills receivable with related companies in the nine months ended September 30, 2012 was primarily due to a significant amount of bills maturing and being paid in cash by the issuing banks, and the increase in the endorsement and discounting by us of bills receivable for payment to our suppliers or for cash.
- (4) The subsequent settlement of September 30, 2012 balance as of January 31, 2013 represents the percentage of balances of the trade and bills receivables as of September 30, 2012 that has been settled as of January 31, 2013.

As of the Latest Practicable Date, [all] the amounts due from our related companies that were past due as of September 30, 2012 have been settled RMB[●] million by cash and RMB[●] million by bank promissory notes.

We generally extend our non-related customers a credit period of 30 to 60 days, and related customers a credit period of three months, from the date of issuance of the invoice, and further extend the credit period by three to six months if at any point during the credit period the customer chooses to pay by bank promissory notes, although such terms may vary based on our historical relationships with, and assessment of creditworthiness of, each customer. Accepting bank promissory notes in lieu of cash payment has the effect of increasing our bills receivable turnover days and increasing pressure on our cash flow and working capital needs. As our key customers are generally creditworthy and have demonstrated a good track record of timely payments, and the bank promissory notes are issued by reputable banks in the PRC, we generally consider the default risks relating to our trade and bills receivables to be relatively low.

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To the extent necessary in light of the prolonged credit periods we may extend to our customers, we supplement our working capital needs through bank borrowings, discounting bills receivable for cash and endorsing bank promissory notes to purchase raw materials and engine component parts from our suppliers in addition to cash generated from our operations, which has the effect of reducing our bills receivable but increasing our finance costs. We believe that settlement by bank promissory notes is a customary practice in our industry. We believe our trade and bills receivables turnover days are comparable to the industry average, and we strive to maintain effective internal management and reduce our trade and bills receivables related risks by maintaining frequent communications with our customers, performing periodic evaluations of the overdue receivables and customer visits to ensure our exposure to bad debts is not significant and adequate impairment losses are made for irrecoverable amounts. We have also included a receivables collection rate as one of the standards to evaluate the performance of our sales personnel to encourage them to collect amounts due from our customers.

For risks related to our increased trade and bills receivables during the Track Record Period, see “Risk Factors — Our trade and bills receivables with related and non-related companies increased significantly during the Track Record Period” and “Risk Factors — We face risks related to discounting and endorsing bills receivable.”

LIQUIDITY AND CAPITAL RESOURCES

To maintain an adequate level of liquidity, we review and analyze our inventory, accounts payable and receivable and cash and cash equivalents on a regular basis and obtain bank borrowings when necessary. During the Track Record Period, our working capital position improved over time, with net current assets of RMB250.8 million, RMB365.6 million, RMB666.1 million and RMB768.8 million as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively.

However, we recorded negative operating cash flows of RMB9.6 million in 2010, primarily due to increases in both the amounts due from our related companies and the number of turnover days associated with these amounts, mainly caused by delayed payments by them, in particular, Brilliance China Group and Huachen Group, when their own cash flows were affected by the launching of their new products and the tightened credit policy by the PRC Government to control inflation in 2010. We did not hold any collateral over these balances because these were trade related receivables and our management assessed these related companies to be financially sound, taking into consideration the gradual and frequent repayments from these related companies. We aim to enhance our liquidity management and collect the payments by our related companies prudently, and as of the Latest Practicable Date, [all the amounts due from our related companies that were past due as of September 30, 2012 have been settled RMB[●] million by cash and RMB[●] million by bank promissory notes]. See “Business — Inventory Management”, “Financial Information — Liquidity and Capital Resources” and “Financial Information — Description of Certain Items from Our Consolidated Statements of Financial Position” for more details regarding our inventory management, liquidity and capital resources and accounts payable and receivable, and “Risk Factors — We recorded negative operating cash flows in 2010, primarily due to increased amounts due from our related companies. There can be no assurance that we will record positive operating cash flows in the future,” “Risk Factors — The global financial crisis, economic downturn and uncertainty may have a material and adverse effect on our business, financial condition and results of operations” and “Risk Factors — Changes in interest rates may affect our financing costs” for the impacts of the PRC’s tightened credit policy in 2010 and 2011 on our business and results of operations.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS AND HUACHEN

Our Controlling Shareholders consist of Brilliance Investment, Brilliance China, Xinhua Investment, Xinhua Combustion Engine, Pushi Group and Wuliangye. Huachen is a controlling shareholder of

SUMMARY

Brilliance China, but Brilliance China is not a subsidiary of Huachen. Huachen is deemed by the [●] as a connected person of our Company but is not a controlling shareholder of our Company.

We have full control over our assets to continue our business independently of our Controlling Shareholders and Huachen. We do not rely on our Controlling Shareholders or Huachen for our operations, technology, product development, production, staffing or marketing, save as certain sale and purchase transactions with our Controlling Shareholders and Huachen and/or their respective associates disclosed in this document. Our Directors and senior management conduct our business with established systems and arrangements in place. Our organizational structure is made up of functional departments, each with specific areas of responsibility. We have also established a set of internal controls to facilitate the effective operation of our business.

During the Track Record Period, we have entered into certain sale and/or purchase transactions with our Controlling Shareholders and Huachen and/or their respective associates which are expected to continue after [●]. These transactions are governed by agreements entered into in the ordinary course of our business and on terms which we believe are fair and reasonable, and we are entitled to choose third parties who can provide the relevant products or services to us upon comparable terms.

Brilliance China has shareholdings in certain automotive engine businesses (namely, Shenyang Xinguang Brilliance and Aerospace Mitsubishi) that are not included in, and may compete with the business of, our Group.

Each of Huachen and Brilliance China has entered into an undertaking in favor of our Company with regard to the above-mentioned automotive engine businesses with our Group. In addition, our Controlling Shareholders and Huachen entered into a deed of non-competition on [●], 2013 in favor of our Company in relation to the non-participation in certain business activities which may compete with our business. For further details, see “Relationship with our Controlling Shareholders and Huachen” in this document.

TRANSACTIONS WITH OUR CONNECTED PERSONS

We sell a substantial portion of our engines to our connected persons. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our sales to Brilliance China Group accounted for approximately 48.8%, 41.4%, 18.0% and 19.6% of our revenue, respectively. For the same period, our sales to Huachen Group accounted for approximately 2.8%, 13.9%, 28.7% and 25.0% of our revenue, respectively. We also procured various engine components from our connected persons during the Track Record Period. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our purchases from Brilliance China Group accounted for approximately 2.2%, 2.2%, 2.1% and 2.3% of our cost of sales, respectively. For the same period, our purchases from Wuliangye Group accounted for approximately 9.8%, 9.9%, 8.4% and 6.9% of our cost of sales, respectively. The key terms of the sales or supply agreements with our connected persons are comparable to those contained in the sales or supply agreements we enter into with our non-connected customers or suppliers, except that the credit periods we extend to our connected customers are longer than those extended to our non-connected customers. We believe that our close relationships with our Controlling Shareholders and Huachen have provided and will continue to provide us with a competitive edge in our industry. For further details about our connected transactions which will continue after [●], see “Connected Transactions” in this document.

[●] INVESTMENT BY DONGFENG MOTORS ENGINEERING

On October 31, 2011, Dongfeng Motors Engineering and our Company entered into a subscription agreement (as amended and supplemented on December 16, 2012), pursuant to which Dongfeng

SUMMARY

Motors Engineering subscribed for 46,200,000 Shares at a consideration of HK\$49,975,714.94, representing approximately 4.914% of the then issued share capital of our Company, after giving effect to the subscription of Shares by Lead In as described below and without giving effect to the completion of the [●] and approximately 3.685% of the issued share capital of our Company upon completion of the [●] (assuming [●]), and approximately 3.552% of the issued share capital of our Company upon completion of the [●] (assuming [●]). We believe that Dongfeng Motors Engineering’s investment in our Company further strengthens our relationship with Dongfeng Group, demonstrates their confidence in our Group’s operation and recognizes the past contribution and performance of our Group. We believe this [●] investment serves as an endorsement of our strength and prospects.

INCENTIVE SCHEME ESTABLISHED BY LEAD IN

We established the Incentive Scheme in 2011 before the [●] to serve as a retention tool, and to align the interests of the Beneficiaries with that of our Company. Lead In was incorporated in 2011 for the purpose of holding the Lead In Subscribed Shares on trust for the Beneficiaries under the Discretionary Trust and the Fixed Trust. On October 31, 2011, Lead In Subscribed for 93,999,794 Shares at a consideration of HK\$101,681,967.73, representing approximately 9.998% of the then issued share capital of our Company, after giving effect to the subscription of Shares by Dongfeng Motors Engineering and without giving effect to the completion of the [●] and approximately 7.498% of the issued share capital of our Company upon completion of the [●] (assuming the [●]), and approximately 7.227% of the issued share capital of our Company upon completion of the [●] (assuming the [●] is fully exercised). Under the Discretionary Trust, Lead In agreed to hold approximately 3.933% of the then issued share capital of our Company on trust for the future benefit of certain Beneficiaries to be jointly determined by the board of directors of Lead In and the Board of our Company after [●]. Under the Fixed Trust, Lead In agreed to hold approximately 6.065% of the then issued share capital of our Company on trust for certain Beneficiaries (consisting of three Directors, namely Mr. Wu Xiao An, Mr. Wang Yunxian and Mr. Li Peiqi, and 48 senior management and employees of our Group). For details of the above arrangements, see “History and Reorganization — Incentive Scheme Established by Lead In” in this document.

OUR COMPETITIVE STRENGTHS

We believe the following competitive strengths have contributed and will continue to contribute to our success:

- we are one of the leading automotive engine manufacturers in the independent branded segment of the fast-growing PV and LCV engine market in China;
- we offer a diversified product portfolio of light-duty engines for a broad range of vehicles;
- we have strong research and development capabilities;
- we have stable and long-term customer relationships; and
- we have a dedicated and experienced management team.

See “Business — Our Competitive Strengths” in this document for a detailed discussion of these strengths.

SUMMARY

OUR STRATEGIES

We aim to strengthen our leading position in the independent branded segment of the PRC PV and LCV engine market and to become the supplier of choice for local and international automotive manufacturers through the following strategies:

- further enhance our research and development capabilities and strengthen our technologies;
- expand our product offerings to cater to evolving market demand;
- expand our production capacity to meet the increasing demand for our products; and
- increase our market share by strengthening relationships with our existing customers and developing new customer relationships.

Please see “Business — Our Strategies” in this document for a detailed discussion of these strategies.

SUMMARY

SUMMARY OF HISTORICAL FINANCIAL INFORMATION

We have experienced rapid growth during the Track Record Period. The following consolidated statements of comprehensive income for the three years ended December 31, 2011 and the nine months ended September 30, 2011 and 2012, and the selected consolidated statements of financial position as of December 31, 2009, 2010 and 2011 and September 30, 2012 are derived from, should be read in conjunction with and are qualified in their entirety by reference to, our Financial Information, including the notes thereto, included in the Accountants’ Report set forth in Appendix I to this document.

Consolidated Statements of Comprehensive Income

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB’000	RMB’000	RMB’000	RMB’000 (unaudited)	RMB’000
Revenue	1,285,167	1,945,114	2,307,748	1,499,996	1,946,268
Cost of sales	(1,114,759)	(1,643,824)	(1,831,140)	(1,197,205)	(1,556,276)
Gross profit	170,408	301,290	476,608	302,791	389,992
Other income	10,197	11,144	10,012	6,643	6,361
Selling and distribution expenses ...	(52,018)	(65,845)	(48,611)	(29,737)	(40,214)
Administrative expenses	(44,378)	(55,419)	(62,638)	(46,772)	(49,891)
Finance costs	(11,130)	(17,753)	(37,520)	(22,872)	(21,555)
Other expenses	(13,568)	(23,595)	(33,212)	(16,962)	(24,577)
Share of result of a jointly controlled entity	—	—	—	—	281
Profit before tax	59,511	149,822	304,639	193,091	260,397
Income tax expense	(1,234)	(365)	(44,250)	(28,524)	(36,628)
Profit and total comprehensive income for the year/period	58,277	149,457	260,389	164,567	223,769
Earnings per share — Basic (RMB)	0.073	0.187	0.316	0.206	0.238

Selected Consolidated Statements of Financial Position

	As of December 31,			As of September 30,
	2009	2010	2011	2012
	RMB’000	RMB’000	RMB’000	RMB’000
Total non-current assets	287,521	318,052	398,319	514,134
Total current assets	1,224,619	1,601,674	2,365,829	2,515,663
Total current liabilities	973,860	1,236,074	1,699,746	1,746,893
Net current assets	250,759	365,600	666,083	768,770
Total assets less current liabilities	538,280	683,652	1,064,402	1,282,904
Total non-current liabilities	35,768	35,179	32,010	26,743
Net assets	502,512	648,473	1,032,392	1,256,161
Paid-in capital/share capital	200,008	200,008	7,693	7,693
Reserves	302,504	448,465	1,024,699	1,248,468
Total equity	502,512	648,473	1,032,392	1,256,161

SUMMARY

RECENT DEVELOPMENTS

As far as we are aware, there has been no material change in the general economic and market conditions in China or the industry in which we operate that materially and adversely affected our business operations or financial condition since September 30, 2012 and up to the Latest Practicable Date. Compared with the same period in 2011, for the three months ended December 31, 2012, our engine production volume and sales volume decreased, primarily due to certain customers reducing their orders for our 1.6L to 2.0L gasoline, 2.0L to 2.5L gasoline and 2.0L to 2.5L diesel engines to temporarily reduce their inventories in the fourth quarter of 2012 as part of their destocking efforts and, to a lesser extent, reduced orders from one customer for our less than 1.6L gasoline engines as it started to use some engines manufactured by itself. During the same period, the prices of our engines remained relatively stable. As a result, compared with the same period in 2011, our revenue and net profit for the three months ended December 31, 2012 are estimated to decrease by approximately 21% to 24% and 30% to 34%, respectively. We have provided ranges for these preliminary estimates because our reporting accountants have not yet completed the audit for the year ended December 31, 2012. Accordingly, although we currently believe that our actual results for the three months ended December 31, 2012 will be within the estimated ranges, they may not be within these ranges due to, among others, the completion of the audit and final adjustments.

In recent months, boycotts of Japanese brand cars by Chinese consumers over the controversy regarding ownership of Diaoyu islands in the East China Sea has impacted some automotive manufacturers in China, including our largest customer, Zhengzhou Nissan, which caused decreased sales of their “Nissan” branded cars and suspensions of their production to a certain degree. However, as we do not currently supply our engines to be installed in their “Nissan” branded cars, the recent boycott incidents surrounding the Diaoyu islands dispute did not have any material, adverse impact on our business or operations, and we do not expect to supply any engine to Zhengzhou Nissan to be installed in their “Nissan” branded cars in the near future.

Our Directors confirm that, up to the date of this document, there has been no material adverse change in the financial or trading position, indebtedness, mortgage, contingent liabilities, guarantees or prospects of our Group since September 30, 2012, the date of the latest audited consolidated financial statements of our Group.

RISK FACTORS

Investing in our Shares involves substantial risks and our ability to successfully operate our business is subject to numerous risks, including those that are generally associated with our industry and operating in China. For example:

- We rely on a limited number of customers with which we have no long-term contracts for a significant portion of our revenue.
- We may face increases in the prices of raw material and engine components.
- Our profitability could be negatively affected by downward pricing trends of our products.
- Our trade and bills receivables with related and non-related companies increased significantly during the Track Record Period.
- We recorded negative operating cash flows in 2010, primarily due to increased amounts due from our related companies. There can be no assurance that we will record positive operating cash flows in the future.

You should carefully consider all of the information set forth in this document and, in particular, should evaluate the specific factors set forth under “Risk Factors” in this document in deciding whether to invest in our Shares.

DEFINITIONS

In this document, unless the context otherwise requires, the following expressions shall have the following meanings. Certain other terms are explained in “Glossary of Technical Terms” in this document.

“Aerospace Mitsubishi”	Shenyang Aerospace Mitsubishi Motors Engine Manufacturing Co., Ltd.* (瀋陽航天三菱汽車發動機製造有限公司), a company incorporated on August 12, 1997 in the PRC, in which Brilliance China has an effective equity interest of 14.43%
“affiliate(s)”	any other person, directly or indirectly, controlling or controlled by or under direct or indirect common control with such specified person
“Articles of Association” or “Articles”	the articles of association of the Company conditionally adopted on April 25, 2012 (as amended or supplemented from time to time)
[●]	
“BMW Brilliance Automotive”	BMW Brilliance Automotive Ltd. (華晨寶馬汽車有限公司) is a sino-foreign equity joint venture company incorporated in the PRC in 2003 and is owned as to 50% by Shenyang Jinbei Automotive Industry Holdings Co., Ltd.* (沈陽金杯汽車工業控股有限公司), an indirect wholly-owned subsidiary of Brilliance China and 50% by BMW Holding B.V.
“Board of Directors” or “Board”	the board of directors of our Company
“Brilliance China”	Brilliance China Automotive Holdings Limited (華晨中國汽車控股有限公司*), a company incorporated on June 9, 1992 in Bermuda, whose shares are listed on the Main Board, and one of our Controlling Shareholders
“Brilliance China Group”	Brilliance China and its subsidiaries
“Brilliance Investment”	Brilliance Investment Holdings Limited (華晨投資控股有限公司), a company incorporated on February 28, 2011 in the BVI, a wholly-owned subsidiary of Brilliance China, and one of our Controlling Shareholders
“Business Day”	a day (other than a Saturday or a Sunday) on which banks in Hong Kong are open for normal banking business
“BVI”	the British Virgin Islands
“CAGR”	compound annual growth rate

DEFINITIONS

“China” or “PRC”	the People’s Republic of China and, except where the context otherwise requires and only for the purpose of this document, references in this document to the PRC or China do not include Hong Kong, the Macau Special Administrative Region of the PRC and Taiwan
“China Aerospace”	China Aerospace Motors Co., Ltd.* (中國航天汽車有限責任公司), a state-owned company established in the PRC and an independent third party
“Companies Law”	the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and amended from time to time) of the Cayman Islands
“Companies Ordinance”	the Companies Ordinance, Chapter 32 of the Laws of Hong Kong (as amended, supplemented or otherwise modified from time to time)
“Company” or “our Company”	Xinchen China Power Holdings Limited (新晨中國動力控股有限公司), an exempted company incorporated on March 10, 2011 in the Cayman Islands with limited liability
“Controlling Shareholder(s)”	means Brilliance Investment, Brilliance China, Xinhua Investment, Xinhua Combustion Engine, Pushi Group and Wuliangye
“CSRC”	China Securities Regulatory Commission (中國證券監督管理委員會)
“Director(s)”	the director(s) of our Company
“Dong Feng Motor Corporation”	Dong Feng Motor Corporation* (東風汽車公司), a state-owned enterprise legally incorporated in the PRC, which wholly owns Dongfeng Motors Engineering and is the parent company of Dongfeng Group
“Dongfeng”	Dongfeng Automobile Co., Ltd.* (東風汽車股份有限公司), a company incorporated on July 21, 1999 in the PRC
“Dongfeng Group”	Dongfeng and its subsidiaries
“Dongfeng JV”	Changzhou Dongfeng Xinchen Engine Co., Ltd.* (常州東風新晨動力機械有限公司), a joint venture incorporated on January 9, 2012 in the PRC and is owned as to 50% by Mianyang Xinchen and 50% by Dongfeng

DEFINITIONS

“Dongfeng Motors Engineering”	Dong Feng Motors Engineering Co., Limited (東風汽車工程有限公司), a company incorporated on December 28, 1998 in Hong Kong, wholly-owned by Dong Feng Motor Corporation and one of our Shareholders
“FAW Jilin”	FAW Jilin Automobile Co., Ltd.* (一汽吉林汽車有限公司), a company incorporated in the PRC and an independent third party
“GAC Changfeng”	GAC Changfeng Motor Co., Ltd.* (廣汽長豐汽車股份有限公司), a company incorporated in the PRC and an independent third party
“Group”, “our Group”, “we” or “us”	our Company and its subsidiaries at the relevant point of time (including where the context so requires, in respect of the period before our Company became the holding company of its present subsidiaries, the present subsidiaries of our Company)
“HK\$” or “Hong Kong dollars”	Hong Kong dollars, the lawful currency of Hong Kong
“HKFRS”	Hong Kong Financial Reporting Standards
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Huachen”	Huachen Automotive Group Holdings Company Limited* (華晨汽車集團控股有限公司), a state-owned company incorporated on September 16, 2002 in the PRC and a controlling shareholder of Brilliance China ⁽¹⁾
“Huachen Group”	Huachen and its subsidiaries
“independent third party(ies)”	individual(s) or company(ies) who is not connected with (within the meaning of the [●]) any directors, chief executive or substantial shareholders of our Company, its subsidiaries or any of their respective associates
“Latest Practicable Date”	[●], 2013, being the latest practicable date for the purpose of ascertaining certain information contained in this document prior to its publication
“Lead In”	Lead In Management Limited (領進管理有限公司), a company incorporated on May 18, 2011 in the BVI and is owned as to 50% by Mr. Wu Xiao An and 50% by Mr. Wang Yunxian, both of whom are our executive Directors
“Main Board”	the stock exchange operated by the Stock Exchange before the establishment of the Growth Enterprise Market of the Stock Exchange (excluding the option market) and which continues to be operated by the Stock Exchange in parallel with the Growth Enterprise Market of the Stock Exchange

(1) Brilliance China is not a subsidiary of Huachen.

DEFINITIONS

“Mianyang High-Tech Development Zone”	Mianyang National High and New Technology Industry Development Zone* (綿陽國家高新技術產業開發區)
“Mianyang Huarui”	Mianyang Huarui Automotive Company Limited* (綿陽華瑞汽車有限公司), a company incorporated on December 27, 2004 in the PRC and a wholly-owned subsidiary of Huachen
“Mianyang Huaxiang”	Mianyang Huaxiang Machinery Manufacturing Co., Ltd.* (綿陽華祥機械製造有限公司), a company incorporated on April 29, 2005 in the PRC and an indirect wholly-owned subsidiary of Huachen
“Mianyang Jianmen Real Estate”	Mianyang Jianmen Real Estate Development and Construction Co., Ltd.* (綿陽劍門房地產開發建設有限責任公司), a company incorporated on June 11, 1997 in the PRC and a wholly-owned subsidiary of Xinhua Combustion Engine
“Mianyang Ruian”	Mianyang Brilliance Ruian Automotive Components Co., Ltd.* (綿陽華晨瑞安汽車零部件有限公司), a company incorporated on July 3, 2000 in the PRC and a wholly-owned subsidiary of Brilliance China
“Mianyang Xincheng”	Mianyang Xincheng Engine Co., Ltd.* (綿陽新晨動力機械有限公司), a company incorporated on March 23, 1998 in the PRC and an indirect wholly-owned subsidiary of our Company
“MIIT”	Ministry of Industry and Information Technology of the PRC (中華人民共和國工業和信息化部)
“MOF”	Ministry of Finance of the PRC (中華人民共和國財政部)
“MOFCOM”	Ministry of Commerce of the PRC (中華人民共和國商務部)
“MST”	The Ministry of Science and Technology of the PRC (中華人民共和國科學技術部)
“NDRC”	National Development and Reform Commission of the PRC (中華人民共和國國家發展和改革委員會)
“PBOC”	The People’s Bank of China (中國人民銀行)
“PRC Government”	the central government of the PRC and all governmental subdivisions (including provincial, municipal and other regional or local government entities) and instrumentalities thereof or, where the context requires, any of them
“Pushi Group”	Sichuan Yibin Pushi Group Co., Ltd.* (四川省宜賓普什集團有限公司), a company incorporated on August 20, 1998 in the PRC and a holding company of Xinhua Engine Combustion, and one of our Controlling Shareholders

DEFINITIONS

“Reorganization”	the reorganization of the companies now comprising our Group in preparation for the [●], details of which are set out in “Statutory and General Information — Further information about our Companies and our Subsidiaries — Corporate Reorganization” in Appendix V to this document
“RMB”	Renminbi, the lawful currency of the PRC
“SAFE”	State Administration of Foreign Exchange of the PRC (中華人民共和國外匯管理局)
“SAIC”	State Administration for Industry and Commerce of the PRC (中華人民共和國國家工商行政管理總局)
“SASAC”	State-owned Assets Supervision and Administration Commission of the State Council of the PRC (中華人民共和國國務院國有資產監督管理委員會)
“SAT”	State Administration of Taxation of the PRC (中華人民共和國國家稅務總局)
“Share(s)”	ordinary share(s) in our Company with a nominal value of HK\$0.01 each
“Share Option Scheme”	the share option scheme conditionally adopted by our Company on April 25, 2012, the principal terms of which are summarized in “Statutory and General Information — Share Option Scheme” in Appendix V to this document
“Shareholder(s)”	holder(s) of Shares
“Shenyang Jinbei”	Shenyang Brilliance JinBei Automobile Co., Ltd.* (瀋陽華晨金杯汽車有限公司), a company established on July 19, 1991 in the PRC, and a non-wholly-owned subsidiary of Brilliance China
“Shenyang Brilliance Power”	Shenyang Brilliance Power Train Machinery Co., Ltd.* (瀋陽華晨動力機械有限公司), a company established on December 13, 2004 in the PRC, and owned as to 51% by Huachen and 49% by Brilliance China
“Shenyang ChenFa”	Shenyang ChenFa Automobile Component Co., Ltd.* (瀋陽晨發汽車零部件有限公司), a company established on June 19, 2003 in the PRC, and owned as to 25% by Brilliance China and 75% by an independent third party
“Shenyang Xinguang Brilliance”	Shenyang Xinguang Brilliance Automobile Engine Co., Ltd.* (瀋陽新光華晨汽車發動機有限公司), a joint venture established on October 28, 1998 in the PRC, and owned as to 50% by Brilliance China and 50% by China Aerospace

DEFINITIONS

“Sichuan Pushi”	Sichuan Yibin Pushi Automotive Components Co., Ltd.* (四川省宜賓普什汽車零部件有限公司), a company established on February 28, 2008 in the PRC and a wholly-owned subsidiary of Pushi Group
“Sole Sponsor”	Merrill Lynch Far East Limited
“State Council”	State Council of the PRC (中華人民共和國國務院)
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Southern State”	Southern State Investment Limited (南邦投資有限公司*), a company incorporated on September 30, 1997 in the BVI and a direct wholly-owned subsidiary of our Company
“Track Record Period”	the three years ended December 31, 2011 and the nine months ended September 30, 2012
“U.S.” or “United States”	the United States of America, its territories, its possessions and all areas subject to its jurisdiction
“Wuliangye”	Sichuan Province Yibin Wuliangye Group Co., Ltd.* (四川省宜賓五糧液集團有限公司), a state-owned company incorporated on August 19, 1997 in the PRC, a holding company of Pushi Group and one of our Controlling Shareholders
“Wuliangye Group”	Wuliangye and its subsidiaries
“Xiamen Golden Dragon”	Xiamen Golden Dragon Bus Co., Ltd.* (廈門金龍旅行車有限公司), a company incorporated in the PRC and an independent third party
“Xing Yuan Dong”	Shenyang XingYuanDong Automobile Component Co., Ltd.* (瀋陽興遠東汽車零部件有限公司), a company established on October 12, 1998 in the PRC and a wholly-owned subsidiary of Brilliance China
“Xinhua Combustion Engine”	Mianyang Xinhua Internal Combustion Engine Joint-stock Company Limited* (綿陽新華內燃機股份有限公司), a joint-stock company established on June 30, 1994 in the PRC and a direct non wholly-owned subsidiary of Pushi Group, and one of our Controlling Shareholders
“Xinhua Investment”	Xinhua Investment Holdings Limited (新華投資控股有限公司), a company incorporated on May 19, 2011 in the BVI, a wholly-owned subsidiary of Xinhua Combustion Engine and one of our Controlling Shareholders
“Zhengzhou Nissan”	Zhengzhou Nissan Automobile Co., Ltd.* (鄭州日產汽車有限公司), a company established in the PRC and an independent third party

DEFINITIONS

The terms “associate”, “connected person”, “connected transaction” and “subsidiary” shall have the meanings given to such terms in the [●], unless the context otherwise requires.

The names of PRC laws, regulations, governmental authorities, institutions, and of companies or entities marked with an asterisk(*) included in this document are translations of their Chinese names or vice versa and are included for identification purposes only. In the event of inconsistency, the Chinese versions shall prevail.

The Chinese names of some of the companies incorporated outside the PRC marked with an asterisk (*) included in this document are translations of their English names and are included for identification purposes only.

The term “on an entity basis” shall mean on the basis of a single entity when referring to that entity; the term “on a group basis” shall mean on the basis of including all the relevant subsidiaries or holding companies or fellow subsidiaries of any such holding company when referring to that entity.

GLOSSARY OF TECHNICAL TERMS

This glossary contains explanations of certain terms used in this document in connection with our business. These terms and their meanings may not correspond to standard industry meaning or usage.

“automotive manufacturers”	automotive manufacturing companies that produce and sell whole vehicles
“controlled burn rate (CBR)”	a method of improving fuel economy by increasing or decreasing the rate which the fuel burns, by way of changing the inlet gas flow and the strength of cylinder swirl and tumble according to changes of working conditions
“DOHC”	double overhead camshaft (also known as dual overhead camshaft) valve-train layout, which is characterized by two camshafts located within the cylinder head, one operating the intake valves and one operating the exhaust valves
“electronic throttle control (ETC)”	an automobile technology which severs the mechanical link between the accelerator pedal and the throttle
“exhaust gas recirculation (EGR)”	a technique used to improve the fuel efficiency of gasoline engines and to reduce the nitrogen oxide (NOx) emission reduction of diesel engines. EGR works by recirculating a portion of an engine’s exhaust gas back to the engine cylinders
“Fuel Consumption Limits”	Passenger Vehicle or Commercial Vehicle Fuel Consumption Limits* (《乗用車或商用車燃料消耗量限值》)
“independent branded engine supplier”	manufacturers that are able to supply unaffiliated automotive manufacturers with engines that retain an independent brand from the manufactured vehicle
“kW”	kilowatt, a unit of power
“L”	liter(s)
“LCVs” or “light commercial vehicles”	light commercial vehicles that are mainly used for carrying passengers or commercial goods, including small truck, light-duty truck and small bus
“light-duty”	with reference to vehicles, displacement or engines, means designed for the purpose of withstanding comparatively moderate loads, use or stress
“light-duty trucks”	trucks with a gross total vehicle weight ranging from 1.8 to 6.0 tonnes
“light-duty vehicles”	vehicles with maximum total mass of 3.5 tonnes or below
“minibuses”	passenger vehicles that are generally equipped with small engines of 1.0L displacement and less

GLOSSARY OF TECHNICAL TERMS

“MPVs” or “multi-purpose vehicles”	multi-purpose vehicles (MPVs) are mainly for personal use with three-row designs for maximum passenger carriers
“National Emission Limits”	Limits and Measurement Methods for Emissions from Light-Duty Vehicles (China Phase III, China Phase IV) (GB18352-2005)* (《輕型汽車污染物排放限值及測量方法 — 中國III、IV階段》)
“National III” and “National IV”	China Phase III and China Phase IV under the National Emission Limits
“National V”	Limits and Measurement Methods for Emissions from Light-Duty Vehicles (China Phase V)* (《輕型汽車污染物排放限值及測量方法 — 中國第五階段》)
“Nm”	Newton meter, a unit of torque
“OEM”	Original Equipment Manufacturer, manufacturer of products or components that are purchased by a company and retailed under that purchasing company’s brand name, and in this document, particularly referring to automotive OEM
“Phase II” and “Phase III”	Phase II under the Commercial Vehicle Fuel Consumption Limits, and Phase II or Phase III under the Passenger Vehicle Fuel Consumption Limits
“powertrain”	a system that usually consists of several parts including engine, transmission, axle and others parts, which generates power and delivers it to the wheels and drives the moving of a motor vehicle
“PVs” or “passenger vehicles”	passenger vehicles which are mainly used for transporting passengers with maximum nine passengers
“rpm”	revolutions per minute, a measure of the frequency of rotation
“sedans”	passenger vehicles in a two-box or three-box configurations, principal volumes articulated in separate compartments for engine, passenger and cargo
“small buses”	small buses are mainly for commercial use with a vehicle length up to seven meters and over seven seats
“small trucks”	trucks with a gross vehicle weight of up to 1.8 tonnes
“SUVs” or “sport utility vehicles”	sport utility vehicle (SUV) is a kind of PV usually built on light-truck chassis and equipped with four-wheel drive
“variable value timing-intelligent (VVT)”	a technology that varies the timing of the intake valves by adjusting the relationship between the camshaft drive (belt, scissor-gear or chain) and intake camshaft. Engine oil pressure is applied to an actuator to adjust the camshaft position. Adjustments in the overlap time between the exhaust valve closing and intake valve opening result in improved engine efficiency

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You should carefully consider all of the information in this document including the risks and uncertainties described below before making an investment in the [●]. Our operations involve certain risks, many of which are beyond our control. You should pay particular attention to the fact that most of our business is located in the PRC and we are governed by a legal and regulatory environment, which may differ in some respects from that which prevails in other jurisdictions. Our business, financial condition and results of operations may be materially and adversely affected by any of these risks and uncertainties. Additional risks and uncertainties not presently known to us, or not expressed or implied below, or that we currently deem immaterial, could also harm our business, financial condition, results of operations and prospects. The [●] could decline due to any of these risks and uncertainties and you may lose all or part of your investment.

RISKS RELATING TO OUR BUSINESS

We rely on a limited number of customers with which we have no long-term contracts for a significant portion of our revenue.

During the Track Record Period, we derived a significant portion of our revenue from a limited number of customers, some of whom are our Controlling Shareholders and related companies and their respective subsidiaries. For the two years ended December 31, 2010, sales to our largest customer, Mianyang Ruian, a subsidiary of Brilliance China, accounted for 29.2% and 23.2% of our revenue, respectively, and for the year ended December 31, 2011 and the nine months ended September 30, 2012, sales to our largest customer, Zhengzhou Nissan, accounted for 27.9% and 26.4% of our revenue, respectively. During the Track Record Period, sales to our top five customers on an entity basis accounted for 82.9%, 77.8%, 76.0% and 75.3% of our revenue, respectively. In addition, during the Track Record Period, sales to our top five customers on a group basis accounted for 86.8%, 86.1%, 84.9% and 81.7% of our revenue, respectively. Such top five customers on a group basis include our related companies, Brilliance China Group and Huachen Group. Furthermore, during the Track Record Period, aggregate sales to Brilliance China, Huachen and Wuliangye on a group basis amounted to RMB663.5 million, RMB1,075.6 million, RMB1,077.8 million and RMB867.4 million, which accounted for 51.6%, 55.3%, 46.7% and 44.6% of our revenue for the same periods, respectively, and total sales to Brilliance China Group on a group basis accounted for 48.8%, 41.4%, 18.0% and 19.6% of our revenue for the same periods, respectively. We expect to continue to generate a significant portion of our revenue from sales to Brilliance China Group and our other major customers in the foreseeable future. Although during the Track Record Period, we did not experience any loss of any major customer, we cannot guarantee that we will be able to maintain or improve our relationships with these major customers, and they may terminate their respective relationships with us according to the terms of our supply agreements. The loss of any of these major customers could materially and adversely affect our business, financial condition and results of operations.

We generally enter into one-year supply agreements with our customers at the beginning of the year. We negotiate with our customers on unit prices and estimated purchase quantities at the beginning of each year, and purchase orders with specific quantities are placed on a regular basis. As a result, although we have long-term relationships with all our major customers, our supply agreements are generally short-term in nature. In circumstances where any of our customers, particularly our key customers, materially reduce, revise, delay or cancel their orders with us or terminate their business relationships with us, we may not be able to obtain replacement orders on similar terms in a timely manner from other customers. The occurrence of any of the foregoing events could materially and adversely affect our business, financial condition and results of operations.

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We do not designate any of our production lines to any of our related companies, Brilliance China Group and Huachen Group. During the Track Record Period, our total sales volumes to Brilliance China Group and Huachen Group accounted for approximately 60.1%, 69.5%, 59.9% and 54.4% of our total designed production capacity, respectively. If any of Brilliance China Group and Huachen Group cancel partially or all their orders with us or terminate their business relationships with us, we may experience idle production capacity.

We may face increases in the prices of raw material and engine components.

Our raw material and engine components include aluminum ingots, cylinder casting, electronic fuel injection systems, crankshafts and other parts and components. As a result, we are directly exposed to fluctuations in the prices of aluminum ingots and various engine components, and indirectly to fluctuations in the price of iron as it is a major raw material for many engine components. During the Track Record Period, the purchase prices of our engine components generally decreased gradually as we were able to reduce the purchase prices of some engine components through negotiations with our suppliers as part of our cost control efforts. However, in the past, we have experienced price fluctuations of aluminum ingots and certain engine components. The prices of aluminum ingots and iron are subject to global as well as regional supply and demand conditions. Our purchase price of aluminum ingots is determined based on the market prices of aluminum ingots of the week of delivery. The market prices of aluminum have fluctuated significantly in the past few years. The average spot price of aluminum increased by 12.4% from 2009 to 2010 and further increased by 7.4% from 2010 to 2011, according to the Shanghai Changjiang Aluminum Spot Price Index. We expect the volatility of aluminum price to continue in the foreseeable future. We do not currently engage in any transactions to hedge against risks relating to fluctuations in aluminum ingots and engine component prices. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our cost of raw material and engine components accounted for 91.4%, 92.0%, 93.4% and 94.0% of our total cost of sales, respectively. In particular, the cost of aluminum ingots accounted for 2.8%, 2.9%, 2.9% and 2.4% of our total cost of sales for the same periods, respectively. Our unit purchase price of aluminum ingots increased by 5.4% from 2009 to 2010, increased by 6.0% from 2010 to 2011 and decreased by 2.3% from 2011 to the nine months ended September 30, 2012, which was consistent with the market trend. Although changes in the purchase prices of any single raw material and engine component during the Track Record Period did not significantly affect our gross profit margin, the cost of raw material and engine components as a whole plays a prominent role in the manufacture of our products, and we normally cannot adjust our product prices with our customers once they are determined by the contracts, unless the contracts include a price adjustment mechanism or there is an unusual significant price fluctuation. Raw material and engine component price increases may add to our cost of sales and we may or may not be able to pass such increased costs to our customers due to our contractual arrangements with our customers and the increasing competition in the PRC automotive engine market. As a result, we may experience lower profit margins if our cost of raw material and engine components increase significantly, which could materially and adversely affect our business, financial condition and results of operations.

Our profitability could be negatively affected by downward pricing trends of our products.

During the Track Record Period, we have experienced downward pressure on our product prices and this trend may continue in the future. For example, the average unit prices for our less than 1.6L gasoline engines decreased from RMB8,232 per unit in 2009 to RMB7,952 per unit in 2010, RMB7,748 per unit in 2011 and RMB7,515 per unit in the nine months ended September 30, 2012; the average unit prices of our 1.6L-2.0L gasoline engines decreased from RMB7,029 per unit in 2009 to RMB6,914 per unit in 2010 and from RMB7,206 per unit in 2011 to RMB6,961 per unit in the

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nine months ended September 30, 2012; and the average unit prices for our 2.0L-2.5L diesel engines decreased from RMB25,559 per unit in 2009 to RMB23,771 per unit in 2010, RMB23,528 per unit in 2011 and RMB21,677 per unit in the nine months ended September 30, 2012. The less than 1.6L gasoline engines accounted for 21.1%, 30.9%, 27.5% and 33.9%, respectively, of our total engine revenue for the Track Record Period. The 1.6L-2.0L gasoline engines accounted for 20.8%, 16.8%, 12.8% and 12.3%, respectively, of our total engine revenue for the Track Record Period. The 2.0L-2.5L diesel engines accounted for 21.9%, 18.4%, 20.4% and 18.7%, respectively, of our total engine revenue for the Track Record Period. The reduction in average unit prices was attributable to a combination of factors, including changes in product mix, lowered product prices of certain engine models to expand our market and attract new customers, or as requested by certain customers who chose to have less spare parts sold with the engines to reduce their production costs, or demanded us to lower the product price for increased purchase quantity from us. This is consistent with the industry trend of expected decreasing engine prices in general. See “Industry Overview — Overview of the PRC PV and LCV Engine Market — Market trends in the PV and LCV engine markets in China.” The decrease in average unit prices, coupled with the increase in raw material and engine components costs, has adversely impacted our profit margins for certain periods and resulted in increased pressure for cost management. In the event that we have to reduce our product prices to remain competitive but fail to offset such reductions by increasing our sales volume, reducing our costs and expenses or by introducing new competitive products, our profitability may be materially and adversely affected.

Our trade and bills receivables with related and non-related companies increased significantly during the Track Record Period.

As of December 31, 2009, 2010 and 2011 and September 30, 2012, our trade and bills receivables from non-related companies were RMB92.8 million, RMB167.5 million, RMB487.0 million and RMB646.0 million, respectively, and our trade and bills receivables from related companies were RMB532.2 million, RMB826.4 million, RMB1,061.9 million and RMB954.3 million, respectively. In particular, as of December 31, 2009, 2010 and 2011 and September 30, 2012, trade receivables from non-related companies of approximately RMB6.7 million, RMB2.6 million, RMB43.5 million and RMB202.2 million were past due but not impaired, and trade receivables due from related companies of approximately RMB145.7 million, RMB266.1 million, RMB419.5 million and RMB471.6 million were past due but not impaired. The increases in our total trade and bills receivables with related and non-related companies were primarily due to the growth in sales of our products and prolonged payment cycles by some of our customers. In particular, our trade receivables from non-related companies increased significantly from RMB33.1 million as of December 31, 2010 to RMB245.4 million as of December 31, 2011 further to RMB380.3 million as of September 30, 2012, primarily due to the PRC Government’s continued tightening of credit policy in 2011 and 2012 to control inflation which increased pressure on our customers’ cash flows who subsequently prolonged their payment cycle. For the same reason, our bills receivable also increased substantially during the Track Record Period, as customers increasingly used bank promissory notes for payment. During the Track Record Period, substantially all our customers to a certain degree used bank promissory notes for payment in lieu of cash which effectively turned trade receivables into bills receivables.

The increased amount of our trade and bills receivables has had, and will likely continue to have, an increased pressure on our working capital needs and increase our bills receivable turnover days. Additionally, if we are unable to recover our trade and bills receivables, which might be affected by factors beyond our and our customers’ control, our business, financial condition and results of operations may be materially and adversely affected. See “Financial Information — Description of Certain Items from Our Consolidated Statements of Financial Position — Trade and other receivables” and “Financial Information — Description of Certain Items from Our Consolidated Statements of Financial Position — Amounts due from related companies” for further details.

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We recorded negative operating cash flows in 2010, primarily due to increased amounts due from our related companies. There can be no assurance that we will record positive operating cash flows in the future.

We recorded negative operating cash flows of RMB9.6 million in 2010, which was primarily attributable to increases in both the amounts due from our related companies and the number of turnover days associated with these amounts, in particular, those due from Brilliance China Group and Huachen Group, who purchased our products and delayed their payments to us, when their cash flows were affected by the launching of their new automobile models and tightened credit policy by the PRC Government to control inflation in 2010. We did not hold any collateral over these balances because these were trade related receivables and our management assessed these related companies to be financially sound, taking into consideration the gradual and frequent repayments from those related companies. We expect to incur amounts due from the related companies in the future as we continue to conduct business with them and there can be no assurance that the associated payments will not be delayed.

In addition, our amounts due from related companies turnover days increased from 186 days in 2009 to 231 days in 2010, to 320 days in 2011, primarily because they delayed their payments to us due to the tightened credit policy by the PRC Government in 2010 and 2011, which increased pressure on their cash flows. The increased turnover days can create increased pressure on our cash flows. In addition, there can be no assurance that we will generate sufficient cash flows from our business operations in the future. If we are unable to continuously finance our business operations and expansion by funds generated from our operating activities or otherwise, our business, financial condition and results of operations could be materially and adversely affected. See “Financial Information — Liquidity and Capital Resources”, “Financial Information — Contingent Liabilities” and “Financial Information — Description of Certain Items from Our Consolidated Statements of Financial Position — Trade and other receivables” for further details.

We face risks related to discounting and endorsing bills receivable.

During the Track Record Period, we received certain bank promissory notes with payment terms of six months from a related party for the settlement of a loan receivable from that related party. As a result, for recording purpose, we recognized the note receivable from the bank and derecognized the loan receivable from that related party. For cash flow management, we settled accounts payable to certain suppliers by endorsing the abovementioned bank promissory notes with recourse to those suppliers in lieu of cash payment. As a result, for recording purpose, we derecognized accounts payable to the suppliers and the note receivable from the bank. The overall effect of these transactions resulted in the settlement of a loan receivable from a related party and the derecognition of certain accounts payable to certain suppliers.

During the Track Record Period, we also discounted certain bills receivable to banks for cash. The average discount rate for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012 (calculated by using the finance costs related to discounted bills for the year/period divided by the aggregate amount of discounted bills for the year/period) was 0.7%, 1.4%, 4.1% and 3.0%, respectively.

The bank promissory notes endorsed to the suppliers provide the suppliers with recourse against us. In case of a default in payment of the endorsed and discounted bills receivable, the maximum possible exposure of our Group was RMB353.0 million, RMB627.2 million, RMB678.9 million and RMB583.5 million as of December 31, 2009, 2010, 2011 and September 30, 2012. Endorsing and/or discounting bills receivable also increase our finance costs, which may have an adverse impact on our financial

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condition and results of operations. We expect to continue this practice of endorsing bills receivable for the settlement of other balances and discounting bills receivable for cash after [●].

We rely on certain major suppliers for key engine components and such suppliers may fail to deliver their supplies to us on a timely basis or fail to meet our product quality standards.

We rely on a limited group of suppliers for the key engine components we use for our production and some of these suppliers, such as the suppliers of electronic fuel injection systems, may be difficult or time-consuming to replace. It could take as long as 12 months to replace them. For example, to change the electronic fuel injection system in our engine, we need to go through a series of procedures in order to determine the corresponding specifications of engine bench, high-altitude, high and low temperature conditions for the applied vehicles and for the applied vehicles to obtain relevant regulatory clearance. In addition, we had one aluminum ingots supplier during the Track Record Period. We normally enter into supply contracts with our suppliers on a yearly basis at the beginning of the year, which provide for, among others, the unit prices of aluminum ingots and engine components which are valid and effective throughout the year. We generally do not enter into long-term supply agreements with our suppliers. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, purchases from the largest supplier of our Group accounted for 9.3%, 9.1%, 7.7% and 9.9% of our total costs of sales, respectively, and purchases from the top five suppliers of our Group accounted for 32.0%, 34.1%, 30.8% and 35.9% of our total costs of sales, respectively. In addition, during the Track Record Period, aggregate purchases from Brilliance China, Huachen and Wuliangye, and their respective subsidiaries, amounted to RMB133.9 million, RMB198.8 million, RMB193.9 million and RMB142.9 million, respectively, which accounted for 12.0%, 12.1%, 10.6%, 9.2% of our total costs of sales for the same periods. Our suppliers may from time to time extend lead-times, limit supplies or increase prices due to capacity constraints or other factors. We have in the past experienced delays by our suppliers in the delivery of some of the engine components during peak seasons. If any of our major suppliers ceases to supply us with aluminum ingots or key engine components, and suitable replacements cannot be secured on similar terms on a timely basis, or we experience any significant decreases in the quantity, quality or increases in the price of aluminum ingots or our key engine components or experience significant delays, our business, financial condition and results of operations could be materially and adversely affected.

We may not be able to accurately forecast customer demand, which could cause us to incur costs associated with carrying excess raw material and engine components, over-invest in and underutilize our new production facilities or render us unable to fulfil customer orders.

We generally manufacture our products and purchase our raw material and engine components according to confirmed purchase orders as well as projected sales. We rely on internal forecasts based on such confirmed purchase orders and projected sales to estimate the type and volume of raw material and engine components to be purchased and the timing of such purchases, as well as the type and volume of products to be manufactured and the timing of such production. If our internal forecasts do not accurately reflect actual customer demand, the level of which may vary for a variety of reasons beyond our control, we may incur costs associated with carrying excess raw material and engine components, over-invest in and underutilize our new production facilities as detailed in “Business — Production” in this document, or encounter shortages of raw material and engine components that make it difficult for us to fulfil customer orders. We may experience fluctuations in customer orders and if sales and shipments do not occur as expected, expenses and inventory levels could be disproportionately high as compared to sales generated in the same period, and our business, financial condition and results of operations could be materially and adversely affected.

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We may not be able to sustain historical financial performance and growth.

We experienced substantial growth in revenue during the Track Record Period. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, the revenue of our Group was RMB1,285.2 million, RMB1,945.1 million, RMB2,307.7 million and RMB1,946.3 million, respectively. However, the changes in our revenue and profit during the Track Record Period may not be indicative of our future performance. As disclosed under “Business — Strategies” in this document, we plan to adopt a number of strategies, such as expansion of production capacity and enhancement of research and development to strengthen our position in the independent branded segment of the PRC PV and LCV engine market in the PRC. These strategies may increase our costs and expenses and therefore impact our profitability. The successful implementation of our business plans depends on a number of factors which may or may not be within our control, including but not limited to whether the automotive industry, particularly in the PRC, will continue to grow at the pace anticipated by our Directors, whether we will be able to timely and effectively capture the opportunities associated with such growth, the level of competition arising from other automotive engine manufacturers, our ability to manage our business growth strategically and cost-effectively, our ability to cope with any increase in product demands and fluctuations in raw material and engine components prices, our ability to enhance our research and development capabilities and the availability of funds to finance our strategic plans. There is no assurance that we can successfully manage any of these factors. If we fail to implement our business plans, our business, financial condition and results of operations could be materially and adversely affected.

Our business is subject to operational risks.

Our results of operations are dependent on the continuing operation of our production facilities. Our operations are subject to hazards inherent to manufacturing industries, including but not limited to fires, unexpected wear and tear or degradation, mechanical failure or misuse and power outages, unscheduled downtimes, performance below expected levels of output or efficiency, transportation interruptions, other industrial accidents, environmental risks and terrorist acts. During the Track Record Period, we did not experience any material operational problems at our production facilities. However, any future occurrence of material operational problems at our facilities may materially reduce our productivity and profitability during and after the period of such operational difficulties. Some of the hazards may interrupt our operations, cause personal injury, loss of life, severe damage to or destruction of property and equipment and environmental damage and result in legal and regulatory liabilities and/or the imposition of civil or criminal penalties. Furthermore, we may be subject to claims with respect to workplace, workers’ compensation and other matters. Consequently, our business, financial condition and results of operations could be materially and adversely affected.

Our business relies heavily on production technologies and processes that are subject to continuous change and we cannot assure you that we will be able to continue to develop our own proprietary production technologies and processes or acquire technologies that would enable us to remain competitive in the PRC automotive engine market.

Our competitiveness in the PRC automotive engine market depends in large part on our ability to develop new production processes and technologies, which we believe help us to continuously tailor our products to meet our customers’ needs. These technologies and processes are subject to continuous evolution and change. Our proprietary technologies and processes may be critical to the continuous improvement of our product quality and performance, as well as our ability to gain market share through improving existing products and launching new products. Furthermore, there is no assurance

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that any research and development activities conducted by us will be completed within the anticipated timeframe or that the costs of such research and development activities can be fully or partially recovered. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our research and development costs, which included research expenses and amortization of capitalized development costs, amounted to RMB24.7 million, RMB31.5 million, RMB29.8 million and RMB14.0 million, respectively. In particular, any new technology for alternative energy or electric vehicles could potentially render our fuel-based engine technologies obsolete. Furthermore, if we design a product for a specific type of vehicle for our customers and their product development fails, our product development costs may also be non-recoverable. If our research and development activities do not result in the successful development of a new product or the technologies developed by us become obsolete, we will need to write off the relevant development costs. If we are unable to develop our own proprietary technologies and processes, or acquire technologies that would enable us to remain competitive in the automotive engine market, our business, financial condition and results of operations could be materially and adversely affected.

We may fail to adequately protect our intellectual property rights.

Our principal intellectual property rights include our proprietary technologies, product designs, technical know-how, patents and trademarks. We are susceptible to infringement by third parties of our intellectual property rights and there is no assurance that third parties will not copy or otherwise obtain and use our intellectual property without our authorization. We have obtained patents for certain aspects of our proprietary technologies and registered certain aspects of our trademarks as referred to in “Appendix V — Statutory and General Information — Further information about our business — Intellectual property.” However, it is not possible for us to comply with, and seek every clearance under, the relevant laws of all possible jurisdictions for the protection and enforceability of our intellectual property rights and there is no assurance that such registrations can completely protect us against any infringement or protect us from any challenges by our competitors or other third parties. When necessary, we may have to expend a significant amount of financial resources to assert, safeguard and/or maintain our intellectual property rights. In the event that our intellectual property rights cannot be enforced against an infringement by our competitors or other third parties, our business, financial condition and results of operations could be materially and adversely affected.

As at the Latest Practicable Date, we were in the process of registering our logo in Hong Kong. For more information on this pending trademark application, see “Appendix V — Statutory and General Information — B. Further Information about Our Business — 2. Intellectual Property.” There is no assurance that there will not be any objection to the pending trademark application or that the pending trademark application will be approved. In addition, there is no assurance that our use of the logo in this document will not infringe the intellectual property rights of any other third party or in breach of the laws of Hong Kong. Any liability claim in relation to our use of the logo, made or threatened to be made against us in the future, regardless of its merits, may result in costly litigation and put strain on our administrative and financial resources.

Our competitors may develop technologies that are similar to our technologies, and they may be more advanced in applying for intellectual property right protections. As a result, we may be forced to abandon and change our technologies, incur more research and development costs and extend our research and development cycle. In addition, as we procure various engine components from third-party suppliers, we may be involved in infringement claims against our suppliers if they are alleged to infringe upon the intellectual property rights of others. There may be patents held by others of which we are unaware that our products or operations may infringe. Any involvement in intellectual property rights infringement litigation may result in substantial costs, reputational damage and diversion of

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resources and management attention. If we are barred from using certain engine components, technologies, designs or other intellectual properties and fail to develop non-infringing substitutes or to obtain licenses to such intellectual properties, our operations may be interrupted and, should that continue, our business, financial condition and results of operations could be materially and adversely affected.

We may not be able to retain members of our senior management team and other key personnel or attract qualified and experienced personnel to join us.

Our management team has extensive experience in and in-depth market knowledge of the PRC automotive engine industry. Our future performance and success depend to a significant extent on our ability to retain and motivate our senior management team, including Mr. Wu Xiao An, our chairman and executive Director, and Mr. Wang Yunxian, our chief executive officer and executive Director, and other key personnel, such as senior research and development personnel. Our senior management team has on average over 20 years of experience in the automotive engine industry. Further information on our Directors and senior management is set forth in “Directors and Senior Management” in this document. During the Track Record Period, we have not lost any member of our senior management team or key personnel to our competitors. There is no assurance that we will be able to retain members of our senior management team and other key personnel or recruit additional competent personnel for our future development. Moreover, we do not maintain insurance for the loss of any key personnel. Any loss of senior management members or key personnel without immediate and adequate replacement may limit our competitiveness, affect our production planning and implementation, reduce our manufacturing quality or cause customer dissatisfaction. As a result, our business, financial condition and results of operations could be materially and adversely affected.

We may not be able to successfully develop our products and new production technologies on a timely basis, or at all.

One of our strategies is to continue to introduce new products to enable us to meet the demand of our new and existing customers. Changes in customer requirements and preferences, frequent product introductions and the emergence of new or substitute technology or evolving industry standards and practices could render our existing products and services obsolete or less attractive. The success of our strategy to introduce new products is dependent on our ability to anticipate customer needs, provide new products and differentiate our products from those of our competitors. The introduction of our new products may be less successful than we expect due to low levels of customer acceptance, costs associated with the introduction of new products, delays in bringing products to market, lower than anticipated prices for new products or quality issues. Our future success depends in part upon our ability to successfully identify, develop and market new products that meet customer needs and are accepted in the market. There is no assurance that we will be able to anticipate and respond to the demand for new products, services and technologies in a timely and cost-effective manner, adapt to technological advances or fulfil customer expectations. As a result, our business, financial condition and results of operations could be materially and adversely affected.

We may fail to pass customer approval processes for our new products or maintain existing approvals with our customers.

Before embarking on the sale of new products or sales to new customers, we must first undergo customer approval processes and become an approved supplier of our target customers. Such approval process may take months, during which we are required to submit our sample engines and related specifications and qualifications to our potential customers, who will conduct a series of tests to determine whether the functionality, compatibility and quality of our engines are in compliance with their requirements. This approval process may be carried out in conjunction with joint product

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development by our customers and us. Although our product development is based on the analysis of government regulations, industry trends and customer demands, we cannot assure you that we will always succeed in obtaining approvals for new products from our customers, obtaining approvals from new customers or remaining as a qualified supplier of our existing products. In addition, automotive manufacturers generally have limited demand for outsourcing engines from independent branded engine manufacturers. If we fail to become an approved supplier to potential customers or fail to remain as a qualified supplier for our existing customers, our business, financial condition and results of operations could be materially and adversely affected.

Any failure to maintain an effective quality control system at our production facilities could harm our business.

The quality of our products is critical to the success of our business. This significantly depends on the effectiveness of our quality control system, which in turn depends on a number of factors, including the design of the system, the quality control training program, and our ability to ensure that our employees adhere to our quality control policies and guidelines. Any significant failure or deterioration of our quality control system could result in the production of defective or substandard products, delays in the delivery of our products, the need to replace defective or substandard products, and damage to our reputation. If our products do not meet the specifications and requirements agreed with or requested by our customers, or if any of our products are defective, or result in our customers suffering losses as a result of product liability claims, we may be subject to product liability claims and litigations, claims for indemnity by our customers, and other claims for compensation. We also could incur significant legal costs regardless of the outcome of any claim of alleged defect. Product failures or defects, and any complaints or negative publicity resulting therefrom, could result in decreased sales of these or other products, or claims or litigation against us regarding the quality of our products. As a result, our business, financial condition and results of operations could be materially and adversely affected.

We may face potential product liability claims or suffer losses due to product defects or recalls.

We may be subject to product liability claims in the event any of our products are alleged or found to be defective. We have not obtained insurance coverage for product liability or implemented any other protection scheme. If our products prove to be defective and result in losses to our customers, we may be subject to product liability claims under the laws of the PRC or other jurisdictions in which our products are sold. As a result, we may have to incur significant legal costs and divert our administrative resources regardless of the outcome of the claims. In addition, any such claims could damage our customer relationships and business and result in negative publicity. In the event of allegations that any of our products are defective, we and/or our customers may also undergo product recalls, which could result in substantial and unexpected expenditure and could materially reduce our operating profit and cash flows. A product recall may require significant management attention, affect the value of our brand image, lead to decreased demand for our products and may also lead to increased scrutiny by regulatory agencies over our operations. We may also be forced to defend lawsuits and, if unsuccessful, to pay a substantial amount of damages. There can be no assurance that we may be able to recover part of the damages by claiming against our suppliers when a product defect is attributable to parts or components supplied by our suppliers.

We are subject to potential changes or discontinuation of the preferential tax treatments and government subsidies in the PRC currently available to us.

Our PRC subsidiary enjoyed preferential enterprise income tax rates during the Track Record Period as approved by the relevant tax authorities in the PRC. Our PRC subsidiary was accredited as a High and New Technology Enterprise by the Sichuan Province branch of MST and other authorities in December 2008 for a term of three years, and was therefore registered with the local tax authority to be

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eligible for the reduced 15% enterprise income tax rate for three years ended December 31, 2011. Our High and New Technology Enterprise qualification was renewed in 2011, which entitles us to enjoy such reduced tax rate for another three years until December 31, 2014. We were also eligible to enjoy a 15% enterprise income tax rate according to the Notice of the State Council on the Implementation of Several Policies for the Western China Development Plan (《國務院關於實施西部大開發若干政策措施的通知》) and the Notice of SAT in relation to the Opinions on the Implementation of the Relevant Tax Treatment Policies for the Western China Development Plan (《國家稅務總局關於落實西部大開發有關稅收政策具體實施意見的通知》) from 2001 to 2010, which will continue for another ten years from 2011 to 2020 according to the Notice of Relevant Issues on Tax Policy for Further Implementation of the Western China Development Plan (《關於深入實施西部大開發戰略有關稅收政策問題的通知》) issued on July 27, 2011. Furthermore, we benefited from a waiver of enterprise income tax for 2009 and 2010 according to the Cai Shui No.104[2008] Notice in Relation to Tax Policies in Support of Recovery and Reconstruction After the Wenchuan Earthquake (《關於支持汶川地震災後恢復重建有關稅收政策問題的通知》) promulgated by the MOF, the General Administration of Customs and the SAT and the Cai Shui No.131[2009] Notice in relation to Extension of Tax Favourable Treatment Period (《關於延長部分稅收優惠政策執行期限的通知》) promulgated by MOF and SAT. Since such tax benefit ended at the end of 2010, our tax liabilities increased in 2011. As a result of the above applicable tax rates, our effective income tax rate for the three years ended December 31, 2011 and the nine months ended September 30, 2012 was 2.1%, 0.2%, 14.5% and 14.1%, respectively. Changes to the past and current preferential tax treatments applicable to us may render the comparisons between our past post-tax financial results not meaningful and should not be relied upon as indicators of our future performance. Our qualification as a High and New Technology Enterprise will be subject to a three-year review by the relevant government authorities in China. There can be no assurance that our PRC subsidiary will continue to be a High and New Technology Enterprise after the current term expires, or the current favorable tax policies available to us will not be withdrawn or revoked by the PRC Government or become less favorable. In addition, during the Track Record Period, we have recognized an aggregate of RMB5.0 million in the form of government funding or subsidies in relation to various research and development projects. If the current preferential tax treatments and government subsidies are reduced or are no longer available in the future, our business, financial condition and results of operations could be materially and adversely affected.

We may be considered a resident enterprise and may therefore be subject to enterprise income tax and our Shareholders may be subject to taxation in the PRC.

Under the PRC Enterprise Income Tax Law (the “PRC EIT Law”), enterprises established outside of China whose “de facto management bodies” are located in China are considered “resident enterprises,” and generally will be subject to the uniform 25% enterprise income tax rate for their global income. Under the Implementation Rules of the PRC EIT Law, “de facto management body” is defined as the body that has material and overall management and control over the production and business, personnel, accounting and assets of the enterprise. A circular issued by the SAT on April 22, 2009 provides that a foreign enterprise controlled by a PRC company or a PRC company group will be classified as a “resident enterprise” with its “de facto management body” located within China if all of the following requirements are satisfied: (i) the senior management and core management departments in charge of its daily operations function are mainly in the PRC; (ii) its financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (iii) its major assets, accounting books, company seals, and minutes and files of its board and shareholders’ meetings are located or kept in the PRC; and (iv) at least half of the enterprise’s directors with voting rights or senior management reside in the PRC. As our financial and human resources decisions are mainly made at the Board or Shareholders’ meetings convened outside of the PRC and our accounting books, company seals, and minutes and files of our Board and Shareholders’ meetings are kept outside of the

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PRC, and we have not received any notice from the PRC tax authorities claiming to recognize us as a resident enterprise, we do not believe that we will be classified as a “resident enterprise”, and our PRC legal adviser, Jingtian & Gongcheng, has advised us that we should not be classified as a “resident enterprise” under the current PRC laws. However, we cannot assure you that the PRC tax authorities will not take a different view. If we are considered a resident enterprise, we will be subject to the enterprise income tax of 25% of our global income.

Under the PRC EIT Law and related implementation rules, PRC income tax at the rate of up to 10% is applicable to dividends payable to investors that are “non-resident enterprises”, which do not have an establishment or place of business in the PRC, or which have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to the extent such dividends have their sources within the PRC. Similarly, any gain realized on the transfer of shares by such investors is also subject to 10% PRC income tax if such gain is regarded as income derived from sources within the PRC unless a treaty otherwise provides. Because we may be treated as a resident enterprise, any dividends we pay to our non-PRC Shareholders on profits earned after January 1, 2008, and the income from disposal of our Shares by non-PRC Shareholders may be subject to PRC income tax, which may materially and adversely affect your investment. Subject to applicable tax agreements or treaties between the PRC and other tax jurisdictions, non-residents are ordinarily subject to a maximum 10% (or lower treaty rate) withholding tax or capital gain tax with respect to dividend income or income from disposal of shares from resident enterprises.

We may be required to pay income tax on capital gains by the relevant PRC tax authorities, which may increase our tax liability and affect our net profit and cash flows.

On December 10, 2009, the SAT issued the Notice on Strengthening the Management on Enterprise Income Tax for Non-resident Enterprises Equity Transfer (Guo Shui Han [2009] No.698) (《關於加強非居民企業股權轉讓所得企業所得稅管理的通知》) (國稅函 [2009] 698 號), or Circular 698, which became effective retrospectively on January 1, 2008. The notice clarified the definition of fair value, cost of investment and other relevant details on corporate income tax management regarding the direct or indirect share transfer of a PRC resident enterprise by non-PRC resident enterprises. On March 28, 2011, the SAT released the SAT Public Notice (2011) No. 24, or SAT Public Notice 24, to clarify several issues related to Circular 698. SAT Public Notice 24 became effective on April 1, 2011. According to SAT Public Notice 24, the term “effective tax” refers to the effective tax on the gain derived from the disposition of the equity interests of an overseas holding company; and the term “does not impose income tax” refers to the cases where the gain derived from the disposition of the equity interests of an overseas holding company is not subject to income tax in the country or region where the overseas holding company is a resident. Our Directors are of the view that our offshore reorganization for the [●] is for bona fide commercial reasons and we intend to carry out any potential future reorganization for genuine commercial reasons. However, it is currently unclear how the relevant PRC tax authorities will implement or enforce the above notices and whether such income tax on capital gain treatment will be subject to further change. According to a confirmation letter issued by the Mianyang State Tax Bureau to us on January 5, 2012, the Reorganization of the Group before its proposed [●] does not subject the Group to any tax payment or withholding liability under PRC tax laws, regulations and regulatory documents. However, we cannot assure you that Circular 698 will not be determined by the tax authorities to be applicable to our future offshore reorganization transactions where non-resident investors are involved. If any of such transactions are determined by the tax authorities to be lacking reasonable commercial purposes, we and our non-resident investors may become at risk of being taxed under Circular 698 and may be required to expend resources to comply with Circular 698 or to establish that we should not be taxed under Circular 698, which may have a material adverse effect on our financial condition and results of operations or such non-PRC resident investors’ investments in us.

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Expansion of our production capacity may not be successful.

Our future growth depends on whether we are able to expand our production capacity and our ability to meet the increasing demand for our products. We plan to increase our production capacity by constructing new production facilities in the Mianyang High-Tech Development Zone. Upon commencement of full commercial production at our new production facilities, we expect our annual production capacity to increase from the current 255,000 units to 300,000 units. We have also established the Dongfeng JV to construct an engine production facility with a planned annual production capacity of 200,000 units to manufacture engines for Dongfeng’s light-duty vehicles. Furthermore, we entered into an engine production line management agreement with FAW Jilin in November 2011, pursuant to which we will manage and operate a 40,000 units per annum production line owned by FAW Jilin located in Jilin Province to manufacture our engines exclusively for their vehicles. However, we may not successfully expand our production capacity according to these plans within the anticipated timeframe. The time involved in the construction of our new production facilities could be adversely affected by our failure to receive required regulatory approvals, technical difficulties, human or other resource constraints, or capital investment or funding constraints. Moreover, the expansion of our production capacity may exceed the cost levels originally anticipated. If any of these events occurs, we may not be able to attain the desired production capacity or the intended economic benefits, which could materially and adversely affect our business, financial condition and results of operations. See “Business — Production — Production Capacity Expansion” for further details.

Our business may be significantly affected because of factors beyond our control.

Our results of operations may fluctuate significantly because of factors that are beyond our control including disruptions of public infrastructure, such as roads or power grids, natural disasters, earthquakes or other catastrophic events. In particular, our production facilities are located in Sichuan Province, which is located in one of the 23 earthquake zones in the PRC according to the Sichuan Earthquake Administration. On May 12, 2008, Wenchuan County of Sichuan Province, a region that is approximately 102 km away from our production facilities in Mianyang City, suffered an earthquake with an 8.0 magnitude on the Richter scale (the “Wenchuan Earthquake”). The impact of the Wenchuan Earthquake on our operations included suspension of operations, damage of properties and injuries to personnel. In particular, the Wenchuan Earthquake caused structural damage to approximately 46% of our buildings and other damage to our equipment and inventories. Our operation was suspended for three days and product deliveries to our customers were delayed. Our communications with our customers and business connections were also temporarily affected as they were concerned about our ability to execute our production schedules and canceled planned trips to visit us. By the end of 2009, our production capacity had substantially recovered to the pre-earthquake level. The actual impairment loss on our assets caused by the Wenchuan Earthquake was mainly related to scrapped engine components of RMB2.3 million (included in provision of inventories in 2008) and fixed assets slightly damaged by the earthquake. The loss of business due to the Wenchuan Earthquake was estimated to be approximately RMB118 million, which was not accounted for in our financial statements. We cannot assure you that we will not suffer any losses in the future as a result of similar events that are beyond our control. Any similar future events could result in operational disruptions, damages to production facilities, equipment and properties, human injuries and casualties, production suspension, delays in deliveries of supplies from our suppliers or products to our customers and material unanticipated costs, and therefore have a material and adverse effect on our business, financial condition and results of operations.

Changes in interest rates may affect our financing costs.

The interest expenses of our Group related to bank loans and other indebtedness for the three years ended December 31, 2011 and the nine months ended September 30, 2012 were RMB11.1 million,

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RMB17.8 million, RMB37.5 million and RMB21.6 million, respectively. Our financing costs and, as a result, our results of operations, are affected by changes in interest rates as most of our loans are short-term in nature. Bank interest rates may increase at the time we renew our bank loans or if and when we seek additional financing when existing loans mature. Since the fourth quarter of 2010, the PBOC has increased the RMB benchmark deposit and loan rates of financial institutions six times. The increased RMB benchmark deposit and loan rates have increased our financing costs of existing loans and will increase our future financing costs. Any future increase in interest rates may further materially and adversely affect our business, financial condition and results of operations.

We have bank borrowings that are secured by property, plant and equipment and land use rights.

As of September 30, 2012, we had RMB552.0 million in bank balances and cash and RMB195.0 million in bank borrowings due within one year. As of September 30, 2012, RMB195.0 million of the bank borrowings were secured by our property, plant and equipment and land use rights, which were pledged to various banks in China. In the event that we fail to repay the borrowings when they mature and the banks enforce their rights against us under the relevant pledges, we may lose part or all of these pledged properties, plant, equipment and land use rights, which may materially and adversely affect our business, financial condition and results of operations.

We are dependent on the availability of a stable supply of labor at reasonable cost, which may not be sustainable.

Our production relies on a stable supply of labor. There is no guarantee that our supply of labor will remain stable and our labor cost will not increase significantly. If we fail to retain our existing labor and/or recruit and properly train sufficient labor in a timely manner, we may not be able to cope with a sudden increase in demand for our products or properly implement our expansion plans. If we are not able to manufacture and deliver our products on schedule or if we are unable to implement our expansion plans, our business, financial condition, results of operations and prospects could be materially and adversely affected. Moreover, if there is a significant increase in our labor costs our profitability could be materially and adversely affected.

We may fail to comply with present or future applicable environmental laws and regulations.

Under relevant PRC environmental laws and regulations, the construction, expansion and operation of our production facilities are subject to certain environmental permits and approvals. The failure to obtain or renew such permits or approvals or to obtain or renew them in a timely manner may subject us to fines and penalties imposed by the PRC Government and we may be required to suspend the use of production facilities or vacate the premises. In addition, as our production processes generate solid waste, noise, wastewater and oil and other industrial wastes, we are also required to comply with national and local environmental regulations applicable to us. In addition to the initial capital investment in making our production facilities compliant with the environmental laws and regulations, our annual cost of compliance with the applicable environmental rules and regulations for the three years ended December 31, 2011 and the nine months ended September 30, 2012 was RMB0.05 million, RMB0.07 million, RMB0.08 million and RMB0.1 million, respectively. If we fail to comply with present or future applicable environmental regulations, we may be required to pay substantial fines, suspend production or cease operations. Any failure by us to control the use or to restrict adequately the discharge of hazardous substances could subject us to potentially significant monetary damages and fines or suspensions in our business operations, which could have a material adverse effect on our business and results of operations. In addition, we cannot assure you that future changes in PRC environmental protection laws and regulations will not impose costly compliance requirements on us or otherwise subject us to future liabilities. As China is experiencing substantial issues with

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environmental pollution, it is likely that the national, provincial and local governmental agencies will adopt regulations setting forth stricter pollution controls and requirements. Any such regulation applicable to the manufacture of our products may increase our operating costs or even cause suspension of our operations, which in turn could have a material and adverse effect on our business, financial condition and results of operations.

We are subject to safety and health laws and regulations in the PRC and our production operations entail significant risks of workplace injury or fatality.

Our operations are subject to various PRC national and local laws and regulations that require us to provide a safe and healthy production and working environment for our employees by providing them with adequate protective clothing and gear, safety education and training and having dedicated safety management personnel. In addition, operators of some of our equipment must undergo special training and obtain special work permits. Any failure to meet and maintain such legal and regulatory standards and requirements could subject us to warnings from relevant governmental authorities, governmental orders to rectify such non-compliance within a specified time frame, governmental fines and legal proceedings. We could also be required to temporarily suspend our production or permanently cease our operations in the event of significant non-compliances.

The production of automotive engines presents significant risks of workplace injury or fatality despite the implementation of safety precautions, training and compliance with state and local safety and health laws and regulations. We have in place and intend to continuously maintain policies and procedures to minimize these risks. During the Track Record Period, we had six incidents resulting in material injuries to our employees during the production process. These injuries were caused by the non-compliance of our safety guidelines by the injured employees or accidents. In addition, we had two non-workplace safety related employee deaths. The employees and their families were compensated by social insurance and welfare fund and relevant payments had been settled in full. There can be no assurance that we will not become subject to material liabilities for workplace injuries or fatalities, which could interrupt our production operations and damage our reputation, as well as have a material adverse effect on our business, financial condition and results of operations.

Our insurance coverage may not be sufficient to cover the risks related to our operations or any losses.

We may experience major accidents and business interruptions due to natural disasters, electrical outages, floods and other acts of God in the course of our operations, which may cause significant losses or damage. Any such accidents, and the consequences resulting from them, may not be covered adequately, or at all, by the insurance policies we carry. Although we carry property insurance, we do not carry any business interruption insurance or third-party product liability insurance for losses or damage arising from accidents relating to our operations or products. In addition, because of market conditions, premiums and deductibles for our existing insurance policies could increase substantially and, in some instances, our existing insurance may become unavailable or available only for reduced amounts of coverage. Losses and damages arising from accidents and business interruptions relating to our operations or products may have a material and adverse effect on our business, financial condition and results of operations if such losses or damages are not fully insured.

We may not be able to successfully implement any overseas expansion plans and strategies that we may undertake in the future.

During the Track Record Period and through the Latest Practicable Date, our engines were directly sold in China, with only a small amount installed in vehicles and sold to overseas markets by automotive manufacturers. Although currently we have no plan to expand into overseas markets, we

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may choose to sell our products directly to overseas markets in the future. However, we may not be able to expand into overseas markets successfully due to various factors, including but not limited to the following:

- our lack of experience and lack of substantial presence overseas may make it difficult for us to effectively expand into foreign markets;
- we may face market entry barriers such as strong local competition or tariffs, taxes and other restrictions, which may prevent us from competing effectively in new markets;
- there may not be a steady increase in our overseas orders, we may not be able to predict market trends and customer needs to offer an appropriate product mix to overseas markets or there may not be sufficient demand for our products;
- we may fail to obtain or maintain licenses or certifications for our operations and products in the overseas markets; and
- current and future trade and economic sanctions among countries may cause difficulties in exporting our products to certain countries.

RISKS RELATING TO OUR INDUSTRY

Market demand for our products may be affected by a slowdown in the growth rate of the PRC automotive industry.

There is a direct correlation between our business and the automotive production and sales volumes of our customers in the PRC, which are in turn dependent on economic policies and market sentiment and demand. The production of vehicles in the PRC has grown at a fast pace in the past due to various factors, including the continued growth of China’s economy, ongoing government incentive policies, increases in consumer purchasing power and a historically low rate of vehicle ownership. Any significant reduction in automotive production and sales by our customers could have a material and adverse effect on our business. There can be no assurance that there will not be negative changes in China’s economy, market conditions, government policies and other factors leading to a slowdown in demand for automobiles. For example, the sale of PV engines in the PRC increased by 5.1% from 2010 to 2011, compared with 34.0% from 2009 to 2010, while the sale of LCV engines decreased by 10.3% from 2010 to 2011, compared with an increase of 26.1% from 2009 to 2010. The decline in demand for the automobiles of our customers would directly and adversely affect demand for our products and hence our business, financial condition and results of operations could be materially and adversely affected.

The global financial crisis, economic downturn and uncertainty may have a material and adverse effect on our business, financial condition and results of operations.

Our operations and performance may be adversely impacted by a deterioration of global economic conditions. The economic conditions in North America, Europe and other regions deteriorated significantly in late 2008 and 2009. The current economic environment continues to be uncertain, and the economic conditions in Europe have worsened as a result of the pending European debt crisis. These conditions may make it difficult for our customers to accurately plan future business activities and could cause our customers to terminate their relationships with us or could cause end-consumers to slow or reduce their spending on our customers’ products. Furthermore, during challenging economic times, our customers may not have timely access to sufficient credit, which could reduce the number of purchase orders they place with us. In particular, since 2010, the PRC Government has tightened its

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credit policy to control rising inflation rate and has raised the RMB benchmark deposit and loan interest rates six times. As a result, during the Track Record Period, we have accrued significant trade and bills receivables and amounts due from our related companies caused by their delayed payments and increasing use of bank promissory notes for payment, as the tightened credit policy increased their costs of financing which in turn increased pressure on their cash flows. Our trade and bills receivables due from related companies amounted to RMB954.3 million as of September 30, 2012, of which RMB471.6 million of trade receivables were past due without collateral, and our trade and bills receivables from non-related companies amounted to RMB380.3 million as of September 30, 2012, of which RMB202.2 million of trade receivables were past due without collateral. We and our customers and suppliers were affected by the PRC Government’s tightened credit policy to various degrees. Furthermore, according to a speech delivered by China’s Premier Wen Jiaobao at the annual meeting of the National People’s Congress in Beijing on March 5, 2012, China’s GDP growth is targeted at 7.5% for the year 2012. Going forward, according to the 12th Five-Year Plan, the PRC Government expects to achieve an average of 7.0% annual GDP growth during the period from 2011 to 2015. We cannot predict the timing, magnitude or duration of any current or future economic slowdown or subsequent economic recovery, globally, in the PRC, the United States, Europe or in our industry. These and other economic factors could have a material adverse effect on our business, financial condition and results of operations.

Furthermore, the availability of credit to entities such as us, operating within emerging markets, is significantly influenced by levels of investor confidence in such markets as a whole and any factors that may affect market confidence could affect the costs or availability of funding for entities within any such markets. These challenging market conditions have resulted in reduced liquidity, widening of credit spreads, lack of price transparency in credit markets, a reduction in available financing and a tightening of credit terms. If this economic downturn continues or there are prolonged disruptions to the credit markets, such as due to the European debt crisis, it could limit our ability to borrow funds from our current or other funding sources or cause the continued access to funds to become more expensive, we may be exposed to a downturn in sales caused by such tightening of credit conditions, and our business, financial condition and results of operations could be materially and adversely affected.

We operate in a competitive industry and face intense competition from our competitors.

We face intense competition from both domestic and foreign competitors and there is no assurance that we will be able to effectively compete with them. To the extent that our competitors, whether domestic or foreign, gain a competitive advantage in terms of pricing, product quality, brand name recognition and financial and technical resources, the market share and profitability of our Group may be adversely affected. One of our main competitors, Shenyang Xinguang Brilliance, is a Sino-foreign equity joint venture held as to 50% by Brilliance China, one of our Controlling Shareholders. For details of our competition with Shenyang Xinguang Brilliance and other competitors, see “Business — Competition” and “Relationship with Our Controlling Shareholders and Huachen — Excluded Business of Brilliance China” in this document. Our ability to compete depends on our ability to offer sufficient quantities of high quality products that are suitable for our customers at a more competitive proposition than that of domestic and foreign competitors. In addition, our competitiveness depends on our ability to maintain our track record of timely deliveries and superior customer service. Our failure to compete effectively could materially and adversely affect our business, financial condition, results of operations and market position.

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Changes in automotive industry policies and regulations may adversely affect our business, financial condition and results of operations.

Our business is significantly affected by automotive industry policies and regulations, particularly in the PRC. Any adverse changes in existing policies and regulations in the automotive industry in the PRC, including, without limitation, tightened restrictions on foreign investment, imposition of stricter fuel economy and emission standards, restrictions limiting automotive purchases in certain cities, such as Beijing, increasing fuel prices and taxes on automotive purchases or the cessation of government incentive plans for the purchase of new or certain types of vehicles, or the adoption of any new policies adversely affecting the automotive industry in the PRC, could reduce the demand for automobiles and auto parts, and in turn reduce the demand for automotive engines. For example, China adopted the Implementation Rules for Old-for-New Replacement of Automotives (《汽車以舊換新實施辦法》) and Implementation Scheme for Promoting Purchase of Motor Vehicles and Motorcycles in Rural Areas (《汽車摩托車下鄉操作細則》) to promote the use of minibuses and LCVs. However, such purchase subsidy programs lasted only from June 2009 to December 2010 and from March 2009 to the end of 2010, respectively. For details of these favorable policies and regulations that were terminated, see “Industry Overview — Overview of the PRC PV and LCV Market — Policies and regulations in China automotive industry” in this document.

Furthermore, existing PRC automotive industry policies and regulations impose certain restrictions on investment by foreign vehicle manufacturers in vehicle production projects in China. Further tightening of these policies and regulations could lead to a lower level of participation by foreign automotive manufacturers in the PRC automotive market, which in turn could reduce the supply of automobiles in the market, resulting in lower demand for automotive engines. See “Regulation Overview — Regulations Relating to Project Initiation Approvals” in this document.

In addition, the PRC Government may adjust the domestic oil supply prices by considering several factors, including changes in the global crude oil prices, which makes the cost of gasoline in the PRC less predictable. If the demand for fuel increases in the PRC, fuel shortages or price increases may occur. Consumers may avoid increased or unpredictable fuel costs by utilizing alternative means of transportation, such as bicycles, public buses and subways, thus reducing the demand for automobiles and automobile engines. For example, the PRC Government has started a reform to adjust the fuel tax and oil price in China in order to promote energy savings and emission reductions. According to the Notice of the State Council on Implementing the Oil Price and Tax Reform (《國務院關於實施成品油價格和稅費改革的通知》), which came into effect on January 1, 2009, gasoline tax increased from RMB0.2 per liter to RMB1.0 per liter, and diesel tax increased from RMB0.1 per liter to RMB0.8 per liter.

The rapid development trend of automobiles may create pressure on our production facilities and affect our business.

Rapid technological development with respect to automobiles may pose challenges to our existing production equipment. For example, we may have to modify our production lines to cater for the development of electric vehicles that require different automotive engines from those applied in traditional vehicles. We possess certain production technologies and know-how in the manufacturing of fuel-electric hybrid automotive engines. Nevertheless, if there is further development of electric vehicles or other technological developments in the automotive industry in the future that require different automotive engines and we cannot timely adjust our production facilities and operations accordingly, our business prospects, financial condition and results of operations could be materially and adversely affected.

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RISKS RELATING TO CONDUCTING BUSINESS IN THE PRC

Any adverse change in the political and economic policies of the PRC Government may materially and adversely affect our business, financial condition and results of operations and may result in our inability to sustain our growth and expansion strategies.

Substantially all our operations are conducted in the PRC and all our revenues are sourced from the PRC. Accordingly, our results of operations, financial condition and prospects are subject to a significant degree to the economic, political and legal developments of the PRC. The PRC economy differs from other developed economies of the world in many respects, including:

- its socialist market economic structure;
- the level of governmental involvement;
- the level of development;
- growth rate;
- the control of foreign exchange; and
- the allocation of resources.

As a result of these differences, our business may not develop in the same way or at the same rate as might be expected if the Chinese economy were similar to those of other developed countries. The PRC economy has been transitioning from a planned economy to a more market oriented economy. The PRC Government has implemented economic reform measures emphasizing utilization of market forces in the development of the PRC economy and is continuing to play a significant role in regulating industries by imposing industrial policies.

We cannot, however, predict whether changes in the political, economic and social conditions and policies in the PRC, or in the relevant laws, rules and regulations, will have any material and adverse effect on our current or future business, financial condition and results of operations.

There are uncertainties regarding the interpretation and enforcement of PRC laws, rules and regulations.

Substantially all of our operations are conducted in the PRC. The PRC legal system is based on written statutes and prior court decisions are not binding. Since 1979, the PRC Government has been developing a comprehensive system of laws, rules and regulations in relation to economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade.

However, due to the fact that these laws, rules and regulations have not been fully developed, and because of the limited volume of published cases and their non-binding nature, the interpretation and enforcement of these laws, rules and regulations involve some degree of uncertainty with respect to the outcome of any legal action in which we may be involved in the PRC.

As a foreign company, our acquisition of PRC companies may take longer and be subject to higher levels of scrutiny by the PRC Government.

On August 8, 2006, MOFCOM, SAIC, SAT, SAFE, SASAC and CSRC jointly promulgated the Provisions on Mergers and Acquisition of Domestic Enterprises by Foreign Investors (《關於外國投資者併購境內企業的規定》, the “M&A Provisions”). The M&A Provisions became effective

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on September 8, 2006 and were reissued by MOFCOM in June 2009. The M&A Provisions established additional procedures and requirements, including but not limited to, the requirement that foreign investors must obtain approval from MOFCOM or its local counterpart at the provincial level when they acquire equity or assets of a PRC domestic enterprise. It is generally expected that compliance with the regulations will be more time-consuming and costly than in the past and will result in a more extensive evaluation by the PRC Government and result in increased control over the terms of the transaction. Therefore, acquisitions in China by non-PRC entities may face difficulties in completion because the terms of the transaction may not satisfy terms required by regulatory authorities in the approval process. If we decide to acquire a PRC domestic enterprise, the execution of our acquisition plan may become more time-consuming, complex and uncertain, and as a result, our business and growth prospects could be materially and adversely affected.

Implementation of the PRC Labor Contract Law and other labor-related regulations in China may materially and adversely affect our business, financial condition and results of operations.

The PRC Labor Contract Law (《中華人民共和國勞動合同法》) and the PRC Labor Contract Law Implementation Rules (《中華人民共和國勞動合同法實施條例》) took effect on January 1, 2008 and September 18, 2008, respectively. These labor laws and rules impose additional stringent requirements on employers in relation to entering into fixed term employment contracts, hiring of part-time employees and dismissing employees. Pursuant to the PRC Labor Contract Law, since January 1, 2008, we have been required to enter into non-fixed term employment contracts with employees who have worked for us for more than 10 consecutive years or for whom a fixed term employment contract has been concluded for two consecutive times, unless otherwise provided in the PRC Labor Contract Law. We may not be able to efficiently terminate non-fixed term employment contracts under the PRC Labor Contract Law without cause unless there exists special circumstances as stipulated in the PRC Labor Contract Law Implementation Rules as well as other PRC laws for the termination of the employment contracts by the employer. We are also required to make severance payments to fixed term contract employees when the term of their employment contracts expire, except for certain circumstances prescribed in the PRC Labor Contract Law including where an employee voluntarily rejects an offer to renew the contract where the conditions offered by the employer are the same as or better than those stipulated in the current contract. The amount of severance payment is equal to the monthly wage of the employee multiplied by the number of full years that the employee has worked for the employer, except in the circumstances where (i) the term of service is more than six months but less than a year, the amount of severance payment shall be calculated the same as a full year of service; (ii) the term of service is less than six months, the employer shall pay half a month's wage to the employee as severance payment; and (iii) the employee's monthly wage is more than three times the local average monthly wage of the proceeding year announced by the local relevant PRC Government, the calculation of the severance payment will be based on a monthly wage equal to three times the average monthly wage multiplied by the number of years of service which cannot exceed a maximum of 12. A minimum wage requirement has also been incorporated into the PRC Labor Contract Law. Liability for damages or fines may be imposed for any material breach of the PRC Labor Contract Law. In addition, under the Regulations on Paid Annual Leave for Employees (《職工帶薪年休假條例》), which became effective on January 1, 2008, employees who have continuously worked for more than one year are entitled to paid holidays ranging from 5 to 15 days, depending on their length of service. Employees who agree to waive their holiday time at the request of their employers must be compensated with three times their normal daily salary for each holiday waived. As a result of these PRC laws, rules and regulations, our labor costs have increased. There can be no assurance that any disputes, work stoppages or strikes will not arise in the future. Further, there can be no assurance that there will be no additional or new labor laws, rules and regulations in the PRC, which may lead to potential increases in our labor costs and future disputes with our employees. In such events, our business, financial condition and results of operations could be materially and adversely affected.

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PRC regulation of loans and direct investment by offshore holding companies to PRC entities may delay or prevent us from using proceeds we receive from the [●] to make loans or additional capital contributions to our PRC subsidiary.

As an offshore holding company of our PRC subsidiaries, our Company may make loans to our PRC subsidiaries, or we may make additional capital contributions to our PRC subsidiaries by utilizing the proceeds we receive from the [●]. Any loans to our PRC subsidiary are subject to PRC regulations and foreign exchange loan registrations, and capital contributions to our PRC subsidiary must be approved by the PRC MOFCOM or its local bureaus. However, we cannot assure you that we will be able to obtain these government registrations or approvals on a timely basis, with respect to our future loans or capital contributions to our PRC subsidiaries or any of their respective subsidiaries. If we fail to receive such registrations or approvals, our ability to use the proceeds received from the [●] and to fund our PRC operations may be negatively affected, which could materially and adversely affect our liquidity and ability to expand our business. As a result, our business, financial condition and results of operations could be materially and adversely affected.

On August 29, 2008, SAFE issued the Notice of the General Department of the SAFE on Improving on Relevant Business Operations Issues Concerning the Administration of the Payment and Settlement of Foreign Exchange Capital of Foreign-Invested Enterprises (《國家外匯管理局綜合司關於完善外商投資企業外匯資本金支付結匯管理有關業務操作問題的通知》, “Notice 142”) which regulates the conversion by a foreign-invested enterprise of foreign currency into RMB by restricting how the converted RMB may be used. Notice 142 requires that the RMB funds converted from the foreign currency capital of a foreign-invested enterprise may only be used for purposes within the business scope approved by the relevant PRC Government and may not be used for equity investments within the PRC unless specifically provided for otherwise. In addition, SAFE strengthened its supervision over the flow and use of RMB funds converted from the foreign currency capital of a foreign-invested enterprise. The use of such RMB capital may not be changed without SAFE’s approval, and may not, in any case, be used to repay or prepay RMB loans if such loans have not been used. Violations of Notice 142 will result in severe penalties, such as heavy fines set out in the relevant foreign exchange control regulations. As a result, Notice 142 may significantly limit our ability to use the net proceeds from the [●] to expand our business in the PRC, and to convert the net proceeds from the [●] into RMB to invest in or acquire other PRC companies.

Our Company is a holding company that relies on payments from our PRC subsidiary for funding.

We are a holding company incorporated in the Cayman Islands and operate our core business primarily through our subsidiary in the PRC. Therefore, the availability of funds to pay dividends to our Shareholders and to service our indebtedness depends on payments received from our PRC subsidiary. If our PRC subsidiary incurs any debts or losses, such indebtedness or losses may impair its ability to pay dividends or other distributions to us. As a result, our ability to pay dividends or other distributions and to service our indebtedness will be restricted.

PRC laws, rules and regulations require that dividends be paid only out of the net profit calculated according to PRC generally accepted accounting principles, which differ from generally accepted accounting principles in other jurisdictions, including HKFRS. PRC laws, rules and regulations also require PRC-incorporated companies, such as our PRC subsidiary, to set aside part of their net profit as statutory reserves. These statutory reserves are not available for distribution as cash dividends.

In addition, although the Group’s existing borrowings contain no such restrictive covenants that restrict the ability of our PRC subsidiary to make distribution to us, restrictive covenants in bank credit facilities, convertible bond instruments or other agreements that our subsidiaries or we may enter into

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in the future, if any, may also restrict the ability of our PRC subsidiary to make distributions to us. Therefore, these restrictions on the availability and usage of our major source of funding may impact our ability to pay dividends to our Shareholders and to service our indebtedness.

Fluctuations in foreign exchange rates and changes in foreign exchange regulations may materially and adversely affect our business, financial condition, results of operations and our ability to remit payments.

Most of our revenue and expenditures are denominated in RMB, which is currently not a freely convertible currency. In addition, we will require foreign currencies for dividend payment (if any) to our Shareholders. As a result, we are exposed to foreign currency fluctuations.

In the PRC, since 1994, the conversion of RMB into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the PBOC. The PRC Government has, with effect from July 21, 2005, reformed the exchange rate regime by permitting RMB to fluctuate within a narrow and managed band based on market supply and demand with reference to a basket of currencies. On July 21, 2005, RMB was revaluated appreciating against the U.S. dollar and Hong Kong dollar by 2.0%. The PRC Government has made further adjustments to the exchange rate system. Any appreciation of RMB may result in the decrease in the value of our foreign currency-denominated assets, including the net proceeds from the [●]. Conversely, any depreciation of RMB may adversely affect the value of any dividends payable on our Shares in foreign currency terms.

Over the years, the PRC Government has significantly reduced its control over routine foreign exchange transactions under current accounts items, including trade and service-related foreign exchange transactions and payment of dividends. However, foreign exchange transactions under capital accounts items continue to be subject to significant foreign exchange controls and require the approval of, or registration with, SAFE. Under our current group structure, our Company's income is derived principally from dividend payments from our subsidiary located in the PRC. Shortages in foreign currency may restrict the ability of our PRC subsidiary to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency-denominated obligations.

In addition, under the current foreign exchange regulations in China, subject to the relevant registration at SAFE, we are able to pay dividends in foreign currencies, without prior approval from SAFE, by complying with certain procedural requirements. However, there can be no assurance that the current PRC foreign exchange policies regarding payment of dividends in foreign currencies will continue in the future. Changes in PRC foreign exchange policies might have a negative impact on our ability to service our foreign currency-denominated indebtedness and to distribute dividends to our Shareholders in foreign currencies.

It may be difficult to effect service of process upon some of our Directors and executive officers who live in the PRC or to enforce against them in the PRC any judgments obtained from non-PRC courts.

Most of our assets and our principal business operations are in the PRC. Substantially all our executive Directors and all members of our senior management team are residing in the PRC with no permanent addresses outside the PRC. Therefore, it may not be possible for investors to effect service of process upon such persons in the PRC or to enforce against our Company or such persons in the PRC any judgments obtained from non-PRC courts. The PRC does not have treaties or arrangements providing for the recognition and enforcement of civil judgments of the courts of the United Kingdom, the United States or most other western countries. Therefore, recognition and enforcement in the PRC of judgments obtained in such jurisdictions may not be possible. On July 14, 2006, the PRC and Hong

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Kong signed the “Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements Between Parties Concerned”. However, investors are reminded that only an enforceable final judgment requiring payment of money arising out of a commercial contract with an exclusive jurisdiction clause and granted by Hong Kong courts may be recognized by PRC courts, subject to the requirements and restrictions set forth in the arrangement.

Shortage of utilities in the PRC could affect our business.

Our production operations require significant and stable supplies of water and electricity, the use of which will further increase substantially as we expand our production capacity. We had not experienced any water and electricity shortage at our production facilities in the PRC during the Track Record Period, except as a result of the Wenchuan Earthquake. Given the increasing demand in the PRC amidst limited supply, shortages or suspensions of utilities are not uncommon and we may not always have adequate supplies to meet our needs at our production facilities. If such shortages or suspensions of utilities happen for a significant period of time, this may have an adverse effect on our business.

Any outbreak of severe communicable diseases in the PRC may cause suspension of our operations and affect the economic conditions of the PRC, which may, in turn, affect our business and operations.

The outbreak of any severe communicable disease in the PRC could have a material adverse effect on the domestic consumption and, possibly, the overall GDP growth of the PRC. As all of our revenue is currently derived from our PRC operations, any contraction or slowdown in the growth of domestic consumption or slowdown in the GDP growth of the PRC may materially and adversely affect our business, prospects, financial condition and results of operations. In addition, if our employees are affected by any severe communicable disease, we may be required to close our facilities or institute other measures to prevent the spread of disease, which may materially and adversely affect or disrupt our production. The spread of any severe communicable disease in the PRC and elsewhere may also affect the economic sentiment and in turn have a material adverse effect on the [●].

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements, including, without limitation, words and expressions such as “expect”, “believe”, “plan”, “intend”, “project”, “anticipate”, “going forward”, “ought to”, “should”, “seek”, “may”, “will”, “would” and “could” or similar words or statements in relation to future events, our future financial, business or other performance and development, the future development of our industry and the future development of the general economy of the PRC market.

These statements are based on numerous assumptions regarding our present and future business strategy and the environment in which we will operate in the future. These forward-looking statements reflecting our current views with respect to future events are not a guarantee of future performance and are subject to certain risks, uncertainties and assumptions, including the risk factors described in this document, and the following:

- our business strategies and plan of operations;
- our capital expenditure plans;
- the amount and nature of, and potential for, future development of our business;
- our operations and business prospects;
- our dividend policy;
- projects under construction or planning;
- the regulatory environment of our industry in general; and
- future development in our industry.

We caution you that, subject to the requirements of applicable laws, rules and regulations, we do not have any obligation to update or otherwise revise the forward-looking statements in this document, whether as a result of new information, future events or otherwise. As a result of these and other risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this document might not occur in the way we expect, or at all. Accordingly, you should not place undue reliance on any forward-looking information. All forward-looking statements contained in this document are qualified by reference to the cautionary statements set out in this section.

In this document, statements of or references to the intentions of our Company or any of our Directors are made as at the date of this document. Any such intentions may potentially change in light of future developments.

DIRECTORS AND PARTIES

DIRECTORS

Name	Address	Nationality
Executive Directors		
Wu Xiao An (also known as Ng Siu On) (吳小安) (Chairman)	Flat C, 48/F Island Lodge 180 Java Road North Point Hong Kong	Chinese
Wang Yunxian (王運先) (Chief Executive Officer)	Room 5, Unit 1, Block 5 No. 228 Jianmen Road West Fucheng District Mianyang Sichuan Province PRC	Chinese
Non-executive Directors		
Qi Yumin (祁玉民)	1-3-2, No. 65 Wansui Street Shahekou District Dalian Liaoning Province PRC	Chinese
Li Peiqi (李培奇)	Annex 20 No. 6 Zhuanshu Street Cuiping District Yibin City Sichuan Province PRC	Chinese
Independent non-executive Directors		
Chi Guohua (池國華)	No. 55, 217 Jianshan Street Shahekou District, Dalian City Liaoning Province PRC	Chinese
Wang Jun (王隼)	Room 902, Building 7 Wan Xing Yuan No. 172 Beiyuan Road Chaoyang District Beijing PRC	Chinese
Huang Haibo (黃海波)	No. 9, Unit 3, Block 24 999 Tuqiaojinzhou Road Jinniu District Chengdu Sichuan Province PRC	Chinese
Wang Songlin (王松林)	Room 1002, Unit 3 No. 205 Jia Ming Tong Cheng No. 86 Beiyuan Road Chaoyang District Beijing PRC	Chinese

DIRECTORS AND PARTIES

Legal advisers to our Company

As to Hong Kong Law and U.S. Law
Shearman & Sterling
12th Floor, Gloucester Tower
The Landmark
15 Queen’s Road Central
Hong Kong

As to Cayman Islands Law
Appleby
2206-19 Jardine House
1 Connaught Place
Central
Hong Kong

As to PRC Law
Jingtian & Gongcheng
34/F, Tower 3
China Central Place
77 Jianguo Road
Beijing 100025
China

As to PRC Law
Global Law Office
15th Floor, Tower 1
China Central Place
No. 81, Jianguo Road
Beijing 100025
China

Auditors and reporting accountants

Deloitte Touche Tohmatsu
Certified Public Accountants
35th Floor, One Pacific Place
88 Queensway
Hong Kong

CORPORATE INFORMATION

Registered Office	Clifton House 75 Fort Street PO Box 1350 Grand Cayman KY1-1108 Cayman Islands
Head office and principal place of business in the PRC	No. 228 Jianmen Road West Fucheng District Mianyang Sichuan Province PRC
Principal place of business in Hong Kong	Suites 1602-05 Chater House 8 Connaught Road Central Hong Kong
Company’s website	[www.xinchenpower.com] (information contained in this website does not form part of this document)
Company Secretary	Ms. Fung Sam Ming
Authorized representatives	Mr. Wu Xiao An Mr. Wang Yunxian
Audit Committee	Mr. Chi Guohua (Chairman) Mr. Wang Jun Mr. Huang Haibo Mr. Wang Songlin
Remuneration Committee	Mr. Huang Haibo (Chairman) Mr. Wang Jun Mr. Wu Xiao An Mr. Wang Songlin
Nomination Committee	Mr. Wang Jun (Chairman) Mr. Huang Haibo Mr. Wu Xiao An Mr. Wang Songlin
Principal Share Registrar and Transfer Office	Appleby Trust (Cayman) Ltd. Clifton House 75 Fort Street PO Box 1350 Grand Cayman KY1-1108 Cayman Islands
Principal bankers	The Hong Kong and Shanghai Banking Corporation Limited, Hong Kong Branch

INDUSTRY OVERVIEW

This section contains information and statistics relating to the PRC, North America, Europe and Japan, as well as the Chinese automotive engine industry, in which we operate. Certain information and statistics set out in this section have been extracted from various government publications, market data providers and other independent third-party sources. Except for the Frost & Sullivan Report referred to below which was commissioned by the Company, neither our Group, its connected persons, [●] nor any other party involved in the [●] has commissioned any such third-party sources. We believe that these sources are appropriate sources for such information and statistics and have taken reasonable care in extracting and reproducing such information and statistics. We have no reason to believe that such information and statistics are false or misleading or that any material fact has been omitted that would render such information and statistics false or misleading. The information in this section has not been independently verified by us, the [●] or any other party involved in the [●] and no representation is given as to its accuracy, completeness or fairness.

Certain information and statistics are extracted from an industry report prepared by Frost & Sullivan, dated [●], 2012 (the “Frost & Sullivan Report”), which we commissioned. The information and statistics extracted from the Frost & Sullivan Report reflects an estimate of market conditions based on Frost & Sullivan’s research and analysis. The information and statistics extracted from the Frost & Sullivan Report should not be viewed as a basis for investments provided by Frost & Sullivan and references to the Frost & Sullivan Report should not be considered as Frost & Sullivan’s opinion as to the value of any security or the advisability of investing in our Company. The information and statistics may not be consistent with other information and statistics compiled within or outside China. For a discussion of the sources, methodologies, bases and assumptions used in preparation of the Frost & Sullivan Report, see “— Source of Information”. For a discussion of risks relating to our industry, see “Risk Factors — Risks Relating to Our Industry” in this document.

SOURCE OF INFORMATION

In connection with the [●], we have engaged Frost & Sullivan to conduct a detailed analysis and prepare an industry report of the automotive engine market in China. We incurred a total of RMB1.4 million in fees and expenses for the preparation of the Frost & Sullivan Report. The payment of such amount was not contingent upon our successful [●] or on the results of the Frost & Sullivan Report. Except for the Frost & Sullivan Report, we did not commission any other report in connection with the [●].

Frost & Sullivan is an independent global market research and consulting company which was founded in 1961 and is based in the United States. Services provided by Frost & Sullivan include market assessments, competitive benchmarking, and strategic and market planning for a variety of industries. We have included certain information from the Frost & Sullivan Report in this document because we believe such information facilitates an understanding of this market for potential investors.

Frost & Sullivan’s independent research was undertaken through both primary and secondary research obtained from various sources within China. Primary research involved interviews with leading industry participants including vehicle manufacturers, engine suppliers and related industry experts. Secondary research involved reviewing company reports, independent research reports and data based on Frost & Sullivan’s own research database. Projected total market size information in China was obtained from historical data analysis plotted against macroeconomic data as well as specific related industry drivers such as increasing disposable income, the rise of PV and LCV sales and increasing product diversification mapped against available projected drivers obtained through interviews with

INDUSTRY OVERVIEW

industry experts and participants. Frost & Sullivan research may be affected by the accuracy of these assumptions and the choice of these parameters.

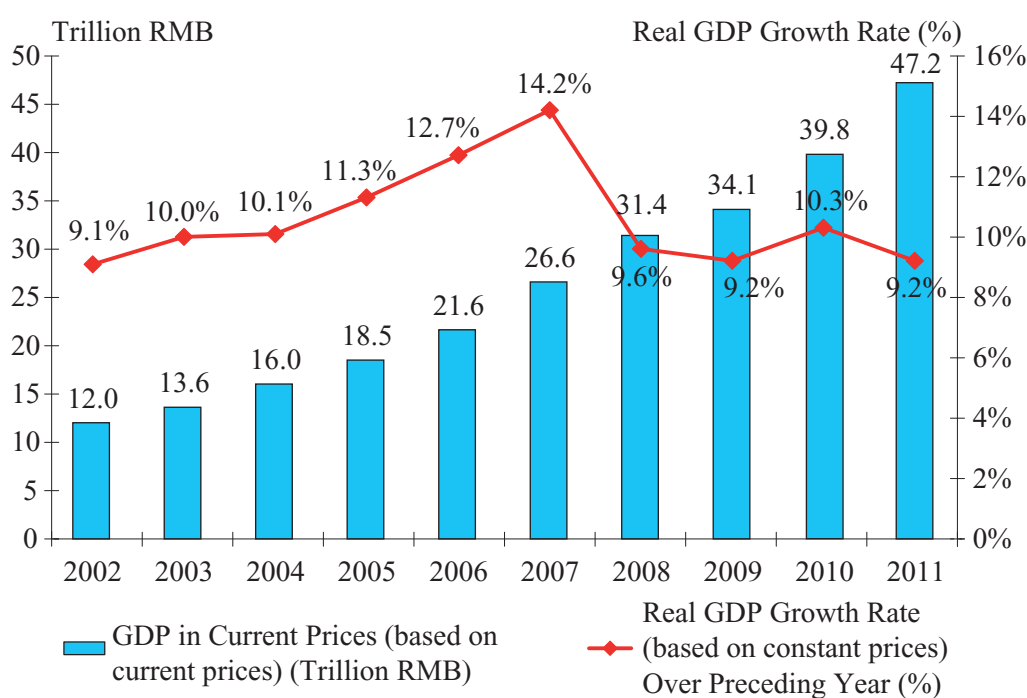
See “Risk Factors — Risks Relating to the [●] — There can be no assurance on the accuracy or completeness of certain facts, forecasts and other statistics obtained from various government publications, market data providers and other independent third party sources, including the industry expert report, contained in this document”.

OVERVIEW OF THE PRC ECONOMY

PRC economic growth

According to the International Monetary Fund (the “IMF”), China experienced significant economic growth between 2002 and 2011, with real GDP increasing by at least 9% each year, making China one of the fastest growing economies in the world. In 2008, the global financial crisis negatively impacted the PRC’s economy. However, the economy began to show signs of recovery and growth in early 2009 in part due to the PRC Government’s strong economic stimulus. In 2009, China’s real GDP grew 9.2% from 2008, exceeding the PRC Government’s 8% target, and it further grew 10.3% in 2010 and 9.2% in 2011. According to the IMF, China’s real GDP growth is expected to be 8.2% in 2012 and 8.8% in 2013. Furthermore, according to a speech delivered by China’s Premier Wen Jiabao at the annual meeting of the National People’s Congress in Beijing on March 5, 2012, China’s GDP growth is targeted at 7.5% for the year 2012. According to the 12th Five-Year Plan for National Economy and Social Development (《國民經濟和社會發展第十二個五年規劃》) (the “12th Five-Year Plan”), the PRC Government expects to achieve an average of 7.0% annual GDP growth during the period from 2011 to 2015. The following chart illustrates China’s real GDP growth from 2002 to 2011:

China’s real GDP growth from 2002 to 2011



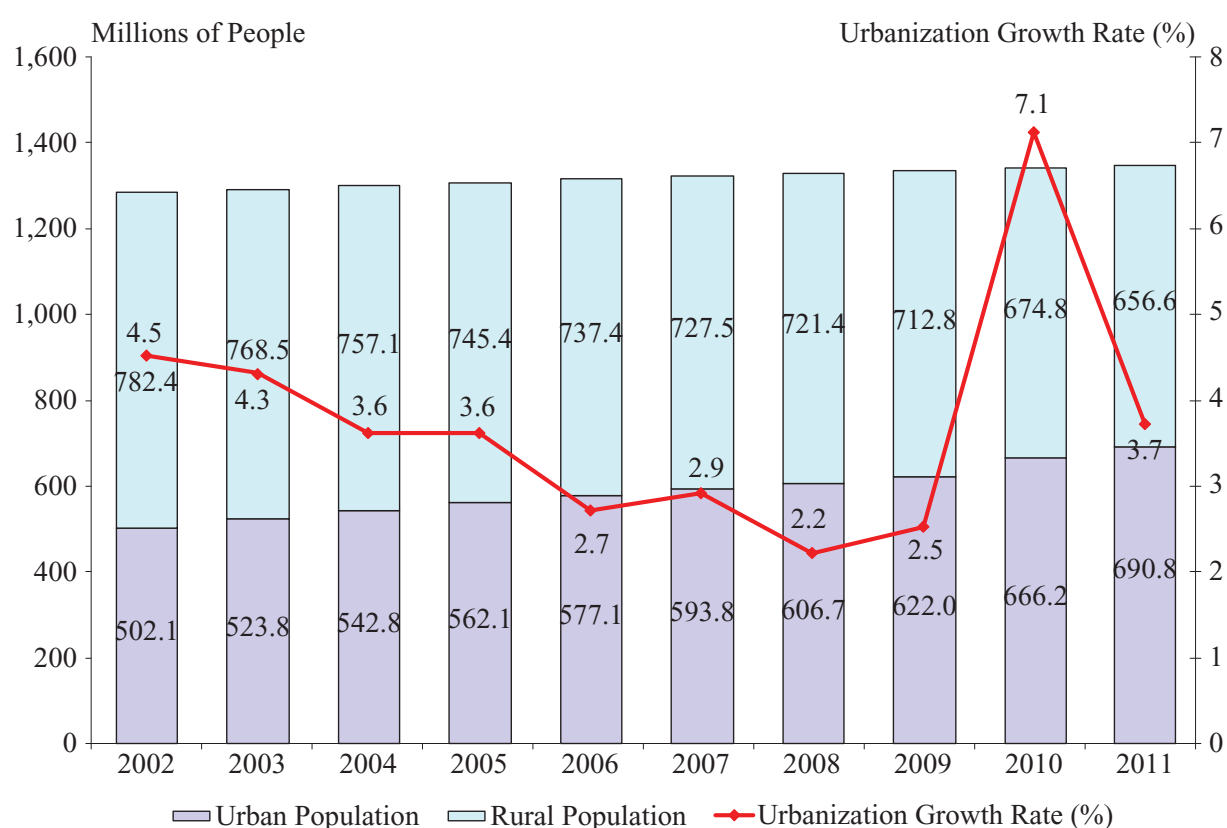
Sources: International Monetary Fund, World Economic Outlook Database, April 2012; National Bureau of Statistics of China

INDUSTRY OVERVIEW

PRC population growth and urbanization

In China, the industrialization process has accelerated urbanization through the migration of rural populations towards urban areas and the transformation of towns into cities or districts. In recent years, China has undergone a significant urbanization process. According to the National Bureau of Statistics of China, the total population in China increased by approximately 62.9 million, or approximately 4.9% from 2002 to 2011, while the urban population in China increased by approximately 188.7 million or approximately 37.6% from 2002 to 2011. In 2011, the total urban population reached 690.8 million, representing approximately 51.3% of the total population of 1,347.4 million in China. The trend of urbanization, along with the large population base, is anticipated to create an attractive consumer group both in terms of size and purchasing power. The following chart illustrates the historical rural and urban population, and the urbanization growth rate in China from 2002 to 2011:

China’s rural and urban population from 2002 to 2011



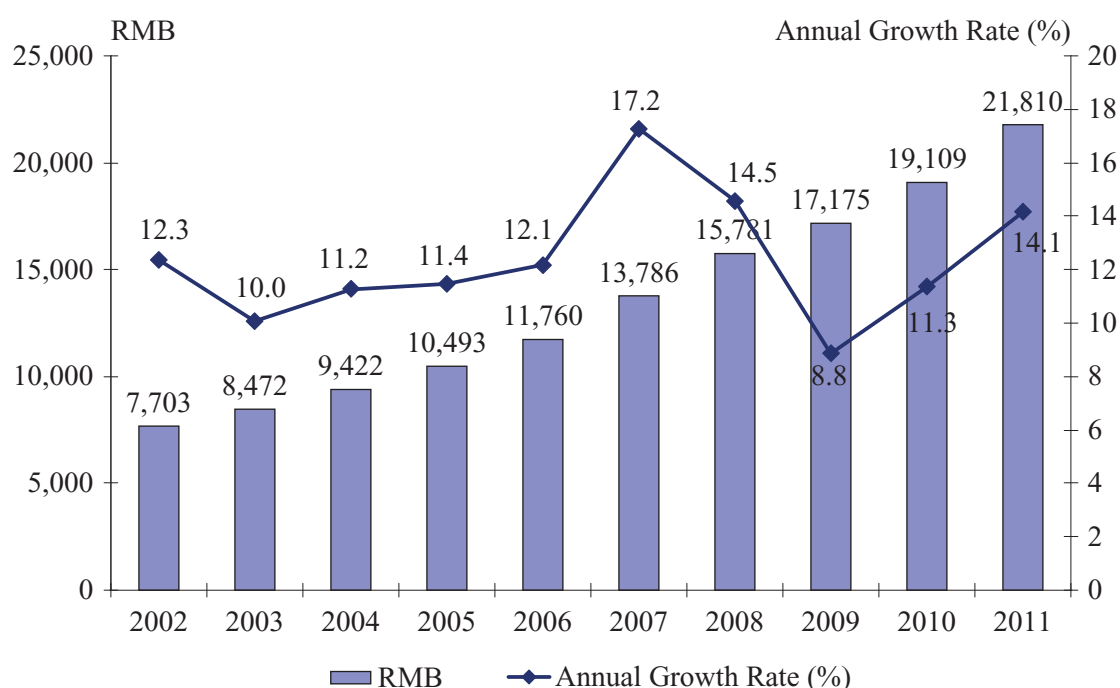
Source: National Bureau of Statistics of China

INDUSTRY OVERVIEW

Disposable income growth of urban and rural households

With the rapid growth of the PRC economy, income levels of urban and rural households have increased and their living standards have improved. According to the National Bureau of Statistics of China, the per capita annual disposable income of urban households in China increased at a CAGR of 12.3% from approximately RMB7,703 in 2002 to RMB21,810 in 2011. In addition, the per capita annual net income of rural households in China also increased at a CAGR of 12.2% from approximately RMB2,476 in 2002 to RMB6,977 in 2011. The following charts set forth the historical per capita annual disposable income of urban households and per capita annual net income of rural households in China from 2002 to 2011:

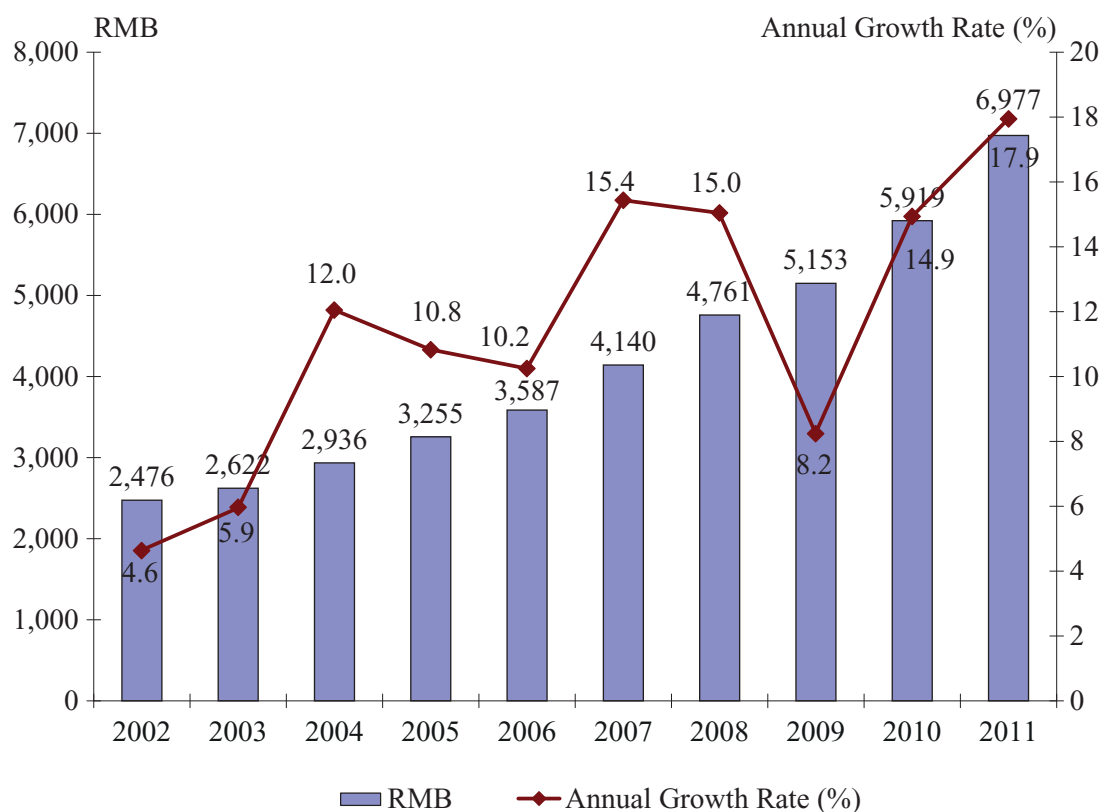
China’s per capita annual disposable income of urban households from 2002 to 2011



Source: National Bureau of Statistics of China

INDUSTRY OVERVIEW

China’s per capita annual net income of rural households from 2002 to 2011



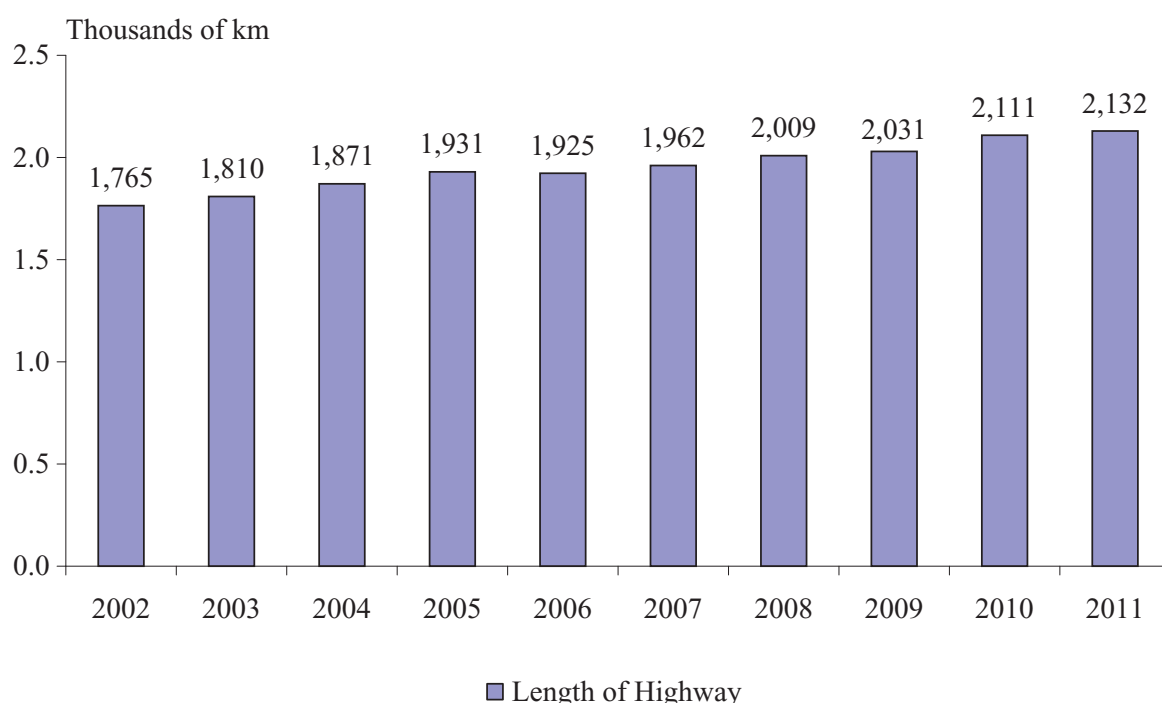
Source: National Bureau of Statistics of China

INDUSTRY OVERVIEW

China’s highway and passenger traffic growth

Since China’s adoption of economic reforms in 1978, rapid economic growth and significant infrastructure spending have led to the rapid expansion of modern highways and expressways in China. According to the National Bureau of Statistics of China, by the end of 2011, China had approximately 4.1 million kilometers of highways, including paved country roads that met PRC national or provincial standards, and approximately 84,900 kilometers of expressways connecting major cities. In addition to the expansion of highways and expressways, according to the PRC Government’s Planning for Technical Development of Highway and Waterway Transportation set forth in the “12th Five-Year Plan”, China expects to construct or re-construct roads in rural areas to reach 3.9 million kilometers by the end of 2015. The following chart illustrates the length of China’s highways from 2002 to 2011, excluding the length of country roads:

Length of China’s highways from 2002 to 2011⁽¹⁾



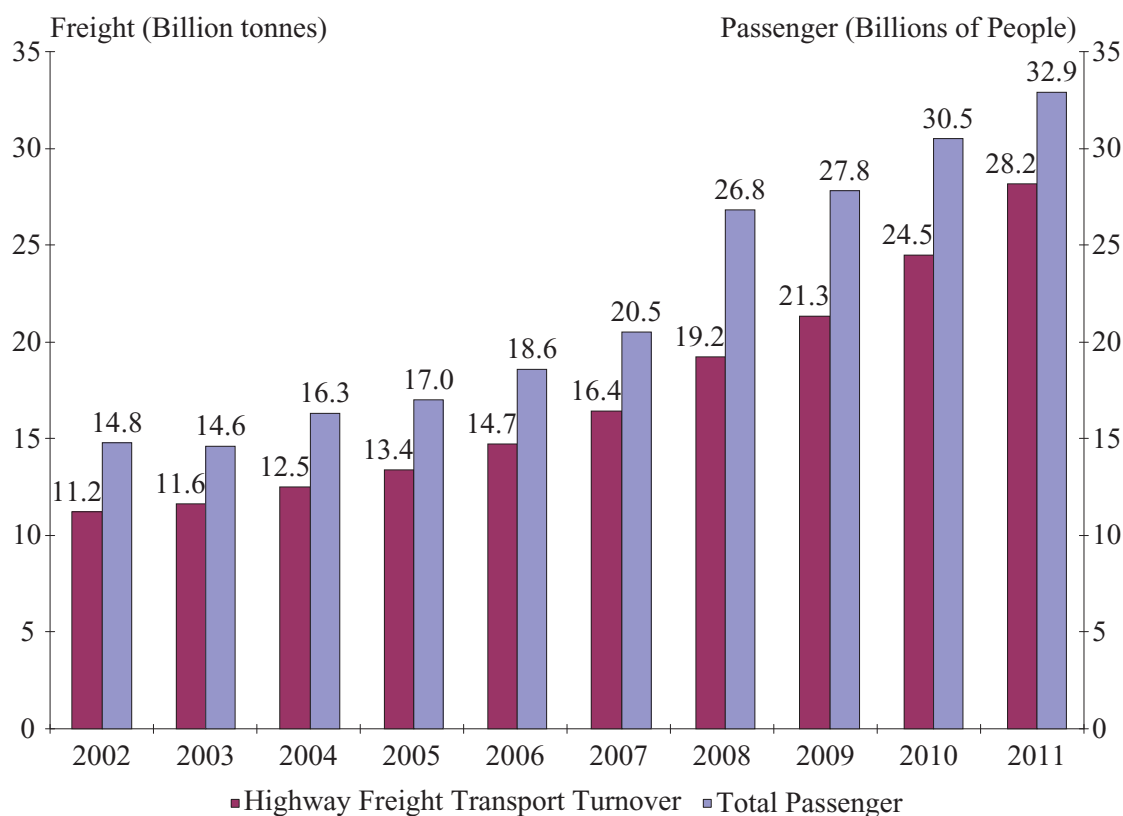
(1) The length of China’s highways excluded the length of country roads.

Source: Ministry of Transportation of China

INDUSTRY OVERVIEW

The continuous efforts by the PRC Government to expand its road transportation network, the increasing disposable income of urban and rural households and the increasing domestic commerce have, in turn, contributed to increased highway freight and passenger traffic in China. The following chart illustrates the highway freight transport turnover and number of total passengers in China from 2002 to 2011:

China’s highway freight transport turnover and number of total passengers from 2002 to 2011



Source: Ministry of Transportation of China

INDUSTRY OVERVIEW

OVERVIEW OF THE PRC PV AND LCV MARKET

The PRC automotive industry policies and regulations

In 2009, the State Council introduced the Restructuring and Rejuvenation Programme of the Automotive Industry (《汽車產業調整和振興規劃》), which lays out certain important means to encourage the growth and development of the automotive industry in China. The major measures of the plan include: (i) encouraging the expansion of major automotive companies through mergers and acquisitions; (ii) earmarking US\$1.5 billion as a special fund to support automotive companies to upgrade their technologies and produce “new energy vehicles” and for related component development; (iii) supporting the development of “self-owned” automotive brands; and (iv) encouraging and driving automotive vehicle market growth and sales. Among others, the following policies and regulations introduced by the PRC Government have been, and some continue to be, particularly favorable to the PV and LCV markets:

- *Fuel tax reform that benefits small and compact vehicles*

The PRC Government has started a reform to adjust the fuel tax and oil price in China in order to promote energy savings and emission reductions. According to the Notice of the State Council on Implementing the Oil Price and Tax Reform (《國務院關於實施成品油價格和稅費改革的通知》), which came into effect on January 1, 2009, gasoline tax increased from RMB0.2 per liter to RMB1 per liter, and diesel tax increased from RMB0.1 per liter to RMB0.8 per liter, and at the same time, six categories of tolls for road maintenance and management were removed. As a result, vehicles with high fuel consumption and emission will incur higher taxes than vehicles with low fuel consumption and emission.

- *Purchase tax reform and subsidies for vehicles with low engine displacement*

The vehicle purchase tax in China was reduced from 7.5% to 5% for consumers who purchased passenger cars with displacements of 1.6L or below from January 20, 2009 to December 31, 2009. Subsequently, the State Council approved an extension of such reduction through December 31, 2010, with the vehicle purchase tax increased to 7.5% in 2010. As a result of the purchase tax relief, the purchase cost for these low engine displacement vehicles decreased, which in turn stimulated the demand for these models. This tax relief program, however, ended in December 2010 and the levy of a 10% vehicle purchase tax resumed at the beginning of 2011.

Further, pursuant to the Promotion and Implementation Rules on “Energy-saving Products and People-benefiting Projects” regarding Fuel-efficient Vehicles (Passenger Vehicles with Displacement of 1.6 liters or below) (《“節能產品惠民工程” 節能汽車 (1.6升及以下乘用車) 推廣實施細則》) jointly issued by the MOF, NDRC and MIIT on May 26, 2010, gasoline passenger vehicles and diesel passenger vehicles (including hybrid and dual-fuel vehicles) with engine displacements of 1.6L or below and integrated fuel consumption lower than the current standard by approximately 20% are included as recommended products under the “energy-saving products and people-benefiting projects”. Customers who purchase these vehicles will receive a one-time subsidy of RMB3,000 per vehicle from the PRC Government through the vehicle manufacturers.

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- *Financial subsidies which encourage consumers in rural areas to purchase light vehicles or trade in older cars*

China adopted the Implementation Rules for Old-for-New Replacement of Automotives (《汽車以舊換新實施辦法》) and the Implementation Scheme for Promoting Purchase of Motor Vehicles and Motorcycles in Rural Areas (《汽車摩托車下鄉實施方案》) to promote the use of minibuses and LCVs. Pursuant to the Operational Rules for the Purchase of Motor Vehicles and Motorcycles in Rural Areas (《汽車摩托車下鄉操作細則》) jointly issued by the MOF with seven other ministries on June 4, 2009, farmers in China who purchased compacts or light trucks or traded in their old vehicles during the period from March 1, 2009 to December 31, 2009 were entitled to subsidies provided by the PRC Government. On December 9, 2009, the State Council decided to extend the period of this subsidy program until the end of 2010. Such measure aimed to stimulate demand and encourage consumption as well as change the consumption structure by promoting vehicle sales in rural areas.

- *Support the development of electric and hybrid vehicles*

On June 28, 2012, the State Council issued the Plan for the Development of Energy-saving and New Energy Automotive Industry (2012-2020) (《節能與新能源汽車產業發展規劃 (2012-2020)》) to encourage the development and manufacture of the energy-saving and new energy automotives. It plans to support the research and development of energy-saving and new energy vehicles such as electric and hybrid cars through various government policies and subsidies. It also stresses the need to build an aftersales service network and a charging network for the energy-saving and new energy vehicles. According to this plan, it targets that the cumulative production and sales of pure electric vehicles and plug-in hybrid electric vehicles will reach 500,000 units by 2015 and five million by 2020, and the fuel-consumption level of the energy-saving PVs and LCVs will reach a lower level. It encourages auto manufacturers to master the key technologies of new energy vehicles such as advance internal combustion engine and hybrid system integration, and form a group of competitive local new energy automotive companies.

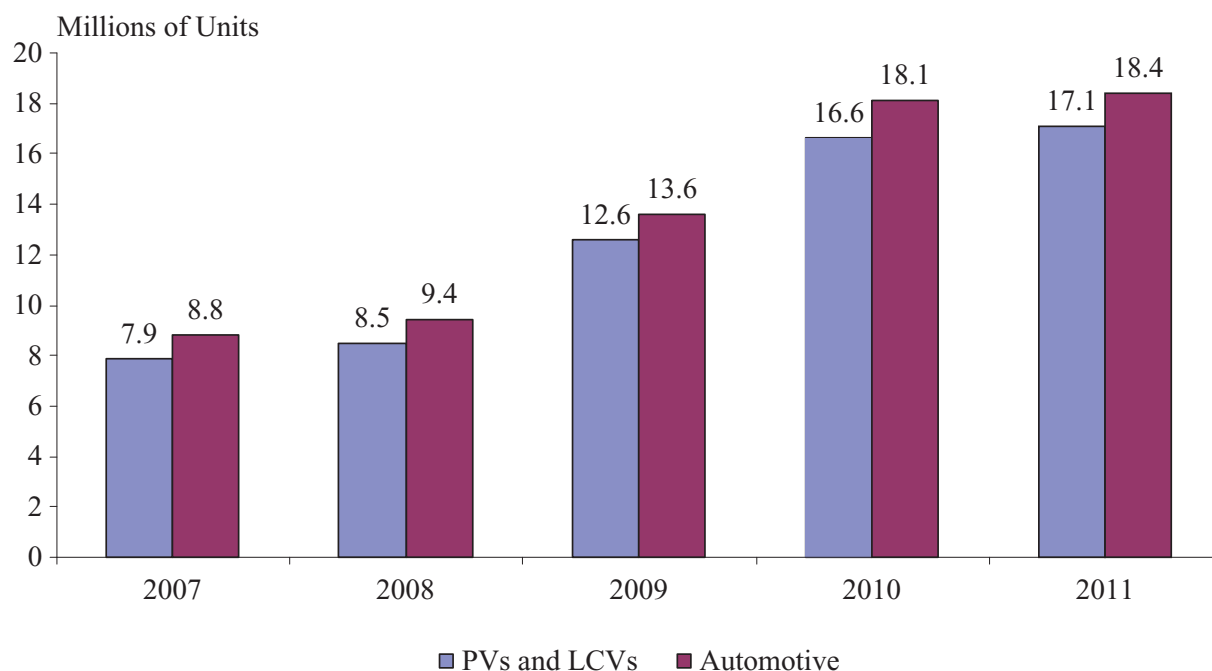
In addition, according to the Regulation on the Implementation of the Vehicle and Vessel Tax Law of the PRC (《中華人民共和國車船稅法實施條例》) which became effective on January 1, 2012, energy-saving and new energy vehicles and vessels may enjoy reduction or exemption of the vehicle and vessel tax.

For a discussion of certain uncertainties with respect to the PRC automotive industry policies and regulations, see “Risk Factors — Risks Relating to Our Industry — Changes in automotive industry policies and regulations may adversely affect our business, financial condition and results of operations” in this document. For a more comprehensive list of the automotive industry policies and regulations, see “Regulatory Overview” in this document.

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In addition to the development of the economy, the growth in urbanization and increased disposable income, the above policies directly encouraged, and some continue to encourage, the purchase and usage of PVs and LCVs in China. According to the China Association of Automobile Manufacturers, from 2007 to 2011, the unit sales of PVs and LCVs in China experienced a significant increase from an aggregate of 7.9 million units in 2007 to 17.1 million units in 2011. The following chart illustrates the unit sales of PVs and LCVs and overall automotive unit sales in China from 2007 to 2011:

**Unit sales of PVs and LCVs, and overall automotive unit sales
in China from 2007 to 2011**



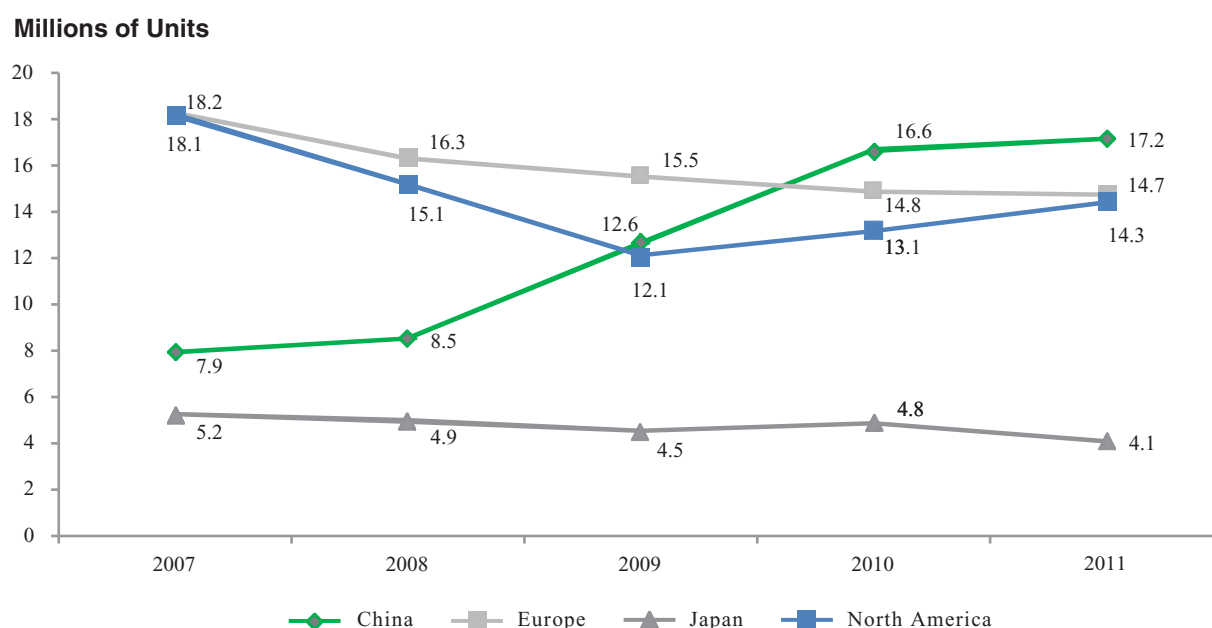
Source: China Association of Automobile Manufacturers; Frost & Sullivan Report

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Development and growth of the PV and LCV market in China

According to the Frost & Sullivan Report, the automotive industry in North America, Europe and Japan contracted during 2008 and 2009 and rebounded slightly in 2010. The worldwide economic slump led to a downturn in global automotive production, except in China. China is the only major PV producing country which experienced positive growth in the production volume of PVs in 2009, and continued to grow and outperform North America, Europe and Japan. In 2010, China overtook Europe to become the largest PV and LCV market in the world. The annual unit sales of PVs and LCVs in China increased by approximately 9.3 million units or approximately 117.7% from 2007 to 2011. The following chart illustrates the PV and LCV unit sales in China, Europe, Japan and North America from 2007 to 2011:

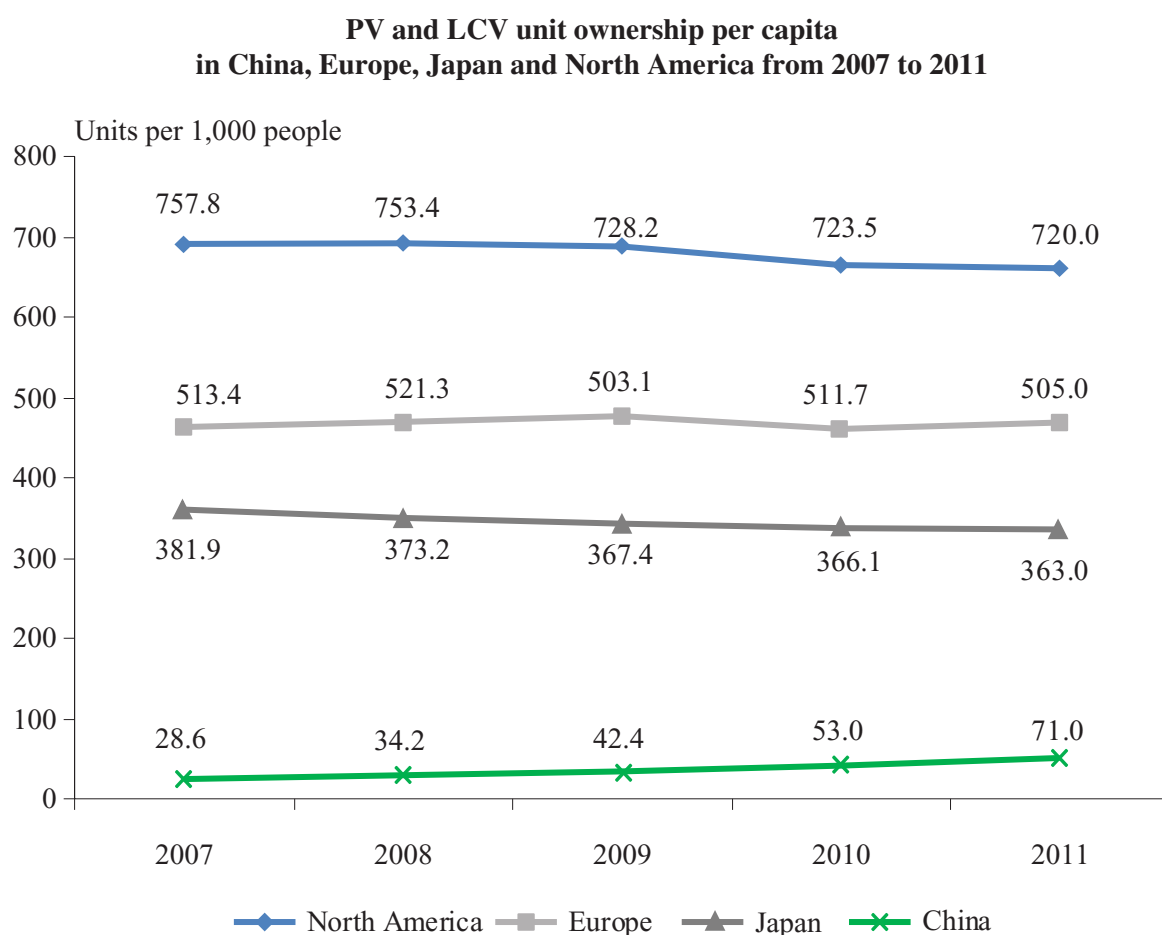
**PV and LCV unit sales in China, Europe, Japan and North America
from 2007 to 2011**



Source: Ministry of Land, Infrastructure, Transport and Tourism of Japan; European Automobile Manufacturers' Association; US Bureau of Transit Statistics; China Association of Automobile Manufacturers; Frost & Sullivan Report

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According to the Frost & Sullivan Report, despite the unit sales growth of PVs and LCVs in China since 2008, the PV and LCV unit ownership per capita ratio in China is far behind that of North America, Europe and Japan. In 2011, the PV and LCV unit ownership per capita in China was approximately 10.1 times, 7.1 times and 5.1 times less than that for North America, Europe and Japan, respectively, which indicates the potential for continued growth of China’s PV and LCV market. The following chart illustrates the PV and LCV unit ownership per capita in China, Europe, Japan and North America from 2007 to 2011:

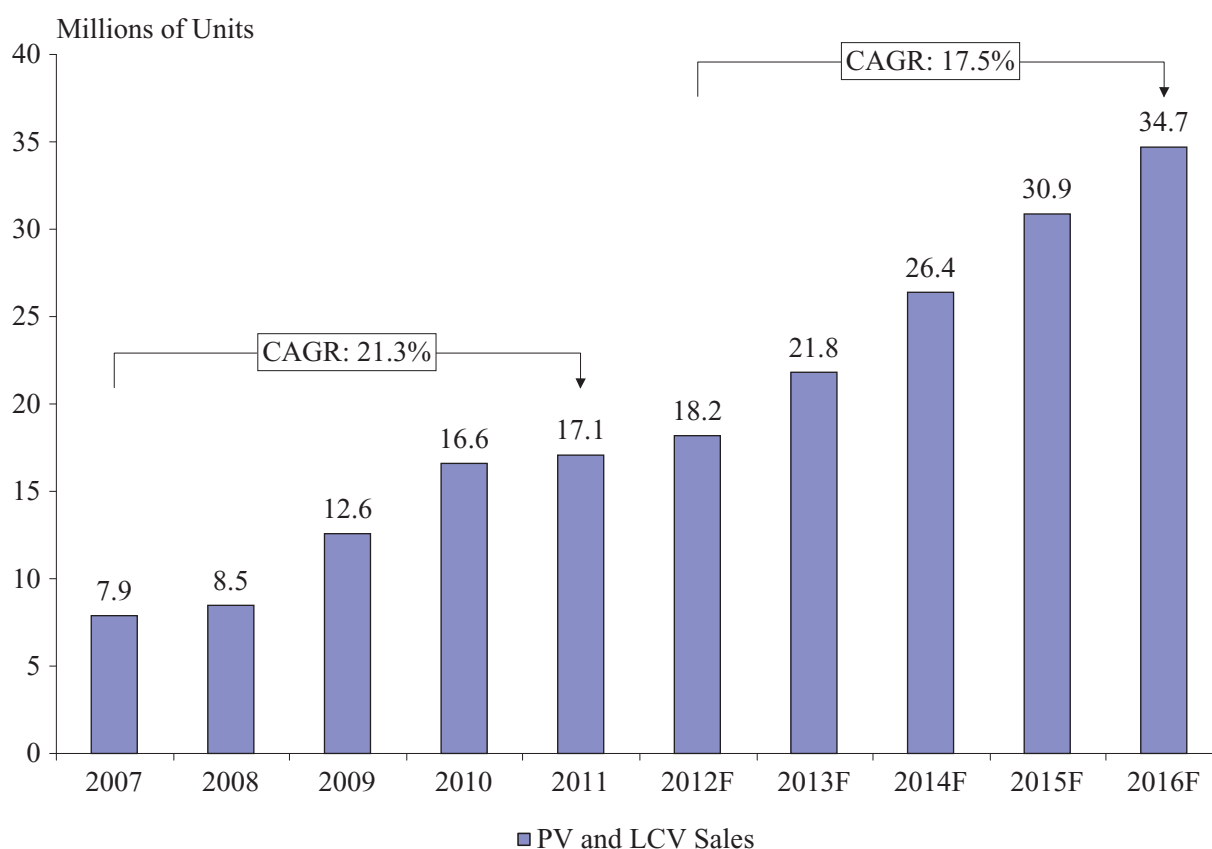


Source: Ministry of Land, Infrastructure, Transport and Tourism of Japan; European Automobile Manufacturers' Association; US Bureau of Transit Statistics; China Association of Automobile Manufacturers; Frost & Sullivan Report

INDUSTRY OVERVIEW

According to the Frost & Sullivan Report, the PV and LCV sales volume in China experienced rapid growth from 2007 to 2011. In particular, the PV and LCV sales volume increased by 48.2% from 2008 to 2009 and by 31.7% from 2009 to 2010. These growth rates were primarily driven by PRC Government initiatives implemented in 2008, including a RMB4 trillion investment plan to stimulate the slowed economy in China and a package of stimulating policies to encourage the consumption of vehicles. However, these policies also encouraged advanced consumption, which combined with the slowed global economy in 2011, contributed to slower growth in 2011. Beyond 2011, the growth of the Chinese PV and LCV market is expected to continue and annual sales are projected to reach approximately 34.7 million units in 2016. The following chart illustrates the historical sales volume of PVs and LCVs in China from 2007 to 2011 and its forecast from 2012 to 2016:

**Historical and forecast PV and LCV sales
in China from 2007 to 2016**



Source: China Association of Automobile Manufacturers (as to historical figures); Frost & Sullivan Report (as to forecasted figures)

The PRC PV Market Landscape

According to the Frost & Sullivan Report, out of the 17.1 million units of PVs and LCVs sold in China in 2011, 14.5 million units or 84.8%, were PVs. The PRC PV market is relatively consolidated, with the top 20 PV manufacturers accounting for 81.2% of the total PV market in terms of sales volume in 2011. Among the PV manufacturers, the local OEM segment accounted for 30.2% of the total PV

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market and the foreign-invested OEM segment accounted for 69.8% of the total PV market in terms of sales volume in 2011. In the local OEM segment of the PV market in China, where the OEMs are local automotive manufacturers without foreign shareholders, the top 10 PV manufacturers accounted for 77.6% of the total local OEM segment of the PV market in terms of sales volume in 2011 in China. Brilliance China Group accounted for 4.5% of the total local OEM segment of the PV market and ranked eighth in terms of sales volume in 2011.

OVERVIEW OF THE PRC PV AND LCV ENGINE MARKET

Independent vs. captive brand engine suppliers

Suppliers of engines to automotive manufacturers can be classified as either independent or captive brands. Independent branded engine suppliers are characterized by their ability to supply unaffiliated automotive manufacturers with engines that retain their own brand independent from the brand of the manufactured vehicle. Furthermore, their engines are designed to adapt to vehicles manufactured by different automotive manufacturers and they generally enjoy more freedom in pricing their engines based on various cost and market factors. Captive brand engine suppliers, on the other hand, generally provide their engines exclusively to affiliated automotive manufacturers, and their engines adopt the same brands as the automotive manufacturers. We are an independent branded engine manufacturer because we are able to supply engines to unaffiliated automotive manufacturers and our engines retain our “XCE 新晨動力” brand rather than the brands of the manufactured vehicles. Our customers include both local OEM and foreign-invested OEMs.

Drivers of the PV and LCV engine markets

According to the Frost & Sullivan Report, there are five major growth drivers of the PV and LCV engine markets in China:

- *The growth in sales of PVs and LCVs is expected to continue to drive the long term demand for engines.*

As mentioned above, China’s PV and LCV sales increased from approximately 7.9 million units in 2007 to 17.1 million units in 2011. The PV and LCV market is expected to maintain stable and strong growth in the coming five years, and annual sales are projected to reach approximately 34.7 million units in 2016. Accordingly, the demand for PV and LCV engines is expected to continue to increase.

- *Rising market share of local manufacturers of PVs encourages the development of local engine manufacturers.*

The market share of local manufacturers of PVs in China was 28.2% in 2007 and reached 30.2% in 2011. The development of local automotive manufacturers encourages the development of local engine manufacturers, since the local automotive manufacturers generally prefer to source engines from local engine manufacturers compared with global automotive manufacturers who generally prefer to source engines from their captive brand suppliers.

- *Solid and stable raw material supply secures the production of key engine parts.*

Aluminum and steel are major raw materials essential to the production of key engine parts, such as engine blocks, cylinder heads and pistons. The production of aluminum and steel reached approximately 22 million tonnes and 624 million tonnes, respectively, in China in 2011. In particular, the production of aluminum in China accounted for

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approximately 44% of global production in 2011. A solid and stable supply of raw material supports the production of key engine parts.

- *The demand from the international market is expected to increase.*

Compared with engines manufactured in developed markets, such as Japan and the U.S., engines manufactured by Chinese engine manufacturers can be manufactured at a lower cost, which could influence more OEMs to source engines from qualified engine manufacturers in the PRC.

- *The local engine manufacturers are keen to improve their technology.*

Driven by higher emission standards issued by the PRC Government and the technical requirements raised by the OEMs, local engine manufacturers need to upgrade their technology through, for example, in-house research and development and external cooperation with overseas automotive manufacturers. Enhanced technologies are expected to better enable them to capture opportunities to enter the supply chains of OEMs in the PRC and overseas markets.

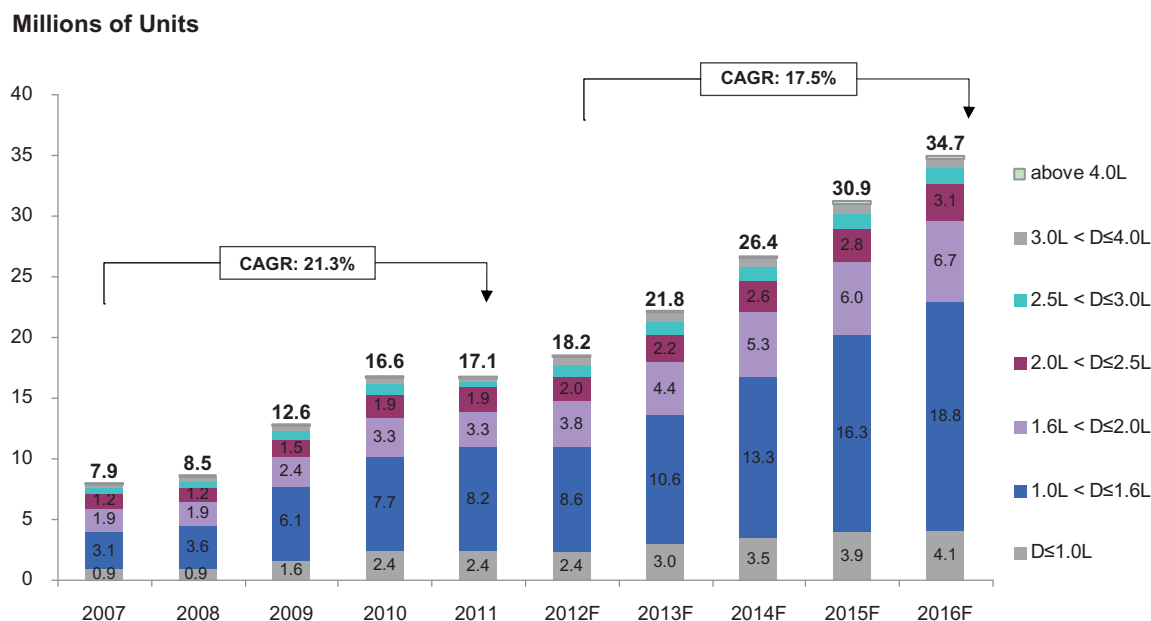
With the above key market drivers, sales of PV and LCV engines in China have increased significantly during recent years. The sales volumes of PV and LCV engines in China were consistent with the sales volumes of PVs and LCVs over the same period, as the replacement volumes and second-hand market sales volumes are negligible, according to the Frost & Sullivan Report.

For a discussion of the risks and uncertainties relating to the PRC automotive and automotive engine industries, see “Risk Factors — Risks Relating to Our Industry”.

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According to the Frost & Sullivan Report, among the different displacement ranges of PV and LCV engines, engines with a displacement range from 1.0L to 1.6L presented the strongest growth in China during the years 2007 to 2011, followed by engines with a displacement range of less than 1.0L. The following chart illustrates the market trend of the PV and LCV engine market in China by displacement range from 2007 to 2011 and its forecast from 2012 to 2016:

Historical and forecasted market trend of the PV and LCV engine market in China by displacement range from 2007 to 2016



Source: China Association of Automobile Manufacturers (as to historical figures); Frost & Sullivan Report (as to forecasted figures)

Growth trends of gasoline and diesel engines in China

Gasoline and diesel are the most common fuel types for PV and LCV engines. In general, the main differences between gasoline and diesel engine are ignition, compression ratios and fuel delivery.

- A gasoline engine intakes a mixture of gas and air, compresses it and ignites the mixture with a spark, while a diesel engine intakes just air, compresses it and injects fuel into the compressed air. The heat of the compressed air lights the diesel fuel spontaneously.
- A gasoline engine compresses at a ratio of 8:1 to 12:1, while a diesel engine compresses at a ratio of 14:1 to as high as 25:1. The higher compression ratio of the diesel engine results in better fuel efficiency.
- A gasoline engine uses either a carburetor or a fuel injection system to deliver the fuel to the cylinder, while a diesel engine uses direct fuel injection, which means a diesel engine has no spark plug. As such, a diesel engine usually has a simplified fuel injection system structure, which allows it to have a comparatively longer service life than gasoline engine.

Based on existing technologies, the thermal efficiency, measured by how much energy is converted from thermal to kinetic form during the process of fuel burning in engine cylinders, of a diesel engine

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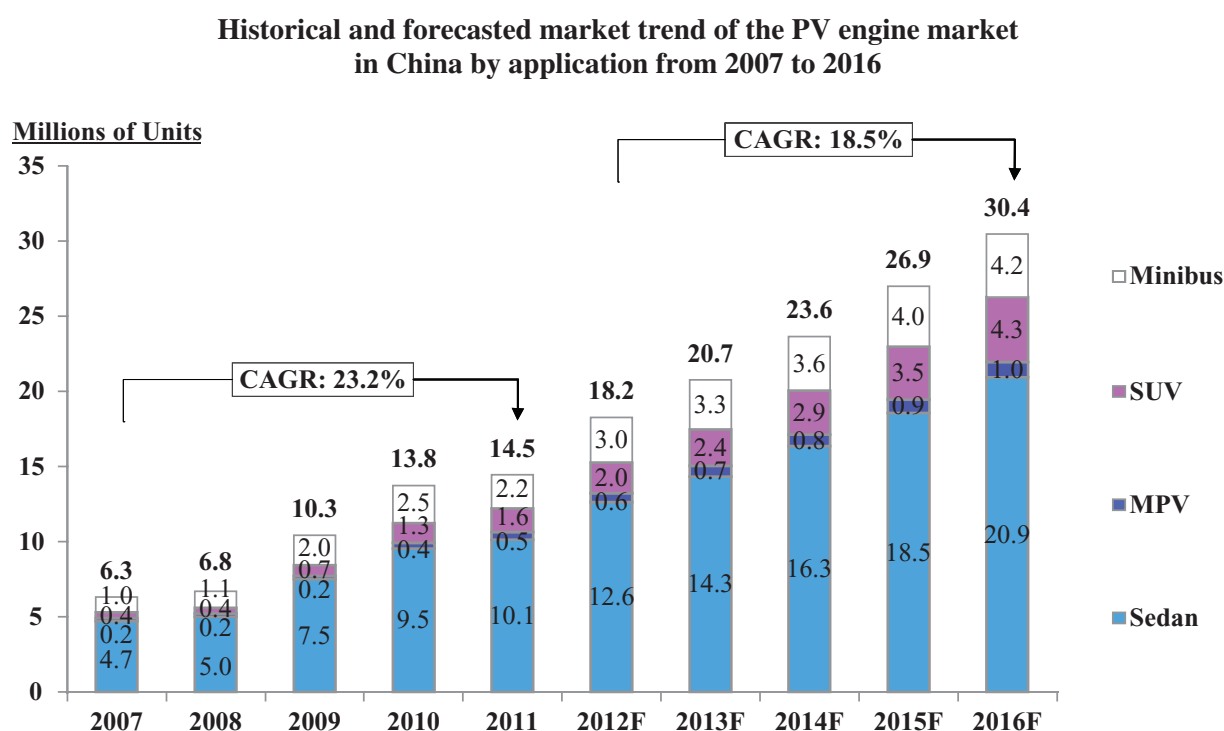
is better than that of a gasoline engine. However, the main disadvantage of the diesel engine is the higher cost for the treatment of particulate and nitrogen oxide emissions and the PRC market often faces a shortage in the supply of diesel. On the other hand, both the OEMs and engine suppliers have launched mature and low cost technologies for gasoline engine emission treatment and the PRC market has a relatively abundant supply of gasoline.

Several factors expected to influence the growth of gasoline and diesel engine sales in China include:

- the price and the supply of gasoline and diesel fuel;
- the innovation and improvement of thermal efficiency for gasoline engines; and
- the cost reduction of the diesel engine emission treatment system.

According to the Frost & Sullivan Report, since 2007, gasoline engines sales in China had a higher growth rate as compared with diesel engines and such trend is expected to continue through 2016. The unit sales of gasoline engines in China increased at a CAGR of 22.0% from 2007 to 2011, while those for diesel engines increased at a CAGR of 15.7% during the same period.

According to the Frost & Sullivan Report, among the different applications of PV engines in China, the engine market for SUVs presented the strongest growth between 2007 to 2011, and its growth is expected to remain the strongest through 2016. The slower growth from 2010 to 2011 is mainly due to the advanced consumption in year 2009 and 2010, which were primarily driven by PRC Government initiatives implemented in 2008, including a RMB4 trillion investment plan to stimulate the slowed economy in China and a package of stimulating policies to encourage the consumption of vehicles. The following chart illustrates the market trend of the PV engine market in China by application from 2007 to 2011, and its forecast from 2012 to 2016:

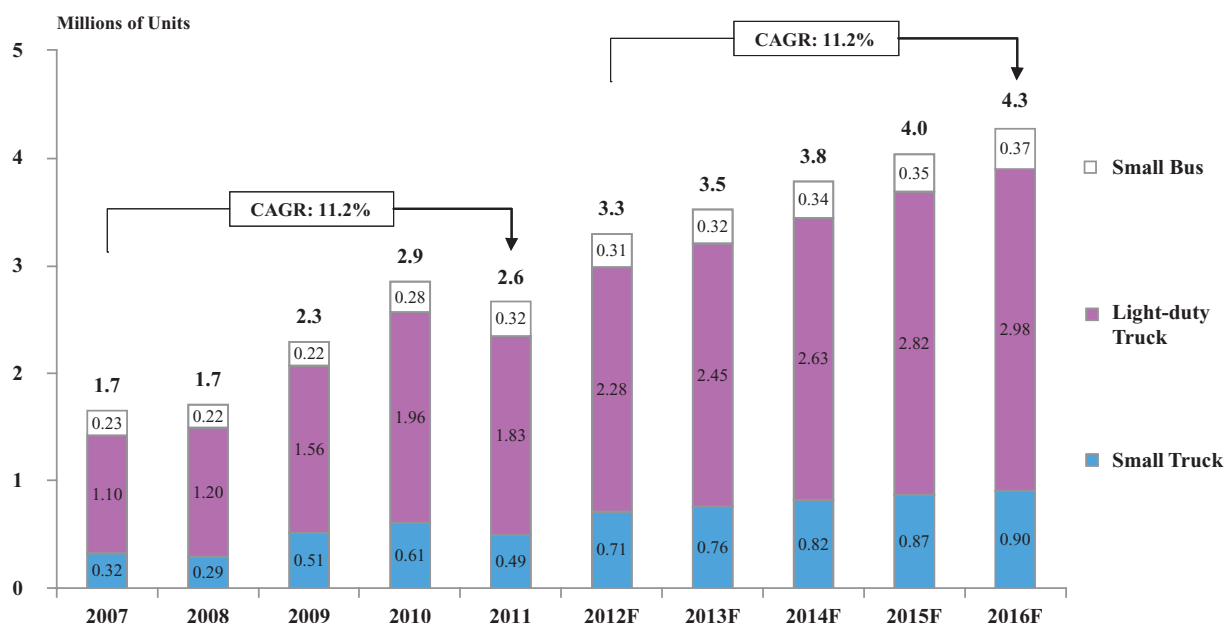


Source: China Association of Automobile Manufacturers (as to historical figures); Frost & Sullivan Report (as to forecasted figures)

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According to the Frost & Sullivan Report, among the different applications of LCV engines in China, the engine market for light-duty truck presented the strongest growth between 2007 to 2011, and its growth is expected to remain stable through 2016. However, the total sales volume of the LCV engines decreased from 2.9 million units in 2010 to 2.6 million units in 2011. The following chart illustrates the trend of the LCV engine market by application in China from 2007 to 2011, and its forecast from 2012 to 2016:

Historical and forecasted market trend of the LCV engine market in China by application from 2007 to 2016



Source: China Association of Automobile Manufacturers (as to historical figures); Frost & Sullivan Report (as to forecasted figures)

Market trends in the PV and LCV engine markets in China

According to the Frost & Sullivan Report, the market trends in the PV and LCV engine markets in China include:

- *The development of low displacement engines*

The popularity of small vehicles in China encourages the production of engines with lower displacement volumes. Vehicles with engines with a displacement range from 1.0L to 1.6L presented the strongest growth during 2007 to 2011 in China, followed by vehicles with engines of the next segment from less than 1.0L. These two segments are expected to continue their strong growth and achieve approximately 21.5% and 14.1% CAGR, respectively, from 2012 to 2016.

- *Automotive engine manufacturers face pressure to improve fuel efficiency*

The automotive industry is engaged in efforts to shift towards developing more environmentally friendly products. The PRC Government has implemented several policies to prompt the development of new energy vehicles so as to lower the country's crude oil consumption. As a result, the traditional internal combustion engine-powered

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vehicles face pressure to improve fuel efficiency, which contributes to competitive pressure in the automotive engine manufacturing industry.

- *Stricter emission standards affect product development of automotive engines*

The PRC Government has accelerated steps of introducing the next phase of emission standards for PVs, requiring engine manufacturers to meet much stricter requirements. It is expected that additional policies on emission standards will be introduced into the market in the near future, leading to necessary technology upgrades for automotive engine manufacturers and affecting their product development plans.

- *Engine prices may decrease in the next few years*

In general, engine prices may decrease in the next few years mainly due to the following reasons: (i) as advanced engine technologies become widely adopted over time, the premium in engine prices caused by the adoption of advanced technologies may gradually disappear; (ii) automotive manufacturers generally demand their engine suppliers to lower the engine prices as part of their own effort of cost control; and (iii) competition between the engine suppliers also causes them to lower the engine prices to stay competitive.

THE COMPETITIVE LANDSCAPE IN THE PRC PV AND LCV ENGINE MARKET

Barriers to entry

According to the Frost & Sullivan Report, the entry barriers for the engine markets in China include:

- *Technology requirements*

The engine is the key component of an automobile. Engine and component suppliers are expected to have strong research and development capabilities in order to enhance the power output, improve fuel efficiency and ensure that their products comply with the increasingly strict emission standards.

- *Equipment requirements*

The manufacturers of automotive engines provide both the equipment for production and product testing. During the research and development period, these manufacturers generally need to conduct around ten product tests for each of their engines and components. Accordingly, the adequacy of the manufacturers' equipment is essential to the operation of their businesses.

- *Quality certification requirements*

Automotive manufacturers usually require engine suppliers to pass certain quality certification standards such as QS9000, VDA6.1 and TS16949, which are awarded by independent third parties. In addition, engine suppliers are normally required to pass quality tests set by the automotive manufacturers. It usually takes around 18 months for an engine supplier to complete the relevant approval process of the automotive manufacturers, after which the supplier would then be listed in the suppliers list of the automotive manufacturers.

- *Customer base*

Most of the automotive manufacturers can manufacture the engines by themselves, primarily due to the fact that the engine is one of the most important components of a

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vehicle. Hence, automotive manufacturers generally have limited demand for outsourcing engines from independent branded engine manufacturers. As a result, it is difficult for a new entrant to establish a customer base and business relationship as an independent branded engine manufacturer.

- *Economies of scale*

Engine manufacturing business is capital intensive. Engine manufacturers need to mass produce to achieve economies of scale in order to lower per unit production costs and to remain competitive. It is hard for a new market entrant, especially independent branded engine manufacturers, to establish scalable production and to achieve economies of scale.

Engine classification

The classification of engines installed on a particular model of vehicle as premium, middle or basic edition can be determined with reference to a combination of various factors including the technology employed, quality of components, raw materials, displacement range and brand awareness. For example, premium edition of an engine, in contrast to basic edition of that engine, is more likely to be made of aluminum rather than iron, uses imported components rather than domestic produced components, employ advance technologies rather than traditional technologies and has a better brand name recognition.

Most of the engine manufacturers have the capability to manufacture a range of engines for a particular vehicle model, from basic to premium editions. However, some of them strategize to focus on manufacturing only premium or basic edition engines, based on their competitive advantages. For example, manufacturers of luxury cars like Mercedes-Benz are more likely to focus on premium engines only, while local independent engine manufacturers tend to focus on middle and basic edition engines.

Engine supplier selection process and criteria

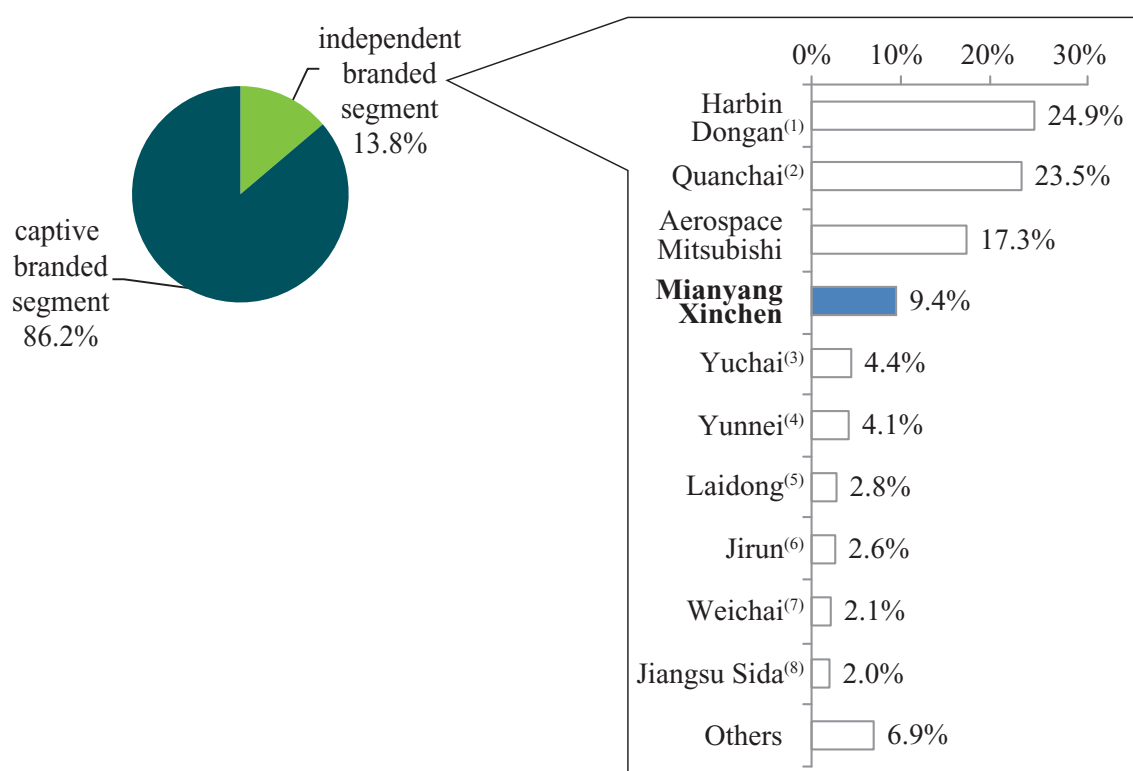
According to the Frost & Sullivan Report, typically, during the product development process, the research and development department of an automotive manufacturer will design a vehicle model based on its market positioning strategy and evaluation of the cost structure and functions of the new model. Afterwards, the production planning department will then evaluate the proposals for cost structure made by the research and development department, and together with the procurement department, identify potential suppliers from different pools of suitable system and parts suppliers based on certain criteria, including manufacturing cost, market positioning and final product pricing. As a result, an automotive manufacturer may have different engine supplier pools for the basic edition and premium edition of one automotive series and it will not invite bidding from engine suppliers from different pools at the same time. As such, even within the same displacement range and supplying to the same automotive manufacturers, two engine suppliers may not form direct competition against each other due to the fact that they belong to different pools of suitable engine suppliers.

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Competitive landscape

According to the Frost & Sullivan Report, captive brands accounted for approximately 86.2% of the PV and LCV engine market in China in 2011 in terms of sales volume, while independent brands accounted for the remaining approximately 13.8% of this market. The following chart illustrates the estimated share in terms of sales volume in 2011 of the PV and LCV engine market in China by engine manufacturers:

Market shares of independent branded manufacturers in the overall PV and LCV engine market in China in 2011



Source: Frost & Sullivan Report

- (1) Harbin Dongan Auto Engine Co. Ltd.* (哈爾濱東安汽車發動機製造有限公司)
- (2) Anhui Quanchai Engine Co., Ltd.* (安徽全柴動力股份有限公司)
- (3) Yuchai Machinery Co., Ltd.* (廣西玉柴機器股份有限公司)
- (4) Kunming Yunnei Power Co., Ltd.* (昆明雲內動力股份有限公司)
- (5) Shandong Huayuan Laidong Engine Co. Ltd.* (山東華源萊動內燃機有限公司)
- (6) Zhejiang Jirun Automobile Company Limited* (浙江吉潤汽車有限公司)
- (7) Weichai Power Co., Ltd.* (濰柴動力股份有限公司)
- (8) Jiangsu Sida Power Mechanical Group Co., Ltd.* (江蘇四達動力機械集團公司)

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The following table illustrates the market positions in terms of sales volume of the top five independent branded manufacturers in the overall PV and LCV engine market in China by displacement in 2011:

Market positions of top five independent branded manufacturers in the overall PV and LCV engine market in China by displacement range in 2011

Rank	D ≤ 1.0L	1.0L < D ≤ 1.6L	1.6L < D ≤ 2.0L	2.0L < D ≤ 2.5L	2.5L < D ≤ 3.0L	3.0L < D ≤ 4.0L	Above 4.0L
1	Harbin Dongan	Harbin Dongan	Aerospace Mitsubishi	Quanchai	Quanchai	Quanchai	Yuchai
2	Mianyang Xincheng	Aerospace Mitsubishi	Quanchai	Aerospace Mitsubishi	Yunnei	Yunnei	Quanchai
3	Jilin Liuji ⁽¹⁾	Mianyang Xincheng	Mianyang Xincheng	Mianyang Xincheng	Chengdu Chengfa ⁽³⁾	Weichai	Weichai
4	Quanchai	Laidong	Harbin Dongan	Yuchai	Yuchai	Deutz ⁽⁵⁾	Deutz
5	Shanxi Chenggong ⁽²⁾	Quanchai	Laidong	Jiangsu Sida	Changchai ⁽⁴⁾	Jiangsu Sida	/

Source: Frost & Sullivan Report

- (1) Jilin Chaofeng Liuji Engines Co., Ltd.* (吉林綽豐柳機內燃機有限公司)
(2) Shanxi Chenggong Huaihai Engine Co., Ltd.* (山西成功淮海發動機有限公司)
(3) Avic Chengdu Engine (Group) Co., LTD* (中航工業成都發動機(集團)有限公司)
(4) Changchai Co., Ltd.* (常柴股份有限公司)
(5) DEUTZ AG (道依茨公司*)

In 2011, Harbin Dongan led the independent branded engine market in the less than 1.6L displacement segment. Aerospace Mitsubishi led the market in the between 1.6L and 2.0L displacement segment, Quanchai led the market in the between 2.0L and 4.0L displacement segment, while Yuchai led the market in the above 4.0L displacement segment. According to the Frost & Sullivan Report, both Harbin Dongan and Aerospace Mitsubishi adopt imported technologies from other parties, hence Mianyang Xincheng was the largest independent branded engine manufacturer with in-house technology in the 1.0L-1.6L market segment in the PRC. In addition, because Quanchai, Yuchai, Laidong and Jiangsu Sida only offer diesel engines, Mianyang Xincheng was the largest engine manufacturer with both gasoline and diesel engine capabilities in the 2.0L-2.5L LCV market segment in the PRC.

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In relation to the performance of independent branded engine manufacturers by application, Mianyang Xincheng, Jilin Liuji and Quanchai ranked as the largest independent branded engine manufacturers in the small bus, small truck and light-duty truck segments in China in 2011, respectively. Further, Harbin Dongan ranked as the largest independent branded manufacturer in the sedan segment, while Aerospace Mitsubishi ranked as the largest independent branded manufacturer in the SUV, MPV and minibus segments in China in 2011. In particular, according to the Frost & Sullivan Report, Mianyang Xincheng is the largest engine manufacturer with independent in-house technology in the Sedan, SUV and MPV segments. The following table illustrates the market positions of the top independent branded manufacturers in the overall PV and LCV engine market by application in China in 2011:

Market positions of top five independent branded engine manufacturers in the overall PV and LCV engine market by application in China in 2011

Rank	Small Bus	Small Truck	Light-Duty Truck	Sedan	SUV	MPV	Minibus
1	Mianyang Xincheng	Jilin Liuji	Quanchai	Harbin Dongan	Aerospace Mitsubishi	Aerospace Mitsubishi	Aerospace Mitsubishi
2	Yuchai	Harbin Dongan	Yunnei	Aerospace Mitsubishi	Harbin Dongan	Harbin Dongan	Harbin Dongan
3	Aerospace Mitsubishi	Shenyang Xinguang Brilliance	Yuchai	Shenyang Xinguang Brilliance	Mianyang Xincheng	Shenyang Xinguang Brilliance	Mianyang Xincheng
4	Harbin Dongan	Laidong	Laidong	Mianyang Xincheng	Shenyang Xinguang Brilliance	Mianyang Xincheng	Shenyang Xinguang Brilliance
5	Shenyang Xinguang Brilliance	Shanxi Chenggong	Jiangsu Sida	Tritec Engine ⁽¹⁾	Yunnei	Yunnei	Shanxi Huaihai ⁽²⁾

Source: Frost & Sullivan Report

(1) Tritec Motors Ltd

(2) Shanxi Chenggong Huaihai Machinery & Electric Co., Ltd.* (山西淮海機電有限責任公司)

REGULATORY OVERVIEW

REGULATIONS

Our operations are mainly carried out by our subsidiary in the PRC, which is subject to PRC laws, rules and regulations. A summary of the PRC laws, rules and regulations applicable to our business is set out below.

Regulations and Policies Relating to Automotive Industry

The Policy on Automotive Industry Development (《汽車產業發展政策》)

On May 21, 2004, the NDRC promulgated the Policy on Automotive Industry Development (《汽車產業發展政策》) (the “Policy”), which replaced the old automotive industry development policy issued in 1994, as an overall guideline for the automotive industry (including the engines industry and the automotive components and parts industry) in China. The Policy contains provisions relating to, among other things, the PRC automotive industry’s technology policies, structural adjustments, market access administration, trademarks, product development, spare parts sales and other relevant sub-industries, distribution networks, investment administration, import administration, and automotive consumption. One of the Policy’s stated aims is to develop the PRC automotive industry into a strong pillar of the PRC national economy.

According to the Policy, China encourages OEMs to further specialize in production and gradually change their internal parts manufacturing units into independent and specialized parts and components manufacturing enterprises.

According to the Policy, China supports engine manufacturers and automotive parts and component manufacturers in establishing product research institutions to form innovative and self-development capabilities. Investment amount in the construction of research facilities of self-development products shall be tax-deductible as long as such investment complies with the relevant tax provisions on promotion of enterprise technological progress and China continues to support large automotive parts and components manufacturers to develop parts and components assembly with proprietary intellectual property and at an advanced level.

According to the Policy, China encourages the automotive industry — in combination with the requirements of the strategy of state energy source structural adjustment and emission standards — to conduct research and industrialize new types of power, such as electric cars, batteries used to power vehicles, and focus on the development of hybrid vehicle technology and diesel engine technology. China will take measures in scientific and technological research, technological transformation, industrialization of new technologies and promoting the production and use of hybrid vehicles.

According to the Policy, enterprises that produce engines, components and parts shall register the self-owned trademarks of the commodities and services of their enterprises, in accordance with the PRC Trademark Law (《中華人民共和國商標法》). The state encourages enterprises to plan for the development and protection of brands, and to make efforts to implement brand-operation strategies.

The Restructuring and Rejuvenation Programme of the Automotive Industry (《汽車產業調整和振興規劃》)

On March 20, 2009, the State Council issued the Restructuring and Rejuvenation Programme of the Automotive Industry (《汽車產業調整和振興規劃》) (the “Programme”), which specifies certain objectives, policies and measures in relation to the automotive industry.

One of the objectives the Programme provided is to boost the restructuring of the automotive industry. The key automotive parts and components manufacturers are encouraged to expand their scale through

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merger, acquisition and reorganization, and to increase their market share in the domestic and overseas markets.

According to the Programme, China will make more investments in technological progress and innovation to develop key parts and assemblies which will fill domestic vacancies, build platforms for research, development and testing of common technologies of automobiles and spare parts, as well as develop new-energy automobiles and special spare parts. Particularly, China aims at achieving the realization of technological independence of key spare parts in engine, transmission, steering system, braking system, drive train system, suspension system and vehicle bus control system, and urges technologies of special spare parts of new-energy automobiles reaching international advanced level. China will provide support on the industrialization of power modules of new-energy automobiles, the upgrade of technologies of internal combustion engines, the industrialisation of advanced transmission, the industrialisation of key spare parts, and the establishment of independent public testing agencies and automotive key spare part technology centers featured in the organic integration of "production, education and research".

Other Provisions Regarding Automobiles

On June 28, 2012, the State Council issued the Plan for the Development of Energy-saving and New Energy Automotive Industry (2012-2020) (《節能與新能源汽車產業發展規劃 (2012-2020)》), pure electric driving force shall be regarded as the main strategic direction for the development of new energy automobiles and the transformation of the automotive industry. At present, China will focus on the promotion of pure electric driving automobiles and plug-in hybrid automobiles, and popularize non-plug-in hybrid automobiles and automobiles with energy-saving internal combustion engine to improve the overall technical proficiency of China's automotive industry.

According to the Automotive Trade Policies (《汽車貿易政策》) issued by MOFCOM on August 10, 2005, China encourages the trade of automotive components (including engine components) to develop into large scale, good brand and networked industry by way of franchise and chain operation. A supplier or dealer of automobiles or automotive components shall intensify the quality management and improve the product quality as well as service quality. No supplier or dealer of automobiles or automotive components may supply or sell any automotive component that fails to comply with the relevant laws, administrative regulations, compulsory standards and the requirements of compulsory product certification of the state. A supplier of automobiles or automotive parts shall inform the general public of the name list of franchised dealers of automotive parts whose accreditation has been granted or abolished on a periodic basis.

According to the China Technologies Category of Encouraged Import (《中國鼓勵引進技術目錄》) jointly formulated by MOFCOM and SAT on December 18, 2006, China encourages enterprises to introduce foreign advanced and applicable technologies into China, such as the design technology, developing technology and product technology in relation to advanced engines.

On February 23, 2012, MOFCOM issued the 12th Five-year Development Plan of Import & Export Electrical and High-tech Products (《機電和高新技術產品進出口 "十二五" 發展規劃》), providing that China will actively promote bilateral mutual recognition of results of test on automotive products and strengthen the construction of the national export bases for automotive vehicles and components. According to the Plan, automobile was listed as one of the key industries and the enterprises in key industries are encouraged to establish and improve the overseas marketing and sale service network.

In addition, enterprises which engage in manufacturing special vehicles and trailers within the territory of the PRC for domestic use and special vehicle products manufactured thereby shall be in compliance

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with the provisions of Administrative Rules on the Entry of Special Vehicle & Trailer Manufacturers and Products (《專用汽車和掛車生產企業及產品准入管理規則》) promulgated by the MIIT on June 18, 2009.

According to the Provisions on the Registration of Motor Vehicles (《機動車登記規定》) issued on April 30, 2004 and revised on May 27, 2008 by the Ministry of Public Security and other related laws and regulations, China practices the system of motor vehicle registration. All motor vehicles shall be registered with the traffic administration department of the public security authorities before they can be driven on roads.

In addition, China has adopted a number of national and local regulatory measures regulating motor vehicles and drivers, including but not limited to the Highway Law of the PRC (《中華人民共和國公路法》), the Law of Road Traffic Safety of the PRC (《中華人民共和國道路交通安全法》), and the Administrative Rules on Highway Driving of Overloading Vehicle (《超限運輸車輛行駛公路管理規定》).

Regulations Relating to Project Initiation Approvals

The General Approval Procedures for Engine Manufacturing Projects

The investment project regarding engine manufacturing shall be either subject to the filing with or the approval from relevant authorities. According to the Policy, existing vehicle-use engines manufacturing enterprises, that wish (i) to enlarge the throughput of the existing products using the funds raised by themselves, and (ii) to increase varieties of the products, including establishing production entities without legal person status that undertake the production of the same class of products in a different place, shall be filed with NDRC by the provincial departments of investment administration or by the enterprise groups separately listed under the State planning (計劃單列企業集團). In addition, pursuant to the Circular on Strengthening the Administration of Record-filing of Investment Projects of Vehicle Manufacturers (《關於加強汽車生產企業投資項目備案管理的通知》) issued by the MIIT on March 12, 2009, such investment projects shall be filed with the MIIT by provincial commerce authorities, provincial development and reform authorities, other provincial authorities in charge of industries, or the enterprise groups separately listed under the State planning, or an enterprise directly affiliated to the Central Government (中央直屬企業).

According to the Policy, an investment project purporting to establish a new vehicle-use engines manufacturing enterprise shall be reported to the NDRC for examination by the provincial departments of investment administration or by the enterprise groups separately listed under the State planning. Total investment in newly established vehicle-use engine enterprises shall be no less than RMB1.5 billion, among which the self-owned capital shall be no less than RMB500 million. Research and development institutions shall be established. The products shall meet the requirements of the increasingly improved mandatory requirements of state technical specification.

According to the Circular on Further Improving the Work of Examination and Approval of Foreign Investment (《關於進一步改進外商投資審批工作的通知》) issued by MOFCOM on March 5, 2009, where an existing foreign-invested enterprise with investment in the production enterprises of automobiles and vehicle engines increases investment for expansion of the production capacity of similar products and increase of varieties (including newly-established non-corporate production units of similar products in other places), it shall be subject to the examination and approval of the local competent commerce authority. Before the local competent commerce authority approves it, the relevant departments of the local people's government shall complete the examination and approval process of the project or the filing procedure.

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Approval of Foreign-invested Projects

The Provisional Measures on the Administration of the Approval of Foreign-invested Projects (《外商投資項目核准暫行管理辦法》) was promulgated by the NDRC on October 9, 2004, which applies to the approval of Sino-foreign equity and cooperative joint venture enterprises, wholly foreign-owned enterprises, domestic enterprises acquired by foreign investors, increases in registered capital of foreign-invested enterprises and other types of foreign-invested projects, projects with total investment below US\$100 million that are within the encouraged or permitted categories of foreign investment, or projects with total investment below US\$50 million that are within the restricted category of foreign investment must be subject to the approval of local counterparts of the NDRC. Specifically, projects within the restricted category of foreign investment must be verified by provincial counterparts of the NDRC and no delegation of authority is permitted for these projects. A project applicant shall, pursuant to examination and approval documents of the NDRC, go through the formalities of applying for the processing of land use, municipal planning, quality supervision, work safety, resources utilization, registration (modification) of enterprise, capital project management, import of equipment and application of tax policies. Authorities in charge of land, urban planning, quality control, production safety supervision, industrial and commercial administration, customs, taxation and foreign exchange administration, among others, may refuse to carry out the approval formalities in respect of foreign-invested projects that have not been approved.

According to the State Council’s Opinions on Further Improving the Use of Foreign Investment (《國務院關於進一步做好利用外資工作的若干意見》) issued by the State Council on April 6, 2010, certain “Encouraged and Permitted Foreign Investment” projects with total investment (including capital increases) of US\$300 million or less are subject to approval by local governments, unless the approval by the relevant State Council departments is required under the List of the Government approved Investment Projects (《政府核准的投資項目目錄》). Pursuant to relevant laws, regulations and approvals, departments of the State Council may delegate approval of the establishment of certain foreign invested enterprises to local governments.

Catalogue of Industries for Guiding Foreign Investment (《外商投資產業指導目錄》)

According to the Catalogue of Industries for Guiding Foreign Investment (2007) (《外商投資產業指導目錄 (2007年修訂)》) promulgated jointly by the NDRC and MOFCOM on October 31, 2007, foreign investment in manufacture of engines of automobiles, manufacture of renewable engine, and establishment of institutes of engine research and development organization (including manufacture of petrol engine with a power of not less than 50kw per liter, diesel engine under 3L with a power of not less than 40kW per liter, and diesel engine above 3L with a power of not less than 40kW per liter, fuel cell and hybrid fuels, and other new energy engine) are classified under the “encouraged investment category”.

On December 24, 2011, the NDRC and MOFCOM jointly promulgated the Catalogue of Industries for Guiding Foreign Investment (2011) (《外商投資產業指導目錄 (2011年修訂)》), which became effective on January 30, 2012. The Catalogue of Industries for Guiding Foreign Investment (2011) revised the above industry under the “encouraged investment category” as “Manufacture of automobile engines and establishment of engine research and development institutions: gasoline engines with power of not less than 70 kW per liter, diesel engines with power of not less than 50 kW per liter and displacement of less than 3 liters, diesel engines with power of not less than 40 kW per liter and displacement of more than 3 liters, and engines using new energy resources such as fuel cells and mixed fuels”, and removed “Manufacture of complete automobiles (foreign investment less than 50%)” and “establishment of automobile research and development institutions” from the “encouraged investment category”, which now fall into the “permitted category” for foreign investment.

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PRC Regulations Relating to Engine Production

Production License

According to the Administrative Regulations of the People’s Republic of China on Production Licenses for Industrial Products (《中華人民共和國工業產品生產許可證管理條例》), which was promulgated by the No. 440 Order of the State Council on July 9, 2005 and came into force as of September 1, 2005, and the Measures for the Implementation of the Administrative Regulations of the People’s Republic of China on Production Licenses for Industrial Products (《中華人民共和國工業產品生產許可證管理條例實施辦法》), which was promulgated by the General Administration of Quality Supervision, Inspection and Quarantine and came into effect on November 1, 2005 and amended on April 21, 2010, internal combustion engines, such as diesel engines and universal gas engines, are placed in the “Catalogue of Implementation of Production License Management for Industrial Products (《實行生產許可證制度管理的產品目錄》). Any enterprise that has not obtained a production license for a product listed in such catalogue shall be prohibited from producing the relevant product. No entity or individual may sell or use in the course of business activities any product listed in the Catalogue for which it has not obtained a production license.

Where an enterprise produces any product listed in the aforesaid catalogue without applying for a production license in accordance with these regulations, the government department responsible for production licenses for industrial products shall order it to stop production, confiscate any illegally produced products, and fine the enterprise between one and three times the value of illegally produced products. Any illegal gains shall be confiscated and where the circumstances constitute a crime, criminal liability shall be pursued in accordance with the law.

Any enterprise that seeks to obtain a production license shall meet the following requirements: (i) have a business license; (ii) have professional and technical personnel required for the products it produces; (iii) have production, inspection and quarantine facilities suitable for the products it produces; (iv) have technical and technological documents relating to the products it produces; (v) established a sound and effective quality control system and a system of responsibilities; (vi) have products that comply with relevant national standards, industrial standards and requirements designed to ensure personal health and the safety of personnel and property; and (vii) in compliance with state industrial policy provisions and not be involved in activities such as the use of any outdated technique, high energy costs, pollution of the environment, or the wastage of resources, prohibited by state proclamation or in which investment is prohibited.

The period of validity of a production license shall be five years. During that period, enterprises shall ensure product quality consistency and conformity and submit periodic reports to the department responsible for production licenses for industrial products within the relevant province, autonomous region or municipality directly under the central government.

The State Council department responsible for production licenses for industrial products and the local departments responsible for production licenses for industrial products at or above the county level shall supervise and examine enterprises on a periodic or ad hoc basis. Where it is necessary to inspect a product, the relevant department shall carry out the inspection on the basis of the relevant provisions of the “PRC Law on Products Quality”.

“PRC Law on Products Quality” (《中華人民共和國產品質量法》)

According to the PRC Law on Products Quality (《中華人民共和國產品質量法》), which was passed on the 30th Session of the Standing Committee of the 7th National People’s Congress on February 22, 1993, revised by the 16th Session of the Standing Committee of the 9th National People’s Congress on July 8, 2000, and came into effect on September 1, 2000, producers and salespeople should establish a

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completed and internal management system for the product quality, strictly implement post-oriented quality regulations (崗位質量規範), quality liabilities stipulations and the corresponding measures for their assessment. Products should pass the quality assessment and those without passing the quality assessment should not pretend to have passed such assessment.

China encourages the use of scientific quality management and advanced scientific technology and promotes that the quality of products should reach and be above the industry standard, the state standard and the international standard.

China also carries out a quality accreditation system for enterprises according to the global quality management standard. Enterprises can apply, of their own will, for the quality certificate from the accreditation institutions that are approved by the quality supervision division of the State Council or approved by the division authorized by the quality supervision division of the State Council.

The quality of products should satisfy the following requirements: (i) no unreasonable risks of personal and property safety, and reaching the state standard and industry standard of securing personal health, personal safety and property safety (if any); (ii) have the functions that the products should have, except for the defect that have been explained; (iii) reach the standards that are stated on the products or its packing and meet the quality stated by product illustration and sample.

For the producers and salespeople who have violated the PRC Law on Products Quality, supervision division of quality technology can order them to cease their production and sale, forfeit the products that are illegally produced and sold, impose a fine on them, forfeit their gains from illegal operation and suspend their business license (as the case may be). If the violation is criminal, the producers and salesmen shall bear criminal responsibility.

In addition, according to the Provisions on the Administration of Recall of Defective Auto Products (《缺陷汽車產品召回管理規定》), jointly promulgated by the General Administration of Quality Supervision, Inspection and Quarantine, the NDRC, the MOFCOM and the General Administration of Customs on March 12, 2004, the manufacturers or importers of automotive products shall recall the defective automotive products they have produced or imported according to the provisions therein, and bear the expenses for eliminating the defects and the necessary transportation fees.

"Standardization Law of PRC" (《中華人民共和國標準化法》)

According to Standardization Law of PRC (《中華人民共和國標準化法》), which was passed on the 5th Session of the Standing Committee of the 7th National People's Congress on December 29, 1988 and came into effect on April 1, 1989, technical requirements for industry products, environmental protection and engineering constructions are required to meet the relevant national standards and trade standards of China. National standards and trade standards are divided into compulsory standards and recommendatory standards. Any entities and individuals that engage in scientific research, production and operation must strictly implement compulsory standards. The production, sale or import of any product that does not conform to compulsory standards shall be handled by the relevant administrative authorities in accordance with the Standardization Law. Where the Standardization Law is silent on such handling, the local SAIC may confiscate the products and any illegal income derived therefrom and impose a fine. In circumstances where serious consequences are incurred and the offence constitutes a crime, the liabilities for responsible personnel may be investigated and established in accordance with law. With respect to products for which national or trade standards have been formulated, enterprises may apply to the standardization administration department under the State Council for product quality certification.

Standards for the discharge of pollutants concerning environmental protection and standards for environmental quality are regulated as the compulsory standards. The compulsory standards we

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complied with include standards such as Technical Specification for No-board Diagnostic (OBD) System of Compression Ignition and Gas Fuelled Positive Ignition Engines of Vehicles (《車用壓燃式、氣體燃料點燃式發動機與汽車車載診斷 (OBD) 系統技術要求》) and Durability of Emission Control Systems of Compression Ignition and Gas Fuelled Positive Ignition Engines of Vehicles (《車用壓燃式、氣體燃料點燃式發動機與汽車排放控制系統耐久性技術要求》) both of which are issued by the Ministry of Environmental Protection of PRC.

In addition, according to the Procedures of the Ministry of Machinery Industry on the Administration of the Standardization of the Automotive Industry (《機械部關於汽車行業標準化管理辦法》) issued on January 16, 1996, where the recommendatory standards have been adopted by the enterprises, stipulated as a basis in the contracts or regulated by provisions of the governmental department as the compulsive obligations, these recommendatory standards will be enforceable within the enterprise between the parties of contracts or to the extent the said provisions provide.

The Production Safety Law of the PRC (《中華人民共和國安全生產法》)

According to the Production Safety Law of the PRC (《中華人民共和國安全生產法》), which was adopted at the 28th session of the Standing Committee of the 9th National People's Congress of the People's Republic of China on June 29, 2002 and amended on August 27, 2009, the State Administration of Work Safety (國家安全生產監督管理總局) is in charge of the overall administration of production safety. The production and business operation entities shall set up prominent safety warning marks at the production or business operation sites that have substantial dangerous elements or on the relevant facilities or equipments. The designing, manufacturing, installation, using, checking, maintenance, reforming and claiming as useless of safety equipments shall be in conformity with the national standards or industrial standards.

The safety facilities of the newly built or rebuilt or expanded engineering projects of the production and business operation entities (hereinafter referred to as construction projects as a general term) shall be designed, built and put into production and use at the same time as the principal part of the projects. The investment in safety facilities shall be included in the budgetary estimates of the construction projects concerned.

Regulations Relating to Foreign Investment

The M&A Provisions

The M&A Provisions issued by six PRC ministries provide the rules with which foreign investors must comply should they seek to purchase by agreement the equities of the shareholders of a domestic non-foreign-funded enterprise or subscribe to the increased capital of a domestic non-foreign-funded enterprise, and thus change the domestic non-foreign-funded enterprise into a foreign funded enterprise to conduct asset merger and acquisition. According to the M&A provisions, the foreign investors shall obtain approval from MOFCOM or its local counterpart at the provincial level when they acquire equity or assets of a PRC domestic enterprise. In case a foreign investor merges or acquires a domestic enterprise and obtains the actual right to control it, and in case it involves key industry, has or may have the influence on the state economic security or cause the transfer of the actual control of the domestic enterprise owning famous trademark or having a name of long history, the person concerned shall submit a report thereof to the MOFCOM. The [●] transaction abroad of the company with special purpose, which is defined by the provisions as an overseas company directly or indirectly controlled by a domestic company or a natural person for the purpose of making the equities of its actual owned domestic company to be listed abroad, shall be approved by the securities regulatory administration of the State Council.

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Circular No. 75

According to the Notice of the SAFE on Relevant Issues concerning Foreign Exchange Administration for Domestic Residents to Engage in Financing and in Return Investment via Overseas Special Purpose Companies (《國家外匯管理局關於境內居民通過境外特殊目的公司融資及返程投資外匯管理有關問題的通知》) (“Circular No. 75”), a PRC domestic resident shall, before establishing or controlling an overseas special purpose company (the “SPC”), bring the prescriptive materials to the local branch of SAFE (the “SAFE Branch”) to apply for going through the procedures for foreign exchange registration of overseas investments, SAFE Branch shall, after examining and checking the materials to the extent there is no mistake, affix the special seal for foreign exchange business for capital account transactions on the “Certificate of Foreign Exchange Registration of Overseas Investments” or the “Form of Foreign Exchange Registration of Overseas Investments of the Domestic Individual Resident”. Where a domestic resident contributes the assets or stock rights of a domestic enterprise it owns into a SPC, or engages in stock right financing abroad after contributing assets or stock rights into a SPC, it shall go through the procedures for modification of foreign exchange registration of overseas investments with regard to the net asset equities of the SPC it holds. After a SPC accomplishes overseas financing, the domestic resident may, according to the plan on use of funds as stated in the business plans or the document, transfer the funds which ought to be arranged for use inside PRC into PRC. A domestic resident may, after accomplishing the procedures for foreign exchange registration of overseas investments or for modification thereof in accordance with the legal provisions, pay the profits, dividends, liquidation expenses, stock right assignment expenses, capital decrease expenses, etc. to the SPC. Where a SPC meets with a major capital modification event such as capital increase or decrease, stock right assignment or exchange, merger or division, investment with long-term stock rights or credits, provision of guaranty to a foreign party, etc., and is not involved in return investment (the “Major Events”), the domestic resident shall, within 30 days as of the major event, apply to the SAFE Branch for going through the procedures for modification or filing of the foreign exchange registration of the overseas investment.

Regulations on Foreign Exchange

The Foreign Exchange Management Regulations (《外匯管理條例》) promulgated by the State Council on January 29, 1996 as amended on August 5, 2008, and the Regulations on the Administration of Foreign Exchange Settlement, Sale and Payment (《結匯、售匯及付匯管理規定》) promulgated by the People’s Bank of China on June 20, 1996 which became effective on July 1, 1996, apply and provide regulatory provisions to the foreign exchange transactions for foreign-invested enterprises. Foreign-invested enterprises are permitted to convert after-tax dividends into foreign exchange and to remit such foreign exchange from their bank accounts in PRC.

According to the Foreign Exchange Management Regulations, China will not impose any restrictions on international payments or transfers on current account. Foreign exchange payments from current account shall, in accordance with the regulations of the SAFE relating to foreign exchange payments and purchases, be made out of own foreign exchange funds on the strength of valid documents or be made with foreign exchange purchased from any financial institution engaged in foreign exchange settlement and sales business. Any foreign exchange income or payment from capital account shall subject to the approval of or registration with the SAFE. Where any guarantee is to be provided for an overseas purpose, an application shall be submitted to the relevant foreign exchange administrative authority which shall, in light of the assets, liabilities and other circumstances of the applicant, make a decision to approve or decline the application. Where state provisions require that the business scope of an applicant be approved by the relevant competent authority, the applicant shall go through the approval formalities before submitting an application to the relevant foreign exchange administrative authority. After entering into an overseas guarantee contract, an applicant shall make the appropriate

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registrations with the relevant foreign exchange administrative authority for the overseas guarantee contract.

In addition, according to the relevant PRC law and regulation, where a foreign-invested enterprise seek a loan from its overseas shareholder, it must apply to SAFE or local SAFE department for foreign loan registration certificates and foreign exchange settlements. The aggregate amount of such foreign loans must not exceed the margin between the total investment and registered capital of such foreign-invested enterprises multiplied by the rate of the foreign shareholders’ paid-in capital divided by their subscribed capital, and the foreign loans must be registered with the local SAFE department.

According to Notice 142 issued by the SAFE on August 29, 2008, a foreign-invested enterprise shall authorize an accounting firm to conduct capital verification before applying for the settlement of the foreign exchange capital. The settled foreign exchange capital shall be merely used for purposes within the business scope approved by the relevant PRC Government and shall not be used for equity investment unless specifically provided for otherwise. It is also prohibited to use the settled foreign exchange capital for purchasing domestic real estate for any purpose other than its own use, unless the enterprise is a foreign-invested real estate enterprise. In addition, the use of such settlement of foreign exchange under capital account of foreign-invested enterprises may not be changed without approval from SAFE, and may not be used to repay RMB loans if the proceeds of such loans have not yet been used.

Regulations Relating to Environment Protection

Environment Protection Law of the PRC (《中華人民共和國環境保護法》)

The Environmental Protection Law of the PRC (《中華人民共和國環境保護法》) promulgated on December 26, 1989 by the Standing Committee of the National People’s Congress and came into effect on the date of promulgation, establishes the legal framework for environmental protection in the PRC. The competent administrative department of environmental protection under the State Council shall supervise and manage environmental protection work throughout the country in a unified manner. The competent administrative departments of environmental protection of the local people’s governments at or above the county level shall supervise and manage environmental protection work within the respective areas under their jurisdiction in a unified manner. According to this law, entities that cause environmental pollution and other social harms are required to introduce environmental protection in their operation plan and establish an accountability system on environmental protection. Enterprises have to adopt effective measures to prevent and control the pollutions and harms by the exhaust gas, waste water, waste residue, dust, odor, radioactive substance, noise, vibration and electromagnetic wave radiation produced during the production and other activities.

Installations for the prevention and control of pollution in construction projects must be designed, built and commissioned together with the principal part of the project. Permission to commence production at or utilize any construction project shall not be granted until its installations for the prevention and control of pollution have been examined and confirmed to meet applicable standards by the competent administrative department of environmental protection that examined and approved the environmental impact statement.

Enterprises that discharge pollutants in their operation have to report and register according to the requirements of the environmental protection administrative competent division of the State Council. Enterprises that discharge pollutants exceeding the state or local standard of pollutant discharge have to pay the pollutant discharge fee for the additional discharge in accordance with the state requirements and be responsible for the remediation of the pollution.

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Environmental Impact Appraisal Law (《中華人民共和國環境影響評價法》)

The Environmental Impact Appraisal Law (《中華人民共和國環境影響評價法》) promulgated by the Standing Committee of the National People's Congress on October 28, 2002 which became effective on September 1, 2003, the Administration Rules on Environmental Protection of Construction Projects (《建設項目環境保護管理條例》) promulgated by the State Council on November 29, 1998 which became effective on November 29, 1998, and the Measures for the Administration of Examination and Approval of Environmental Protection Facilities of Construction Projects (《建設項目竣工環境保護驗收管理辦法》) promulgated by the State Environmental Protection Administration of China on December 27, 2001 which became effective on February 1, 2002, require enterprises planning construction projects which have impacts on the environment to engage qualified professionals to provide assessment reports on the environmental impact of such projects. The assessment report must be filed with, and approved by, the local environmental protection bureau, prior to commencement of any construction work.

Regulations on Administration of Collection and Use of Pollutant Discharge Fees (《排污費徵收使用管理條例》)

In accordance with the Regulations on Administration of Collection and Use of Pollutant Discharge Fees (《排污費徵收使用管理條例》) promulgated by the State Council on January 2, 2003 and effective as of July 1, 2003, as well as Administrative Measures for Pollutant Discharge Fee Imposition Standards (《排污費徵收標準管理辦法》) jointly promulgated by the NDRC, MOF, the State Environmental Protection Administration of PRC, and the State Economic and Trade Commission of PRC on February 28, 2003, any entity which directly discharges the pollutants to the environment shall pay a fee for discharge in accordance with law. Types and amounts of discharge fees shall be verified by the environmental protection administration of the local people's government above county level as per the verification authority specified by State Environmental Protection Administration of China, and shall be communicated to the entities discharging the pollutants.

Law of PRC on the Prevention and Control of Atmospheric Pollution (《中華人民共和國大氣污染防治法》)

According to the Law of PRC on the Prevention and Control of Atmospheric Pollution (《中華人民共和國大氣污染防治法》), which was adopted on September 5, 1987, first revised on August 29, 1995, second revised on April 29, 2000, and came into effect on September 1, 2000), the projects under establishment, expansion and reconstruction that discharge atmospheric pollutants have to comply with the state environmental protection administrative requirements relating to construction projects. Enterprises that discharge polluted gas should report to the environmental protection administrative competent division in the place where the enterprises are located for their equipments that discharge pollutants, the facilities that dispose pollutants, and the type, amount and concentration of the pollutants under their ordinary operation. Enterprises are also required to provide the related technology information about the prevention and control of atmospheric pollution. The concentration of the pollutants must not exceed the state and local standard of discharge.

Enterprises should also apply a clean production process that has a high utilization rate of energy and low pollutant discharge, and reduce the production of pollutants.

Cleaner Production Promotion Law (《中華人民共和國清潔生產促進法》)

According to the Cleaner Production Promotion Law (《中華人民共和國清潔生產促進法》), which was promulgated by the 28th Session of the Standing Committee of the 9th National People's Congress on June 29, 2002, and came into effect on January 1, 2003, as amended on February 29, 2012 the purchase and use of recycled products that are beneficial to the environmental and resource protection are

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encouraged as a priority. This law also encourages the use of technology and equipment with a high utilization rate of resources and which cause less pollutant and the displacement of technology and equipment with a low utilization rate of resources and which cause more pollutant. This law also encourages the integrated and recurring use of the waste materials produced during the production process. The law also requires enterprises to recycle and reuse wastes that are produced during the production process whenever economically and technologically feasible or to transfer the wastes to other enterprises or individuals that have such economic and technological conditions.

If the pollutant discharge is in excess of the state and local standard of discharge or exceeds the control standard of total pollutant discharge required by the local government, the enterprises should examine the clean production process.

Measures on Supervision of Exhaust Pollution from Automotives (《汽車排氣污染監督管理辦法》)

According to the Measures on Supervision of Exhaust Pollution from Automotives (《汽車排氣污染監督管理辦法》) which was jointly promulgated by the Ministry of Public Security, Ministry of Communications, State Import and Export Commodity Inspection Bureau, People's Liberation Army General Logistics Department, China Automobile Industry Corporation and State Environmental Protection Administration of PRC on August 15, 1990, all individuals and entities, who produce, modify, use, and repair imported automotives or engines, must implement these measures.

Administrative of production of automotives and their engines must put the emission pollution index of the automotives and their engines as one of product quality indexes. Enterprises producing automotives and their engines must be equipped with necessary facilities of testing the emission pollution, and examining section of the enterprise shall, in accordance with the standard, conduct strict inspection of products leaving the factory, and products failing to meet national standards shall not be allowed to leave the factory.

The finalized design of new automotives and their engines (not including those re-assembled new automotives adopting the set automotive chassis) must include emission pollution index, and related materials shall be submitted to the department administrating the enterprise and in charge of environmental protection administration in the province, autonomous region or municipality for record. Emission of automotives and their engines shall be sampled and tested by inspecting and examining institutions approved by administrative departments of the environmental protection of provinces, autonomous regions and municipalities. The time of sampling and testing shall not be more than once each quarter, and less than twice each year. Products failing to meet the national emission standard must not be allowed to leave the factory. Enterprises whose automotive and engine products fail to meet or fail to meet stably the national emission standard shall be ordered to meet the national standard stably within a limited time.

The Technical Policy for the Recovery of Automotive Products (《汽車產品回收利用技術政策》)

According to the Technical Policy for the Recovery of Automotive Products (《汽車產品回收利用技術政策》), which was announced by the NDRC, the MST and the State Environmental Protection Administration on February 6, 2006, in the design and production of any automotive product to be sold in China, the dismantlability and easiness of dismantlement after the discarding of the product shall be taken into full consideration, and the principle of being easy to sort out different kinds of materials shall be followed. Priority shall be given to the adoption of technologies and techniques that can utilize the resources in a highly efficient manner, produce little pollutants, and are conducive to the recovery of the product after discarding. The level of technologies for the design and production of automotive products shall be enhanced. A supporting enterprise of automotive components shall provide the

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automotive production enterprises with the composition, structural design or dismantlement guide, content and nature of the harmful substances, methods for the disposal of wastes, and other information relevant to the components it supplies so as to help the complete automotive production enterprises calculate the recoverability rate of their respective products.

Taxation Laws and Regulations

PRC Enterprise Income Tax Law

Prior to January 1, 2008, foreign-invested enterprises paid enterprise income tax pursuant to the Foreign-Invested Enterprise and Foreign Enterprise Income Tax Law of the PRC (《中華人民共和國外商投資企業和外國企業所得稅法》) promulgated by the Standing Committee of National People’s Congress in 1991 (“Prior EIT Law”) and related implementation regulations. Pursuant to the Prior EIT Law, except for the preferential tax rates, a foreign-invested enterprise was subject to enterprise income tax at a statutory rate of 33%. In addition, certain foreign-invested enterprises were exempted from enterprise income tax for two years starting from the first profit-making year and followed by a fifty percent reduction of the enterprise income tax in the next three consecutive years.

On March 16, 2007, the National People’s Congress passed the PRC EIT Law, with effect from January 1, 2008. The PRC EIT Law adopted a uniform tax rate of 25% for both domestic enterprises and foreign-invested enterprises and revoked the current tax exemption, reduction and preferential treatments applicable to foreign-invested enterprises. However, according to the Notice of the State Council on the Implementation of the Enterprise Income Tax Transitional Preferential Policy (《國務院關於實施企業所得稅過渡優惠政策的通知》) issued on December 26, 2007 and effective on January 1, 2008, there is a transition period for enterprises, whether foreign-invested or domestic, that received preferential tax treatments granted by relevant tax authorities prior to the effectiveness of the PRC EIT Law. Enterprises that were subject to an enterprise income tax rate lower than 25% before the effectiveness of the PRC EIT Law may continue to enjoy the lower rate and gradual transition to the new tax rate within five years after the effective date of the PRC EIT Law. Enterprises that were granted preferential enterprise income tax treatments with fixed terms before the effectiveness of the PRC EIT Law may continue to enjoy the preferential enterprise income tax treatments until their expiration. However, for those enterprises not profitable enough to enjoy preferential enterprise income tax treatments, the fixed terms for the preferential treatments shall commence on January 1, 2008.

Under the PRC EIT Law, enterprises are classified as either “resident enterprises” or “non-resident enterprises”. Pursuant to the PRC EIT Law and its implementation rules, besides enterprises established within the PRC, enterprises established outside China whose “de facto management bodies” are located in China are considered “resident enterprises” and subject to the uniform 25% tax rate for their global income. According to the implementation rules of the PRC EIT Law, “de facto management body” refers to a managing body that exercises, in substance, material and overall management and control over the production and business, personnel, accounting and assets of an enterprise. In addition, any gain realized on the transfer of ordinary shares by a non-PRC resident investors is also subject to 10% PRC income tax if such gain is regarded as income derived from sources within the PRC unless a treaty otherwise provides.

According to the Circular of the SAT on Issues Concerning the Identification of Chinese-Controlled Overseas Registered Enterprises as Resident Enterprises in Accordance With the Standards of de facto Management Body (《國家稅務總局關於境外註冊中資控股企業依據實際管理機構標準認定為居民企業有關問題的通知》), promulgated on April 22, 2009 and effect from January 1, 2008, a foreign enterprise controlled by a PRC company or a PRC company group will be classified as a “resident enterprise” with its “de facto management body” located within China if all of the following requirements are satisfied: (i) the senior management and core management departments in charge of its daily operations

REGULATORY OVERVIEW

function are mainly in the PRC; (ii) its financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (iii) its major assets, accounting books, company seals, and minutes and files of its board and shareholders' meetings are located or kept in the PRC; and (iv) at least half of the enterprise's directors with voting rights or senior management reside in the PRC.

Furthermore, the PRC EIT Law provides that a non-resident enterprise refers to an entity established under foreign law whose "de facto management bodies" are not within China but which have an establishment or place of business in the PRC, or which do not have an establishment or place of business in the PRC but have income sourced within the PRC. The implementation rules of the PRC EIT Law provide that after January 1, 2008, an income tax rate of 10% will normally be applicable to dividends declared to non-PRC resident investors which do not have an establishment or place of business in the PRC, or which have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to the extent such dividends are derived from sources within the PRC. The income tax on the dividends may be reduced pursuant to a tax treaty between China and the jurisdictions in which the non-PRC shareholders reside.

According to the Notice of the State Council on the Implementation of Several Policies for the Western China Development Plan (《國務院關於實施西部大開發若干政策措施的通知》) promulgated by the State Council on October 26, 2000 and the Notice on Issues Concerning Preferential Tax Policy for the Western China Development Plan (《關於西部大開發稅收優惠政策問題的通知》) issued by the MOF, General Administration of Customs and the SAT on December 30, 2001, for domestic enterprises and foreign-invested enterprises in the western regions that are in an industry sector encouraged by the state, enterprise income tax should be levied at a tax rate of 15% during the period between 2001 and 2010. According to the Notice of Relevant Issues on Tax Policy for Further Implementation of the Western China Development Plan (《關於深入實施西部大開發戰略有關稅收政策問題的通知》) issued by the MOF, the General Administration of Customs and the SAT on July 27, 2011, enterprises in encouraged industries that are established in the western region may continue to enjoy the reduced tax rate of 15% for another ten years from January 1, 2011 to December 31, 2020.

An enterprise, which is recognized as a High and New Technology Enterprise by the relevant authorities in accordance with the Administrative Measures for Certification of New and High Technology Enterprises (《高新技術企業認定管理辦法》) circulated by the MST, MOF and SAT on April 14, 2008, may apply for preferential tax policy in accordance with the PRC EIT Law and the implementation rules thereof, and the Law of the People's Republic of China Concerning the Administration of Tax Collection (《中華人民共和國稅收徵收管理法》). According to the PRC EIT Law, high and new technology enterprises that require key state support are subject to the applicable enterprise income tax rate with a reduction of 15%.

Tax Collection for Share Transfer by Non-PRC Resident Enterprises

Pursuant to the Notice on Strengthening the Management on Enterprise Income Tax for Non-resident Enterprises Equity Transfer (《關於加強非居民企業股權轉讓所得企業所得稅管理的通知》) or the Circular 698, issued by SAT on December 10, 2009 with retroactive effect from January 1, 2008, except for the purchase and sale of equity through a public securities market, where a foreign investor transfers its indirect equity interest in a PRC resident enterprise by disposing of its equity interests in an overseas holding company, or an Indirect Transfer, and such overseas holding company is located in a tax jurisdiction that: (i) has an effective tax rate less than 12.5% or (ii) does not tax foreign income of its residents, the foreign investor shall report to the competent tax authority of the PRC resident enterprise this Indirect Transfer. If the tax authority, upon examining the nature of the Indirect Transfer, deems that the Indirect Transfer has no reasonable commercial purpose other than to avoid PRC tax evasion,

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the tax authority may disregard the existence of the overseas holding company that is used for tax evasion purposes and re-characterize the Indirect Transfer.

On March 28, 2011, the SAT released the SAT Public Notice (2011) No. 24, or SAT Public Notice 24, to clarify several issues related to Circular 698. SAT Public Notice 24 became effective on April 1, 2011. According to SAT Public Notice 24, the term “effective tax” refers to the effective tax on the gain derived from disposition of the equity interests of an overseas holding company; and the term “does not impose income tax” refers to the cases where the gain derived from disposition of the equity interests of an overseas holding company is not subject to income tax in the country or region where the overseas holding company is a resident.

Tax on dividends from PRC Enterprise with foreign investment

According to the Circular of MOF and SAT on Several Preferential Policies Relevant to Enterprise Income Tax (《財政部、國家稅務總局關於企業所得稅若干優惠政策的通知》), the undistributed profits earned by foreign investment enterprises prior to January 1, 2008 and distributed to foreign investors later shall be exempt from PRC withholding tax, whereas the profits earned and distributed after January 1, 2008 shall be subject to PRC withholding tax pursuant to the PRC EIT Law.

The PRC EIT Law prescribes a standard withholding tax rate of 20% on dividends and other China-sourced passive income of non-resident enterprises. Its implementation rules reduced the rate from 20% to 10% which was effective from January 1, 2008. The PRC and Hong Kong signed the Arrangement between the Mainland and Hong Kong for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (內地和香港特別行政區關於對所得避免雙重徵稅和防止偷漏稅的安排) on August 21, 2006. According to the arrangement, no more than a 5% withholding tax rate applies to dividends paid by a PRC company to a Hong Kong tax resident, provided that the recipient is a company that has held at least 25% of the capital of the PRC company in any time in the 12 months before the dividend distribution. The 10% withholding tax rate applies to dividends paid by a PRC company to a Hong Kong resident if the recipient is a company that holds less than 25% of the capital of the PRC company.

In accordance with the circular issued by SAT in relation to How to Understand and Determine “Beneficial Owners” under Tax Conventions (《國家稅務總局關於如何理解和認定稅收協定中“受益所有人”的通知》), a beneficial owner is a person who has both ownership and right of control over the income or the assets or rights generating the income and generally must be engaged in substantive business. A Hong Kong resident entity also needs to be a beneficial owner so as to enjoy the preferential tax treatment.

Value Added Tax

The Provisional Regulations of PRC Concerning Value Added Tax (《中華人民共和國增值稅暫行條例》) (the “VAT Regulations”) were promulgated by the State Council on November 10, 2008 and came into effect on January 1, 2009. Under the VAT Regulations, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC. Unless stated otherwise, for VAT payers who are selling or importing goods, and providing processing, repairs and replacement services in the PRC, the tax rate shall be 17%.

Business Tax

The Provisional Regulations of PRC Concerning Business Tax (《中華人民共和國營業稅暫行條例》) (the “Business Tax Regulations”) was promulgated by the State Council on November 10, 2008 and came into effect on January 1, 2009. Under the Business Tax Regulations, businesses that provide

REGULATORY OVERVIEW

services (including entertainment business), assign intangible assets or sell immovable property are liable to business tax at a rate ranging from 3.0% to 20.0%, of the charges of the services provided, intangible assets assigned or immovable property sold, as the case may be. The amount of tax payable equals the business income times the applicable tax rate. The business income shall be calculated in RMB. Taxpayers that settle their amounts of business income in currency other than RMB shall convert the amounts into RMB.

PRC Customs Duties

According to the Customs Law of the PRC (《中華人民共和國海關法》) adopted by the NPC on July 8, 2000 which came into effect on January 1, 2001, the consignee of the imports, the consignor of exports and the owner of the imports and the exports are the persons obligated to pay customs duties (generally speaking, exports are not subject to customs duties). The Customs is the authorities in charge of the collection of customs duties.

The customs duties in the PRC mainly fall under ad valorem duties, i.e. the price of import/export commodities is the basis for the calculation of the duties. When calculating the customs duties, import/export commodities shall be classified under appropriate tax items in accordance with the category provisions of the Customs Import and Export Tariff and shall be subject to tax levies pursuant to relevant tax rates.

Under the laws of the PRC, raw material, supplementary materials, parts, components, accessories and packing materials imported for processing and assembling finished products for foreign parties or for manufacturing products for export shall be exempt from import duties pursuant to the actual amount of goods processed for export or import duties may be levied upfront on import materials and parts and subsequently refunded pursuant to the actual amount of goods processed for export.

To encourage the introduction of foreign investment, as of 1992, the PRC exercised exemption and reduction of customs duties on the import of machinery, equipment, parts and other materials within the total investment of foreign investment companies. But after the adjustment of policies as of April 1, 1996, such exemption and reduction has been terminated, while the foreign investment companies incorporated before then can still continue to enjoy such preferential treatment within the grace period.

As from January 1, 1998, according to the Notice of the State Council regarding the Adjustment of Taxation Policy of Import Equipment (《國務院關於調整進口設備稅收政策的通知》), in respect of the foreign investment projects that fall under Encouraging Category and Restricted B Category of the Industrial Guidance Catalogue of Foreign Investment and also involve the transfer of technology, the equipment imported for its own use within the total investment can be exempt from the customs duties, except for the commodities listed in the Catalogue of the Non-tax-exemption Import Commodity of Foreign Investment Projects.

Vehicle Acquisition Tax

According to the Tentative Regulations of the People's Republic of China on Vehicle Acquisition Tax (《中華人民共和國車輛購置稅暫行條例》) promulgated by the State Council on October 22, 2000 and came into effect on January 1, 2001, all entities and individuals who acquire motor vehicles, which include motor cars, motorcycles, tramcars, trailers and agricultural lorries, within the territory of the PRC shall pay Vehicle Acquisition Tax in accordance with the provisions therein.

Vehicle Acquisition Tax shall be calculated using ad valorem rate, in accordance with the following formula: Vehicle Acquisition Tax payable = Taxable value × Tax rate. The Vehicle Acquisition Tax

REGULATORY OVERVIEW

rate is 10%. Adjustments to the scope of charge and the Vehicle Acquisition Tax rate shall be determined and announced by the State Council.

Vehicle and Vessel Tax

According to the Law of the People’s Republic of China on Vehicle and Vessel Tax (《中華人民共和國車船稅法》) promulgated by the State Council on February 25, 2011 and came into effect on January 1, 2012, owners or managers of the vehicles and vessels within the territory of the PRC shall pay Vehicle and Vessel Tax in accordance with the provisions therein. The applicable tax amount for vehicles and vessels shall be executed according to the Table of Items and Amounts for Vehicles and Vessels Taxes attached in these regulations. According to the Regulation on the Implementation of the Vehicle and Vessel Tax Law of the PRC (《中華人民共和國車船稅法實施條例》) which became effective on January 1, 2012, energy-saving and new energy vehicles and vessels may enjoy reduction or exemption of the vehicle and vessel tax.

Regulations Relating to Intellectual Property

China has adopted legislations related to intellectual property rights, including trademarks, patents and copyrights. China is a signatory to all major intellectual property conventions, including the Paris Convention for the Protection of Industrial Property (《保護工業產權巴黎公約》), Madrid Agreement on the International Registration of Marks (《商標國際註冊馬德里協定》), Patent Cooperation Treaty (“PCT”) (《專利合作條約》), Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (《國際承認用於專利程序的微生物保存布達佩斯條約》), the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPs”) (《與貿易有關的知識產權協定》), the Berne Convention for the Protection of Literary and Artistic Works (《保護文學和藝術作品伯爾尼公約》) and the World Intellectual Property Organization Copyright Treaty (《世界知識產權組織版權條約》).

Regulations on Patents

Under the revised Patent Law of the PRC (《中華人民共和國專利法》) promulgated on December 27, 2008 and effective on October 1, 2009, there are three types of patents, including invention patents, design patents and utility model patents. Invention patents are valid for twenty years, while design patents and utility model patents are valid for ten years, in each case commencing on their respective application dates. Persons or entities who use patents without the consent of the patent owners, make counterfeits of patented products, or engage in activities that infringe upon patent rights are held liable to the patent owner for compensation and may be subject to fines and even criminal punishment.

According to the Patent Law of the PRC, the “first to file” principle is adopted for the patent application, which means when more than one person files a patent application for the same invention, the patent will be granted to the person who files the application first. In addition, China requires absolute novelty for the sake of an invention to be patentable. Therefore, in general, a patent will be denied if it is publicly known in or outside of China. Furthermore, patents issued in China are not enforceable in Hong Kong, Taiwan or Macau, each of which has an independent patent system.

According to PCT to which China is a signatory, applications for the protection of inventions in any of the contracting states of the PCT may be filed as international applications.

Regulations on Trademarks

Both Trademark Law of the PRC (《中華人民共和國商標法》) promulgated by the National People’s Congress Standing Committee in 1982 and amended in 2001, and the Regulation on Implementation of

REGULATORY OVERVIEW

Trademark Law of the PRC (《中華人民共和國商標法實施條例》) promulgated by the State Council in 2002 provide protection to the holders of registered trademarks. In the PRC, registered trademarks include commodity trademarks, service trademarks, collective marks and certificate marks.

The Trademark Office under the SAIC (國家工商行政管理總局商標局) handles trademark registrations and grants a term of ten years to registered trademarks, renewable every ten-years where a registered trademark needs to be used after the expiration of its validity term, a registration renewal application shall be filed within six months prior to the expiration of the term.

Under the Trademark Law of the PRC, any of the following acts may be regarded as an infringement upon the right to exclusive use of a registered trademark, including (i) using a trademark which is identical with or similar to the registered trademark on the same or similar commodities without authorization; (ii) selling the commodities that infringe upon the right to exclusive use of a registered trademark; (iii) forging, manufacturing the marks of a registered trademark of others without authorization, or selling the marks of a registered trademark forged or manufactured without authorization; (iv) altering another party's registered trademark without authorization and selling goods bearing such an altered trademark; and (v) causing other damage to the right to exclusive use of a registered trademark of another person.

Violation of the Trademark Law of the PRC may result in the imposition of fines, confiscation and destruction of the infringing commodities.

Trademark license agreements must be filed with the Trademark Office under the SAIC or its regional counterparts. The licensor shall supervise the quality of the commodities on which the trademark is used, and the licensee shall guarantee the quality of such commodities.

In addition, according to the Provisions on Recognition and Protection of Well-known Trademarks (《馳名商標認定和保護規定》) promulgated by SAIC on April 17, 2003 and effective on June 1, 2003, well-known trademarks, which are recognized on a case-by-case basis by the Trademark Review and Adjudication Board of SAIC, the Trademark Office, or the PRC courts, are protected by PRC law.

Regulations on Domain Names

The Measures for the Administration of Domain Names for the Chinese Internet (《中國互聯網絡域名管理辦法》), which were promulgated by the MIIT on November 5, 2004 and effective on December 20, 2004, regulate registrations of domain names with the Internet country code ".cn" and domain names in Chinese.

The Measures on Domain Name Dispute Resolution (2006 Edition) (《中國互聯網絡信息中心域名爭議解決辦法(2006年修訂)》), which were promulgated by the Chinese Internet Network Infrastructure Center on February 14, 2006 and became effective on March 17, 2006, require domain name disputes to be submitted to institutions authorized by the Chinese Internet Network Information Center for resolution.

Labor Law and Regulations

Enterprises in China are mainly subject to the following PRC labor laws and regulations: Labor Law of the PRC (《中華人民共和國勞動法》), the PRC Social Insurance Law (《中華人民共和國社會保險法》), the PRC Labor Contract Law (《中華人民共和國勞動合同法》), the Regulation on Paid Annual Leaves of Employees (《職工帶薪年休假條例》), the Regulation of Insurance for Work-Related Injury (《工傷保險條例》), the Regulations on Unemployment Insurance (《失業保險條例》), the Provisional Measures on Insurance for Maternity of Employees (《企業職工生育保險試行辦法》), the Interim Provisions

REGULATORY OVERVIEW

on Registration of Social Insurance (《社會保險登記管理暫行辦法》), the Interim Regulation on the Collection and Payment of Social Insurance Premiums (《社會保險費征繳暫行條例》), the Administrative Regulation on Housing Fund (《住房公積金管理條例》) and other related regulations, rules and provisions issued by the relevant governmental authorities from time to time.

Pursuant to Labor Law of the PRC companies must enter into employment contracts with their employees, based on the principles of equality, consent and agreement through consultation. Companies must establish and effectively implement a system of ensuring occupational safety and health, educate employees on occupational safety and health, preventing work-related accidents and reducing occupational hazards. Companies must also pay for their employees' social insurance premium.

The principal regulations governing the employment contract is the PRC Labor Contract Law, which was promulgated by the Standing Committee of the National People's Congress on June 29, 2007 and came into effect on January 1, 2008. Pursuant to the PRC Labor Contract Law, employers shall establish employment relationship with employees on the date that they start employing the employees. To establish employment, a written employment contract shall be concluded, or employers will be liable for the illegal actions. Employers are required to enter into non-fixed term employment contracts with employees who have worked for them for more than 10 consecutive years or for whom a fixed term employment contract has been concluded for two consecutive times, unless otherwise provided in the PRC Labor Contract Law. Employers may not be able to efficiently terminate non-fixed term employment contracts under the PRC Labor Contract Law without cause unless there exists special circumstances as stipulated in the PRC Labor Contract Law Implementation Rules as well as other PRC laws for the termination of the employment contracts by the employer. Employers are also required to make severance payments to fixed term contract employees when the term of their employment contracts expire, except for certain circumstances prescribed in the PRC Labor Contract Law including where an employee voluntarily rejects an offer to renew the contract where the conditions offered by the employer are the same as or better than those stipulated in the current contract. The amount of severance payment is equal to the monthly wage of the employee multiplied by the number of full years that the employee has worked for the employer, except in the circumstances where (i) the term of service is more than six months but less than a year, the amount of severance payment shall be calculated the same as a full year of service; (ii) the term of service is less than six months, the employer shall pay half a month's wage to the employee as severance payment; and (iii) the employee's monthly wage is more than three times the local average monthly wage of the preceding year announced by the local relevant PRC Government, the calculation of the severance payment will be based on a monthly wage equal to three times the average monthly wage multiplied by the number of years of service which cannot exceed a maximum of 12. A minimum wage requirement has also been incorporated into the PRC Labor Contract Law. Liability for damages or fines may be imposed for any material breach of the PRC Labor Contract Law.

Pursuant to the Regulations on Paid Annual Leave for Employees (《職工帶薪年休假條例》), which became effective on January 1, 2008, employees who have continuously worked for more than one year are entitled to paid holidays ranging from 5 to 15 days, depending on their length of service. Employees who agree to waive their holiday time at the request of their employers must be compensated with three times their normal daily salary for each holiday waived.

As required under the Regulation of Insurance for Work-Related Injury, the Provisional Measures on Insurance for Maternity of Employees, the Interim Provisions on Registration of Social Insurance and the Administrative Regulation on Housing Fund, enterprises in China are obliged to provide employees with welfare schemes covering pension insurance, unemployment insurance, maternity insurance, injury insurance, medical insurance and housing accumulation fund.

HISTORY AND REORGANIZATION

OUR MILESTONES

We have achieved the following key milestones:

- | | |
|------|--|
| 1998 | Mianyang Xinchun was established and commenced production of light-duty diesel engines. |
| 2004 | Our research and development center was recognized as a “state certified enterprise technology center” by the NDRC and other government authorities. |
| 2007 | Our laboratory was accredited by the China National Accreditation Service for Conformity Assessment. |
| 2008 | Our ZD25TCR light-duty diesel engine was awarded the “Top 10 Chinese Engines” title by China Internal Combustion Engine Industry Association and China Automotive News, with the other nine engines all being gasoline engines. |
| 2010 | Our “XCE 新晨動力” brand was named as one of the “Top 10 Brands for Diesel Engines” and our 4A13 and 4A15 light-duty gasoline engines were awarded a “2010 Efficient Fuel Consumption Gold Award” by China Internal Combustion Engine Industry Association and China Automotive News. |
| 2011 | Our D20A light-duty diesel engine was awarded a “2011 Fuel Efficiency Award” by China Internal Combustion Engine Industry Association and China Automotive News. |
| 2011 | Since the end of 2010, we have been in the process of transitioning all our production lines, equipment and personnel to the new production base located in the Mianyang High-Tech Development Zone, and the construction of the new production facilities is expected to be completed and the production facilities commence full commercial operation by September 30, 2013. |

MIANYANG XINCHEN

The history of our Group traces back to March 1998 when our operating subsidiary, Mianyang Xinchun, was jointly established by Southern State and Xinhua Combustion Engine as a Sino-foreign joint venture in the PRC with an initial registered capital of US\$8.6 million. At that time, Mianyang Xinchun was held as to 50% by Southern State and 50% by Xinhua Combustion Engine. Southern State was incorporated in the BVI on September 30, 1997, and its entire issued share capital was acquired by Brilliance China in 1998. Xinhua Combustion Engine was a PRC company incorporated on June 30, 1994. The business scope of Mianyang Xinchun includes the design, manufacture, sales and after-sales services of automotive engines and power machinery.

In September 2003, Mianyang Xinchun increased its registered capital by US\$15.52 million from US\$8.6 million to US\$24.12 million, which was contributed by Southern State and Xinhua Combustion Engine in equal proportion.

For the purpose of setting up Mianyang Xinchun, a joint venture agreement was entered into between Southern State and Xinhua Combustion Engine on October 25, 1997 and amended on July 10, 2003 (the “JV Agreement”). The key terms of the JV Agreement are as follows:

Principal Terms of the JV Agreement

- | | |
|--|---|
| Number and composition of board of directors of Mianyang Xinchun | The board of directors shall consist of 7 to 15 directors to be appointed by Southern State and Xinhua Combustion Engine. |
| | The quorum of a board meeting is 60% of the then number of directors in the board. |

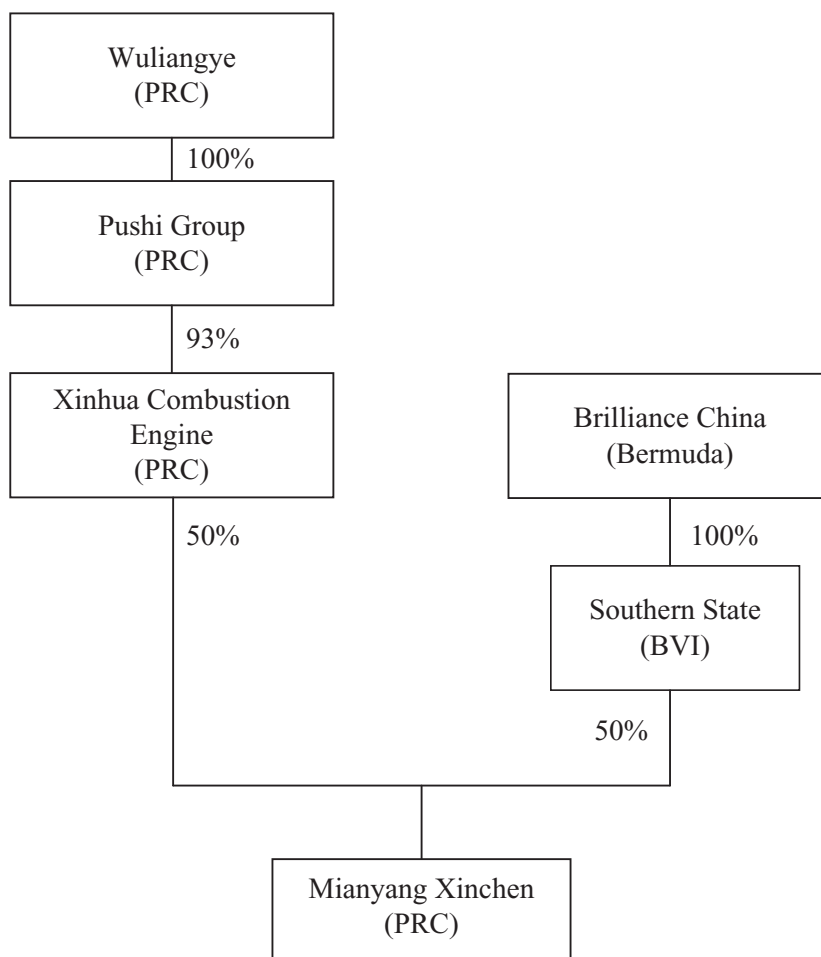
HISTORY AND REORGANIZATION

Voting rights arrangement	Each of the chairman, vice chairman and the directors shall have one vote during board meetings.
Dispute resolution	If there are disputes as to the interpretation or execution of the JV Agreement, each party shall participate in mediation to resolve the matters.
Management of daily operations of Mianyang Xincheng	<p>The Management Department is responsible for the management and daily operation of Mianyang Xincheng, and execute the decisions of the board of directors of Mianyang Xincheng.</p> <p>The Management Department consists of one general manager, a few deputy general managers and one chief financial officer.</p>
Key terms and obligations of the contracting parties	Each of Southern State and Xinhua Combustion Engine shall contribute 50% of the registered capital of Mianyang Xincheng by cash or assets.
Profit sharing arrangement	Profits will be distributed once a year and such amount is subject to the decision of the board of directors. Each of the joint venture parties is entitled to the profit distribution proportional to its respective capital contribution.
Ownership of intellectual property rights	<p>Mianyang Xincheng is allowed to register for its own trademarks, which shall be decided by the board of directors.</p> <p>Mianyang Xincheng can elect to use the trademarks registered in the PRC under Xinhua Combustion Engine in Mianyang Xincheng's products.</p>
Term	Mianyang Xincheng shall have a term of 50 years from the date of its first business license (i.e. from June 16, 1998), and such term can be extended upon the proposal of extension by either party and the unanimous consensus of the directors.
Termination clause	<p>Mianyang Xincheng shall have a term specified above.</p> <p>Mianyang Xincheng shall be dissolved before the 50-year term upon the occurrence of, among others, the following events:</p> <ul style="list-style-type: none"> (i) one of the contracting parties is in breach of the terms and obligations of the JV Agreement for a period exceeding 90 days, which leads to the impracticability of operations of Mianyang Xincheng; (ii) Mianyang Xincheng suffers a serious loss for a consecutive period of three financial years; and (iii) Mianyang Xincheng is not able to achieve its business objectives and further development is considered infeasible. <p>The party in breach of the terms of the JV Agreement shall, at the time of the termination of Mianyang Xincheng, compensate to the other party and Mianyang Xincheng for their damages.</p>

HISTORY AND REORGANIZATION

As a result of the Reorganization, Mianyang Xincheng became wholly-owned by Southern State. As such, the JV Agreement is no longer effective. For details, please refer to “History and Reorganization — Acquisition of 50% equity interest in Mianyang Xincheng from Xinhua Combustion Engine by Southern State” of this document.

The following chart sets forth our corporate structure immediately before the Reorganization:



REORGANIZATION

In preparation for the [●], we underwent the Reorganization which involves the following:

Incorporation of Brilliance Investment

Brilliance Investment was incorporated in the BVI as a limited liability company on February 28, 2011 with an authorized share capital of US\$50,000 divided into 50,000 ordinary shares of par value of US\$1.0 each. At the time of its incorporation, one share of Brilliance Investment was issued and allotted to Brilliance China. Since then, Brilliance Investment has become a wholly-owned subsidiary of Brilliance China. Brilliance Investment is an investment holding company.

Incorporation of our Company

Our Company was incorporated as an exempted limited liability company in the Cayman Islands on March 10, 2011 with an authorized share capital of HK\$80,000,000 divided into 8,000,000,000 Shares

HISTORY AND REORGANIZATION

of HK\$0.01 each. At the time of its incorporation, one Share was issued and allotted to the initial subscriber. On March 10, 2011, the initial subscriber transferred that one Share to Brilliance Investment at a consideration of HK\$0.01 and Brilliance Investment subscribed for additional 999 Shares, as a result of which our Company became a wholly-owned subsidiary of Brilliance Investment at that time.

Incorporation of Xinhua Investment

Xinhua Investment was incorporated in the BVI as a limited liability company on May 19, 2011 with an authorized share capital of US\$50,000 divided into 50,000 ordinary shares of par value of US\$1.0 each. At the time of its incorporation, one share of Xinhua Investment was issued and allotted to Xinhua Combustion Engine. Since then, Xinhua Investment has become a wholly-owned subsidiary of Xinhua Combustion Engine. Xinhua Investment is an investment holding company.

Transfer of the entire issued share capital of Southern State to our Company

Pursuant to a share transfer form executed by Brilliance China and our Company dated July 1, 2011, Brilliance China transferred the entire issued share capital of Southern State to our Company at a consideration of US\$1.0, and as a result, Southern State became our direct wholly-owned subsidiary.

Acquisition of 50% equity interest in Mianyang Xincheng from Xinhua Combustion Engine by Southern State

On July 1, 2011, an equity transfer agreement was entered into between Xinhua Combustion Engine as the transferor and Southern State as the transferee, pursuant to which Southern State agreed to acquire 50% equity interest in Mianyang Xincheng from Xinhua Combustion Engine at a consideration of RMB354,654,500 (the “Consideration”), which was determined based on a valuation report of Mianyang Xincheng prepared by Beijing Zhongqihua Asset Valuation Co., Ltd.* (北京中企華資產評估有限責任公司), an independent valuer (the “Mianyang Xincheng Valuation Report”), through a public auction listed on the Southwest United Equity Exchange Co., Ltd.* (西南聯合產權交易所有限責任公司), as the aforementioned 50% equity interest of Mianyang Xincheng held by Xinhua Combustion Engine was considered state-owned asset (the “Acquisition”). The Acquisition was completed on August 29, 2011. The equity transfer was approved by, and the valuation of the state-owned asset was filed with, the SASAC of Yibin City Government in Sichuan Province. Our PRC legal adviser, Jingtian & Gongcheng, has advised us that the Acquisition complies with all relevant PRC laws and regulations including the Interim Measures for the Management of the Transfer of the State-owned Property Rights of Enterprises (《企業國有產權轉讓管理暫行辦法》).

For the purpose of the Acquisition, on August 24, 2011, a loan agreement (the “Loan Agreement”) was entered into between Xinhua Investment as the lender and our Company as the borrower, pursuant to which Xinhua Investment has agreed to lend to our Company an amount of HK\$433,000,000 (which was equivalent to the Consideration), for the sole purpose of assisting our Company and Southern State to pay for the Acquisition.

Allotment of 50% Shares in our Company to Xinhua Investment

Pursuant to the Loan Agreement, Xinhua Investment was entitled to request our Company to issue 50% of the then issued share capital of our Company to Xinhua Investment. The Loan Agreement stipulates that the loan would be applied, in its entirety, to pay up such Shares in full at par value and upon completion of the said issuance of such Shares, our Company would be released from any liability in relation to the repayment of the loan under the Loan Agreement. At the request of Xinhua Investment,

HISTORY AND REORGANIZATION

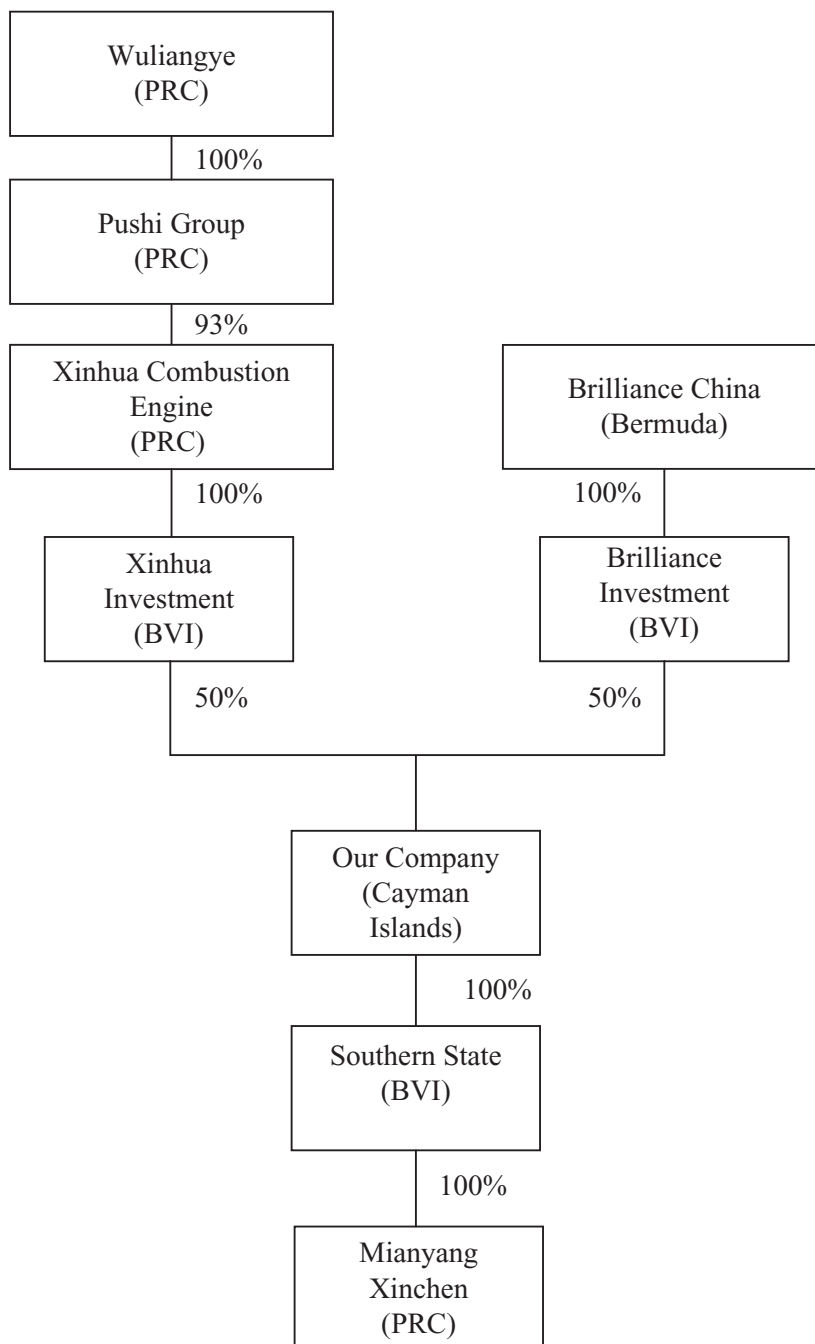
our Company issued and allotted 1,000 Shares, representing 50% of our then issued share capital, to Xinhua Investment on August 29, 2011, and the loan under the Loan Agreement was applied, in its entirety, to pay for such Shares in full. Upon completion of the allotment of the 1,000 Shares, our Company was owned as to 50% by Xinhua Investment and 50% by Brilliance Investment.

Capitalization Issue

On October 25, 2011, our Company issued and allotted 399,999,000 Shares (the “Capitalization Shares”), credited as fully paid at par value, to each of Brilliance Investment and Xinhua Investment, by way of capitalization of the sum of HK\$7,999,980 (being the amount necessary to pay up the Capitalization Shares at par value) out of the share premium account of our Company (the “Capitalization Issue”). Upon completion of the Capitalization Issue, each of Brilliance Investment and Xinhua Investment holds 400,000,000 Shares, representing 50% of our then issued share capital.

HISTORY AND REORGANIZATION

The following chart sets forth our corporate structure immediately after the Reorganization:



HISTORY AND REORGANIZATION

[●] INVESTMENT BY DONGFENG MOTORS ENGINEERING

Dongfeng Motors Engineering is a company incorporated in Hong Kong and wholly-owned by Dong Feng Motor Corporation. Dong Feng Motor Corporation is a state-owned company incorporated in the PRC and the ultimate holding company of Dongfeng Group. On October 31, 2011, Dongfeng Motors Engineering and our Company entered into a subscription agreement (the “Subscription Agreement”), as amended and supplemented on December 16, 2012, the terms of which are set out below (the “[●] Investment”):

Principal Terms of the Subscription Agreement

Name of [●] investor	Dongfeng Motors Engineering
Date of Subscription Agreement	October 31, 2011
Number of subscribed Shares	46,200,000 Shares, representing approximately 4.914% of the enlarged issued share capital of our Company after the [●] Investment and the subscription of Shares by Lead In (see below)
Price per Share	HK\$1.0817
Total consideration	HK\$49,975,714.94
Payment date of consideration	October 27, 2011
Basis of determination	The consideration is determined based on the Mianyang Xinchun Valuation Report, which was determined using the asset basis of appraisal
Rights	There are no special rights attached to the Shares
Put right	Dongfeng Motors Engineering may exercise a put right to sell its Shares to the Company on the same terms as its original subscription if the [●] is not completed on or before December 31, 2013 (such term was extended pursuant to the supplemental agreement dated December 16, 2012)
[●]	The Shares will not be subject to any [●] after [●]

Our Company considers that the [●] Investment by Dongfeng Motors Engineering further strengthened the relationship between our Group and Dongfeng Group. It demonstrates that the customer is confident in our Group’s operation and recognizes the past contribution and performance of our Group. A [●] investment by a strong strategic investor will serve as an endorsement of our Company’s strength and prospects.

As at the [Latest Practicable Date], the consideration received from Dongfeng Motors Engineering pursuant to the [●] Investment had not been utilized.

As Dongfeng Motors Engineering is not a connected person of our Company nor related to any connected persons of our Company, all the Shares subscribed by Dongfeng Motors Engineering pursuant to the [●] Investment shall be counted as part of the [●] for the purposes of [●].

INCENTIVE SCHEME ESTABLISHED BY LEAD IN

Our Directors consider that our business heavily relies on research and development and the retention of human talents is vital to the success of our Company. As such, we established an incentive scheme (the “Incentive Scheme”) in 2011. The Incentive Scheme was established before the [●] to serve as a

HISTORY AND REORGANIZATION

retention tool, and to align the interests of certain Directors, management, employees and relevant personnel of our Group (the “Beneficiaries”) with that of our Company. Lead In was incorporated for the purpose of holding the Lead In Subscribed Shares (as defined below) on trust for the Beneficiaries pursuant to the Incentive Scheme.

Lead In was incorporated in the BVI on May 18, 2011 and Mr. Wu Xiao An, our chairman and executive Director, was the then sole shareholder and sole director of Lead In. On October 10, 2011, Mr. Wang Yunxian, our chief executive officer and executive Director, became a shareholder and a director of Lead In and, as a result, Mr. Wu Xiao An and Mr. Wang Yunxian hold, and each will continue to hold upon [●], 50% of the issued share capital of Lead In.

On October 31, 2011, Lead In subscribed for 93,999,794 Shares (the “Lead In Subscribed Shares”) at a consideration of HK\$101,681,967.73, representing approximately 9.998% of the then issued share capital of our Company after giving effect to the subscription of Shares by Dongfeng Motors Engineering and without giving effect to the completion of the [●], and approximately 7.498% of the issued share capital of our Company upon completion of the [●] (assuming the [●] is not exercised), and approximately 7.227% of the issued share capital of our Company upon completion of the [●] (assuming the [●] is fully exercised). The consideration was determined based on the Mianyang Xincheng Valuation Report, and was paid on the same date and funded as described below. Lead In holds the Lead In Subscribed Shares on trust for the Beneficiaries under two separate trust arrangements as set out below.

Discretionary Trust

A trust deed [and a supplemental trust deed] was/[were] entered into among Mr. Wu Xiao An, Mr. Wang Yunxian, each executive Director, and Lead In on October 25, 2011 [and [●], 2013, respectively], pursuant to which Lead In agreed to hold 36,977,960 Shares, representing approximately 3.933% of the then issued share capital of our Company (after giving effect to the subscription of Shares by Dongfeng Motors Engineering and without giving effect to the completion of the [●]) on trust for the future benefit of certain Beneficiaries (the “Discretionary Trust Beneficiaries”) to be identified after six months following the [●] (the “Discretionary Trust”). The board of directors of Lead In and the Board of our Company may, at any time during the term of the Discretionary Trust following the date of expiry of the six-month period following the [●], jointly determine the identity of the Discretionary Trust Beneficiaries to whom interests in any of the Lead In Subscribed Shares will be offered. The Discretionary Trust Beneficiaries will be determined on the basis of that Beneficiary’s contribution to the development and growth of our Group or such other factors as the board of directors of Lead In and the Board of our Company may deem appropriate.

The consideration of approximately HK\$40,000,000 paid by Lead In for the Lead In Subscribed Shares held under the Discretionary Trust was lent by our Company to Lead In. This loan was funded from loans to our Company from Brilliance Investment and Xinhua Investment in equal proportions. For details, please refer to “Relationship with our Controlling Shareholders and Huachen — Financial Independence”.

The entitlement of each Discretionary Trust Beneficiary to his/her interests in the Discretionary Trust will vest and become exercisable in accordance with a two-year vesting period, namely (i) a certain percentage of his/her entitled interests (to be determined by the board of directors of Lead In and the Board of our Company at the time of offer) shall vest on the date following the first anniversary from the date the Discretionary Trust Beneficiaries acquired the Lead In Subscribed Shares, and (ii) the remaining percentage of his/her entitled interests (to be determined by the board of directors of Lead In and the Board of our Company at the time of offer) shall vest on the date following the second anniversary from the date the Discretionary Trust Beneficiaries acquired the Lead In Subscribed Shares. The Discretionary Trust will be terminated on (i) the date which is 10 years from the date of

HISTORY AND REORGANIZATION

the trust deed; or (ii) the date on which the transfer of all the trust assets to the Discretionary Trust Beneficiaries is completed, whichever is earlier. While the Fixed Trust Beneficiaries (as defined below) and their respective entitlements have been determined prior to [●], the Discretionary Trust Beneficiaries and their respective entitlements under the Discretionary Trust will be identified and determined no earlier than six months after [●]. Once any of the Discretionary Trust Beneficiaries have been identified and their entitlements have been determined, they will purchase the Lead In Subscribed Shares at the same subscription price per share paid by Lead In based on his/her respective entitlement.

Fixed Trust

A trust deed [and a supplemental trust deed] was entered into among Mr. Wu Xiao An, Mr. Wang Yunxian, Lead In and 51 Beneficiaries (the “Fixed Trust Beneficiaries”) (consisting of three Directors, namely Mr. Wu Xiao An, Mr. Wang Yunxian and Mr. Li Peiqi, and 48 senior management and employees of our Group) on October 25, 2011 [and [●], 2013, respectively], pursuant to which Lead In agreed to hold 57,021,834 Shares, representing approximately 6.065% of the then issued share capital of our Company (after giving effect to the subscription of Shares by Dongfeng Motors Engineering and without giving effect to the completion of the [●]) on trust for the Fixed Trust Beneficiaries (the “Fixed Trust”). Each Fixed Trust Beneficiary has paid the consideration of HK\$1.0817 per Lead In Subscribed Share by himself/herself, which was determined based on the Mianyang Xinchun Valuation Report, to Lead In in cash for the subscription of the Lead In Subscribed Shares held under the Fixed Trust. The total consideration paid by each of the Beneficiaries is calculated based on his/her respective entitlement. For further details, please see “Appendix V — Statutory and General Information — D. Incentive Scheme” in this document.

The entitlement of each Fixed Trust Beneficiary to his/her interests in the Fixed Trust shall vest and become exercisable in accordance with three phases of vesting period, namely (i) the first 40% of his/her entitled interests shall vest on the date following the expiry date of the six-month period from the [●] (the “[●] Period”); (ii) the next 40% of his/her entitled interests shall vest on the date following the first anniversary from the expiry date of the [●] Period; and (iii) the remaining 20% of his/her entitled interests shall vest on the date following the second anniversary from the expiry date of the [●] Period. The Fixed Trust will be terminated on (i) the date which is 10 years from the date of the trust deed; or (ii) the date on which the transfer of all the trust assets to the Fixed Trust Beneficiaries is completed, whichever is earlier.

In the event a Beneficiary under the Fixed Trust or the Discretionary Trust intends to realize his/her entitled shares held by Lead In in accordance with the above vesting periods, Lead In will transfer such Shares to the Beneficiary. As all Lead In Subscribed Shares have been issued and held on trust by Lead In, no new Shares will be issued and there will be no dilution effect on the Shareholders upon [●].

Lead In will be entitled to exercise all of the voting rights of the Lead In Subscribed Shares. To the extent that Lead In receives any dividends from our Company, Lead In will distribute such dividends to the Beneficiaries who are still interested in the relevant Lead In Subscribed Shares with reference to their entitled Lead In Subscribed Shares. In the event that there is any residual dividend or amount retained in the trust, such residual dividend or amount will be used for the sole purpose of future subscriptions of the Shares to award future Beneficiaries.

The Incentive Scheme in respect of the trust arrangements is a share-based payment arrangement. For the Discretionary Trust, share-based payment expense, if any, is recognized upon granting and vesting of the relevant Shares. Once the Discretionary Trust Beneficiaries have been identified and their entitlements have been determined, our Company will recognize the share-based payment expense in

HISTORY AND REORGANIZATION

accordance with HKFRS 2. For the Fixed Trust, no share-based payment expense will be recognized by our Company as the Shares were issued at fair value to the Fixed Trust Beneficiaries.

The price for the Lead In Subscribed Shares (i.e. HK\$1.0817 per Lead In Subscribed Share) is considered as fair value since it was determined based on the Mianyang Xinchun Valuation Report, which was issued by an independent valuer and it was also used to determine the consideration for the [●] Investment by Dongfeng Motors Engineering (i.e. HK\$1.0817 per Share), which is an independent third party prior to the [●] Investment.

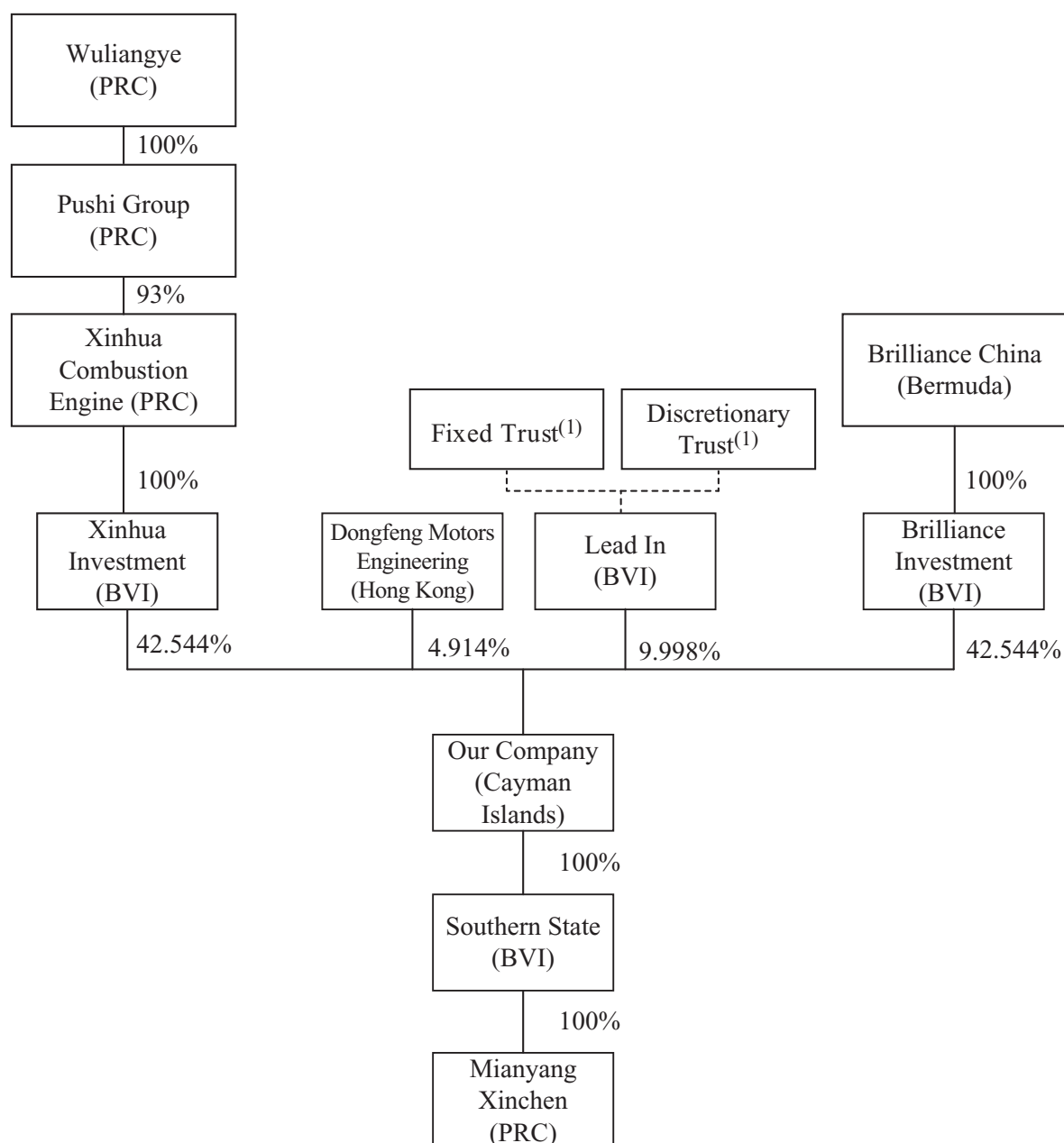
There is no Chapter 14A implication under the [●] in respect of the above trust arrangements since the subscription of the Lead In Subscribed Shares by Lead In had been completed prior to the [●], in which the consideration paid by Lead In was determined based on the Mianyang Xinchun Valuation Report, which reflected the fair value at the time of the valuation.

The Incentive Scheme is structured in the form of a [●] investment whereby the Fixed Trust Beneficiaries and Lead In had fully settled the consideration for the Lead In Subscribed Shares prior to the [●]. In addition, our Company has complied with the Interim Guidance on [●] Investments published by the [●] on October 13, 2010. Our Company considers that the Incentive Scheme is of a different nature comparing to a share option scheme which involves the granting of options instead of Shares and which will only become effective upon [●]. As such, the Incentive Scheme is not subject to the requirements under Chapter 17 of the [●] and no recording of employee compensation expenses is required during the Track Record Period.

Our Group has obtained the necessary approval or consent for the above arrangement from the Brilliance China Group, Wuliangye Group, Mianyang Municipal Government, Mianyang SAFE, SASAC of Yibin City, SASAC of Liaoning Province, and SASAC of Sichuan Province.

HISTORY AND REORGANIZATION

The following chart sets forth our corporate structure after the [●] Investment and the subscription of Shares by Lead In:



(1) Under the Fixed Trust, after the [●] Investment and the subscription of Shares by Lead In, Lead In held approximately 6.065% of the then issued share capital of our Company on trust for the Fixed Trust Beneficiaries, and under the Discretionary Trust, Lead In held approximately 3.933% of the then issued share capital of our Company on trust for the Discretionary Trust Beneficiaries.

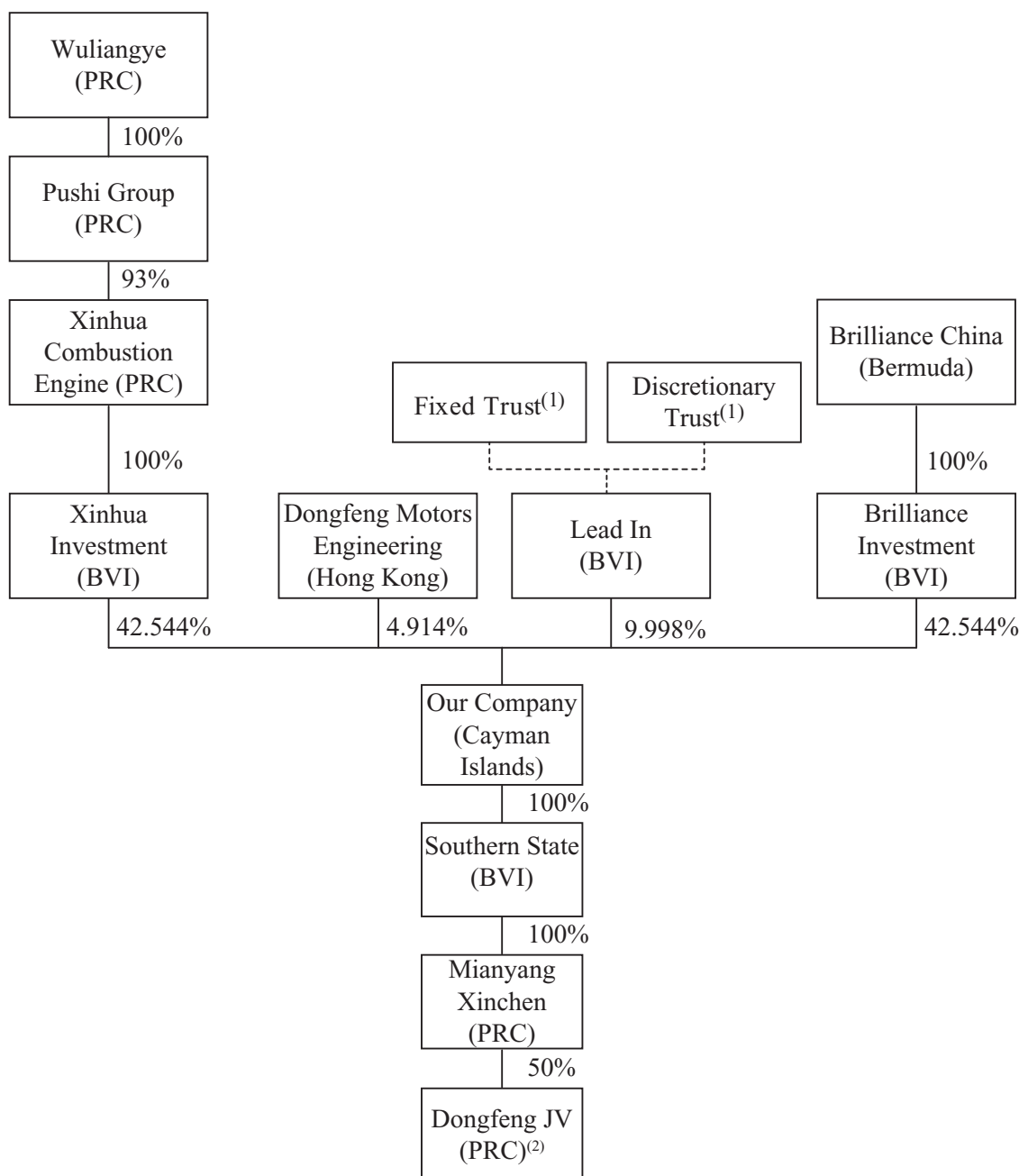
ESTABLISHMENT OF DONGFENG JV

Pursuant to a joint venture agreement entered into between Mianyang Xincheng and Dongfeng in December 2011, Dongfeng JV was established on January 9, 2012 as a joint venture by the two parties and has a term of 20 years. Dongfeng JV is owned as to 50% by Mianyang Xincheng and 50% by Dongfeng. The registered capital of Dongfeng JV is RMB250 million, of which RMB100 million has been paid up by Mianyang Xincheng and Dongfeng in equal proportions. The purpose of establishing

HISTORY AND REORGANIZATION

Dongfeng JV is to construct an engine production facility with an annual production capacity of 200,000 units in Changzhou, Jiangsu Province to manufacture the joint venture branded engines for Dongfeng’s light-duty vehicles. For details of Dongfeng JV, please refer to “Business” section of this document.

The following chart sets forth our corporate structure after the establishment of Dongfeng JV and immediately before the [●]:



(1) Under the Fixed Trust, after the establishment of Dongfeng JV and immediately before the [●], Lead In held approximately 6.065% of the then issued share capital of our Company on trust for the Fixed Trust Beneficiaries, and under the Discretionary Trust, Lead In held approximately 3.933% of the then issued share capital of our Company on trust for the Discretionary Trust Beneficiaries.

(2) Dongfeng JV is a joint venture incorporated on January 9, 2012 and is owned as to 50% by Mianyang Xincheng and 50% by Dongfeng.

HISTORY AND REORGANIZATION

Immediately after the completion of the [●] (assuming the [●] is not exercised), the shareholding of the Controlling Shareholders will be diluted and Brilliance China, through its wholly-owned subsidiary, Brilliance Investment, will be interested in approximately [31.908]% of the issued share capital of our Company. Accordingly, our Company will not become a subsidiary of Brilliance China.

HISTORY AND REORGANIZATION

BRILLIANCE CHINA AND XINHUA COMBUSTION ENGINE

Our Company understands from Brilliance China and Xinhua Combustion Engine that:

- (i) Brilliance China and Xinhua Combustion Engine do not have any agreement or understanding (whether formal or informal) to actively cooperate to obtain or consolidate control of our Group;
- (ii) the boards of Brilliance China and Xinhua Combustion Engine operate independently from each other. All investment decisions are evaluated and decided by each group in consideration of its own interests without consulting the other. Pursuant to our Company’s Articles of Association, there is no obligation (formal or informal) for them to vote in the same way on any shareholders’ resolution and they both exercise their voting rights independently from each other;
- (iii) pursuant to the Company’s Articles of Association, there is no obligation (formal or informal) on the Directors who were nominated by Brilliance China and Xinhua Combustion Engine to vote in the same way on any matter approved or to be approved by the Board of Directors of the Company; and
- (iv) each of Huachen, being the controlling shareholder of Brilliance China, and Wuliangye, being the controlling shareholder of Xinhua Combustion Engine, is a state-owned enterprise operated under different PRC provincial government authorities which is subject to the different regulations and requirements from their respective provincial government authorities based on distinctive and unique consideration. There is no agreement or understanding between them to obtain or consolidate control of our Group.

HISTORY AND REORGANIZATION

PRC APPROVAL AND REGISTRATION REQUIREMENT

Under the M&A Provisions, the approval of the MOFCOM is required if an offshore special purpose vehicle controlled by PRC domestic companies or PRC resident natural persons acquires the equity interest of an affiliated PRC domestic company for the purpose of [●] in an overseas equity market, and the approval of the CSRC is required prior to the [●] of such special purpose vehicle in an overseas equity market. As Mianyang Xincheng was established as a Sino-foreign equity joint venture enterprise in 1998, prior to the promulgation date of the M&A Provisions initially became effective on September 8, 2006, our Company’s Reorganization and the [●] do not fall within the regulated activities as set out in the M&A Provisions, the M&A Provisions is not applicable to our Reorganization or the [●].

Furthermore, registration with SAFE is required pursuant to the Notice on Foreign Exchange Control Issues Relating to Financing and Reverse Investment by Domestic Residents Through Offshore Special Purpose Vehicles (《關於境內居民通過境外特殊目的公司融資及返程投資外匯管理有關問題的通知》), or Circular 75, if PRC resident legal or natural persons directly establish or indirectly control an offshore enterprise for the purpose of carrying out offshore equity financing with the assets or equity interests they hold in PRC domestic companies. According to the Official Reply Concerning the Procedures of Offshore Investment-related Foreign Exchange Registration (《關於辦理境外投資外匯登記手續的覆函》(綿匯管[2011]31號)) issued by the Mianyang branch of SAFE (“Mianyang SAFE”) on September 16, 2011, as the establishment of Xinhua Investment by Xinhua Combustion Engine has been approved by competent commerce authorities and has obtained the Foreign Exchange Registration Certificate with the registration number 00013702, and the subscription of the issued Shares of the Company by Xinhua Investment is in accordance with its approved business scope, Xinhua Combustion Engine does not need to do the offshore investment-related foreign exchange registration under Circular 75 for

HISTORY AND REORGANIZATION

its aforesaid offshore investment. According to the minutes for the meeting regarding the foreign exchange matters for the [●] held by, among others, Mianyang Municipal Government and Mianyang SAFE dated October 28, 2011, the officials of Mianyang SAFE stated that, as Mr. Wang Yunxian and other individuals who have invested in Lead In did not hold the Shares directly, the investment in Lead In by Mr. Wang Yunxian and those individuals is not subject to the registration requirement under Circular 75.

Based on the above, our PRC legal adviser, Jingtian & Gongcheng, has advised us that the MOFCOM and CSRC approval requirement under the M&A Provisions and the registration requirement under Circular 75 are not applicable in the context of our Reorganization and [●].

In addition, according to the Circular on Further Strengthening the Administration of the [●] and [●] of Shares Outside the PRC (the “[●]”) issued by the State Council on June 20, 1997, the Company’s PRC legal adviser, Jingtian & Gongcheng, has advised us that as Mianyang Xincheng is held by Brilliance China, a Chinese-funded overseas-listed company, the proposed [●] of our Company, which indirectly wholly-owns Mianyang Xincheng, is not subject to CSRC’s approval under the [●]. Huachen, as the domestic controlling shareholder of Brilliance China, is required to report the [●] to the CSRC for record purposes after its completion.

BUSINESS

OVERVIEW

We are one of the leading automotive engine manufacturers in the independent branded segment of the PRC passenger vehicle, or PV, and light commercial vehicle, or LCV, engine market in terms of sales volume in 2011. We develop, manufacture and sell light-duty gasoline and diesel engines used by various local and foreign-invested PV and LCV manufacturers in the PRC. We were the largest independent branded engine manufacturer of small bus engines in China in 2011 in terms of sales volume, according to the Frost & Sullivan Report. According to the Frost & Sullivan Report, in terms of sales volume in 2011, we accounted for 9.4% of the independent branded segment of the PV and LCV engine market in China, and independent brands accounted for approximately 13.8% of the PV and LCV engine market in China. Our target PV and LCV engine market in China has experienced rapid growth in recent years. According to the Frost & Sullivan Report, the total sales volume of PV and LCV engines in China had grown from 7.9 million units in 2007 to 17.2 million units in 2011. We believe our brand “XCE 新晨動力” enjoys high brand recognition in the PRC automotive industry and it was named as one of the “Top 10 Brands for Diesel Engines” by China Internal Combustion Engine Industry Association and China Automotive News in 2010. We believe that we are one of the few local light-duty gasoline and diesel engine manufacturers in China with the research and development capabilities to independently develop automotive engines. Our Directors confirm that to their best knowledge, our market position in the nine months ended September 30, 2012 has not materially deteriorated from 2011.

Our light-duty gasoline and diesel engines have displacement ranging from 1.0L to 2.7L and engine power ranging from 38.5kW to 120.0kW. As of the Latest Practicable Date, we manufacture and sell 36 models of automotive engines, including 28 models of light-duty gasoline engines, which include 15 models under 1.6L (incl.), three models between 1.6L and 2.0L (incl.), eight models between 2.0L and 2.5L (incl.) and two models between 2.5L and 3.0L (incl.); and eight models of light-duty diesel engines between 2.0L and 2.5L (incl.). All 36 models have obtained necessary regulatory clearance, among which 30 models are in mass production, and six models are not in mass production pending the launch of the compatible vehicles. Our engines are installed in a wide range of PVs and LCVs, including sedans, SUVs, MPVs, small and mini buses, small and light-duty trucks. All vehicles installed with our engines meet the current mandatory National Emission Limits (National III and IV) and Phase II of the Fuel Consumption Limits, or the equivalent overseas standards, and some vehicles installed with our engines meet the Phase III of the PV Fuel Consumption Limits. Our products have received numerous awards in recognition of their quality and performance. For example, China Internal Combustion Engine Industry Association and China Automotive News awarded our D20A light-duty diesel engine with a “2011 Fuel Efficiency Award” in 2011, our 4A13 and 4A15 light-duty gasoline engines with a “2010 Efficient Fuel Consumption Gold Award” in 2010 and our ZD25TCR light-duty diesel engine as one of the “Top 10 Chinese Engines” in 2008, with the other nine engines all being gasoline engines. For the nine months ended September 30, 2012, sales of our gasoline engines and diesel engines accounted for 81.3% and 18.7% of our total engine sales revenue, respectively.

Our customers include local and foreign-invested automotive manufacturers and automotive components companies in China, including well-known automotive manufacturers such as Brilliance China Group, Huachen Group, Zhengzhou Nissan, Xiamen Golden Dragon and GAC Changfeng. We have established stable and long-term relationships with our major customers through joint product development focusing on engine compatibility and by providing high quality products and services. We provide before and after-sales services to our customers through a wide sales network covering all major regions of China. Our independent branding strategy allows us to sell to multiple automotive manufacturers in the fast-growing PV and LCV segments of the automotive industry in China, such as SUVs, minibuses, small trucks, sedans and MPVs.

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We have been a jointly controlled entity of Brilliance China and Wuliangye during the Track Record Period. We believe that our close relationship with Brilliance China has provided and will continue to provide us with a competitive edge in our industry. We entered into a non-binding strategic alliance agreement with Dongfeng in January 2007 to jointly develop engines suitable for Dongfeng’s vehicles. To solidify this alliance, we established the Dongfeng JV in January 2012 to manufacture engines for Dongfeng’s light-duty vehicles. In addition, we entered into a strategic alliance agreement with Zhengzhou Nissan in February 2007 to jointly pursue the research and development and production of engines for Zhengzhou Nissan’s SUVs and pickups. We entered into a cooperation agreement in August 2011 and a subsequent engine production line management agreement in November 2011 with FAW Jilin, pursuant to which we will manage and operate one of their engine production lines to manufacture our engines exclusively for their vehicles.

We focus on designing and developing new models of automotive engines based on market demands and trends as well as improving the performance and functionality of our existing engine models. Our research and development team consists of over 160 personnel who have on average over 12 years of automotive engine industry experience in mechanical engineering, internal combustion and other related areas. As we undertake substantially all of our research and development activities in-house, we believe we are able to quickly respond to market demands and changes in market trends. Our research and development capabilities allow us to independently develop our products, which we believe sets us apart from our competitors. Our research and development center was recognized as a “state certified enterprise technology center” by the NDRC and other government authorities in 2004 and our laboratory was accredited by China National Accreditation Service for Conformity Assessment in 2007. As of the Latest Practicable Date, we are in the process of upgrading 11 existing engine models and developing four new engine models, which are in various stages of product development by our in-house research and development team. We plan to bring five engine models out of these 15 models to the market between 2013 and 2014. We have adopted design software, testing and examination equipment made by leading international machinery, auto parts and automotive manufacturers to strengthen our research and development capabilities and to improve the performance of our engines in areas such as power, fuel consumption, emissions and reliability.

All of our current products are manufactured at our production facilities in Mianyang, Sichuan Province. As of the Latest Practicable Date, we had 15 production lines, including three for casting, seven for machining and five for assembly and testing. For the designed engine production capacity, actual engine production volume and utilization rate of our production facilities, see “— Production” in this document.

To meet the increasing demand for our products and to increase our revenue, we plan to expand our current production capacity through construction of new production facilities, improving our production technologies and purchase of new production equipment. Since the end of 2010, we have begun to transition all of our production to new production facilities that are still under construction in the Mianyang High-Tech Development Zone. Upon commencement of full commercial production of our new production facilities by September 30, 2013, our old production facilities will cease operation and our designed annual engine production capacity will increase from the current 255,000 units to 300,000 units. In addition, our Dongfeng JV expects to construct its production facilities with a total planned production capacity of 200,000 units per annum with 100,000 units upon the completion of the phase one of the construction by June 2013. Further, under the engine production line management arrangement with FAW Jilin, we will manage and operate a production line of FAW Jilin, which has a current production capacity of 40,000 units per annum to manufacture our engines exclusively for their vehicles. See “— Production — Production Capacity Expansion” for further details.

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We have experienced rapid growth during the Track Record Period. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our revenue was RMB1,285.2 million, RMB1,945.1 million, RMB2,307.7 million and RMB1,946.3 million, respectively. For the same periods, we had net profit of RMB58.3 million, RMB149.5 million, RMB260.4 million and RMB223.8 million, respectively.

OUR COMPETITIVE STRENGTHS

We believe the following competitive strengths have contributed and will continue to contribute to our success:

We are one of the leading automotive engine manufacturers in the independent branded segment of the fast-growing PV and LCV engine market in China.

We are one of the leading automotive engine manufacturers in the independent branded segment of the PRC PV and LCV engine market, with a market share of 9.4% in terms of sales volume among the independent branded engine manufacturers in 2011, according to the Frost & Sullivan Report. We were the largest independent branded engine manufacturer of small bus engines in China in 2011 in terms of sales volume. We focus on producing high quality and high performance/price ratio automotive engines with low fuel consumption, emissions and noise. Our products have received a number of awards over the years. For example, our D20A light-duty diesel engine was awarded “2011 Fuel Efficiency Award” in 2011 and our 4A13 and 4A15 light-duty gasoline engines were awarded a “2010 Efficient Fuel Consumption Gold Award” by China Internal Combustion Engine Industry Association and China Automotive News, and our ZD25TCR light-duty diesel engine was awarded the “Top 10 Chinese Engines” title by the same institutions in 2008, with the other nine engines all being gasoline engines.

China’s automotive industry is growing rapidly as the living standard of Chinese consumers continues to improve, which drives the increasing demand for automotive engines. According to the Frost & Sullivan Report, the PV and LCV engine market in China has experienced rapid growth in recent years. Also, according to the Frost & Sullivan Report, the growing trend is expected to continue from 2012 through 2016, with sales volume expected to reach 34.7 million units in 2016. As one of the leading automotive engine manufacturers in the independent branded segment of the PRC PV and LCV engine market, we believe we are well positioned to take advantage of this expected continued growth of China’s automotive industry.

We offer a diversified product portfolio of light-duty engines for a broad range of vehicles.

We have one of the broadest engine portfolios among local engine manufacturers, according to the Frost & Sullivan Report. As of the Latest Practicable Date, our engine portfolio included 36 models of automotive engines, including 28 models of light-duty gasoline engines and eight models of light-duty diesel engines, supporting a broad range of PVs and LCVs, with displacement ranging from 1.0L to 2.7L and power ratings ranging from 38.5kW to 120.0kW. Some of our engines can be converted into compressed natural gas or mixed fuel engines if required by our customers. We developed the ability to manufacture these convertible engines through our in-house research and development efforts and we believe these engines have significant market potential due to their environment friendly features. All vehicles installed with our engines meet the current mandatory National Emissions Limits (III & IV) and Phase II of the Fuel Consumption Limits, or the equivalent overseas standards. We believe that our broad range of product offerings helps us to satisfy our key customers’ specific needs while appealing

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to a wide group of customers. Our key customers include several well-known local and foreign-invested automotive manufacturers in the PRC, such as Brilliance China Group, Huachen Group, Zhengzhou Nissan, Xiamen Golden Dragon and GAC Changfeng. We believe that we are well positioned to benefit from the increasing demand for light-duty gasoline and diesel engines and PRC state policies of encouraging development and purchase of light-duty vehicles with low emissions, high fuel efficiency and reliable engines. For details of such state policies, see “Industry Overview — Overview of the PRC PV and LCV Market — The PRC automotive industry policies and regulations” in this document.

We have strong research and development capabilities.

We believe we are one of the few independent branded light-duty gasoline and diesel engine manufacturers in China with the research and development capabilities to independently develop engine products. We do not rely on any third party for our research and development and do not pay technology licensing fees to any third party. We undertake substantially all of our research and development activities in-house. We also have the capabilities of designing and assembling our own production lines based on our product designs, which we believe are cost-efficient and can shorten the lead time from product design to start of production. We have an experienced research and development team consisting of over 160 personnel who have on average over 12 years of automotive engine industry experience in mechanical engineering, internal combustion and other related areas. Our research and development center was recognized as a “state certified enterprise technology center” by the NDRC and other government authorities in 2004 and our laboratory was accredited by China National Accreditation Service for Conformity Assessment in 2007. In February 2009, our D20 light-duty diesel engine development project was included in the National High-Tech Development Plan, or the “863 Plan”, in the modern transportation technology, energy efficiency and new energy automotive areas by the MST in recognition of our strong research and development capabilities. In the past decade, we have independently developed over 36 engine models.

We communicate with our customers on a regular basis to understand their needs, and we design engines that are compatible with their vehicles. As of the Latest Practicable Date, we had [56] effective patents and [16] pending patent applications. During the Track Record Period, we had submitted [49] patent applications in the PRC, of which [32] have been granted, one was withdrawn and [16] are still pending approval. We have adopted advanced software and equipment of, and entered into collaboration arrangements with leading international machinery, auto parts and automotive manufacturers and consulting firms, such as Wuxi Bosch Automotive Diesel System Co., Ltd. (“Wuxi Bosch”) and Global Optima Automotive Inc. (“Global Optima”), to develop new technologies to improve the performance of our products in areas such as power, fuel consumption, emissions and reliability. We believe these collaborations will help us to further strengthen our research and development capabilities and expand our product portfolio and pipeline.

We have stable and long-term customer relationships.

Compared to captive brand manufacturers, our independent branding strategy and diversified product portfolio have enabled us to sell our products to multiple customers. We have maintained stable and long-term relationships with our customers, with our average relationship with major customers spanning five years. Our Company has been a jointly controlled entity of Brilliance China during the Track Record Period and one of our largest customers during the Track Record Period was our connected person, Mianyang Ruian, which is a wholly-owned subsidiary of Brilliance China. Our engines purchased by Mianyang Ruian are primarily installed in vehicles manufactured by Brilliance China. We believe that our close relationship with Brilliance China Group has provided and will continue to provide us with a competitive edge in our industry, and we expect to continue to leverage on the growth of Brilliance China Group to sustain our future sales revenue. We have also established

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strategic alliances with some of our major customers, such as Zhengzhou Nissan and FAW Jilin, to conduct joint product development, and have conducted joint marketing activities with our customers to promote our products. We have recently established the Dongfeng JV with Dongfeng in Changzhou, Jiangsu Province, to manufacture automotive engines for Dongfeng’s light-duty vehicles and we have entered into an engine production line management arrangement with FAW Jilin to manage and operate one of their engine production lines to manufacture our engines exclusively for their vehicles. We believe that these activities have helped to strengthen our customer relationships.

We have a dedicated and experienced management team.

As of the Latest Practicable Date, the members of our senior management team had on average over 20 years of experience in the PRC automotive engine industry. In particular, Mr. Wang Yunxian, our chief executive officer and executive Director, has 36 years of industry experience in the areas of production, research and development, quality management and marketing. He was awarded numerous honorable titles such as “National Model Worker” by the national government, recognized as an “Outstanding Innovative Talent of Sichuan Province” by the Sichuan provincial government and also enjoys special government expert allowances (engineering class). Mr. Wu Xiao An, our chairman and executive Director, has been the Chairman of Brilliance China since 2002. He has also been the Chairman of BMW Brilliance Automotive, a 50-50 joint venture between Shenyang Jinbei Automotive Industry Holdings Co., Ltd. and BMW Holding B.V., since its inception in 2003. Mr. Wu Xiao An has extensive experience in the overall management and strategic planning of these companies, as well as in the areas of corporate finance and corporate governance. We believe we have a strong management team with a proven track record in, and deep understanding of, the PRC automotive engine industry, which will help us to capture market opportunities, and develop and execute our future strategies. We believe that the quality and stability of our senior management is one of the key factors driving our success.

OUR STRATEGIES

We aim to strengthen our leading position in the independent branded segment of the PRC PV and LCV engine market and to become the supplier of choice for domestic and international automotive manufacturers through the following strategies:

Further enhance our research and development capabilities and strengthen our technologies

We believe that ongoing enhancement of our technology capabilities is crucial for our development as a PRC independent branded automotive engine manufacturer. We plan to further leverage our years of accumulated experience in the automotive engine industry and our deep understanding of the automotive engine market to enhance our research and development capabilities and to extend our external cooperation with overseas leading automotive manufacturers to adopt their advanced engine technologies. We intend to achieve this by increasing research and development investment, establishing a new research and development center in Chengdu, Sichuan Province by 2014, recruiting more research and development personnel with extensive experience and knowledge in our industry, increasing our collaborations with our existing research partners and establishing collaborations with new research partners. Our research and development activities will be focused on improvement of existing products, development of new models of light-duty engines, and fuel-efficient and environment friendly hybrid engines. For example, our research and development projects include developing fuel-electricity hybrid engine with displacement less than 1.5L. We expect these increased research and development efforts will allow us to broaden our product portfolio, increase our capabilities in the areas of new energy engine technology, key parts manufacturing technology and consolidated testing and analysis.

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Expand our product offerings to cater to evolving market demand

Leveraging our current leading position in the independent branded segment of the PRC PV and LCV engine market, we intend to expand our product portfolio to meet the evolving market demand for cleaner, more fuel-efficient and higher performance automotive engines. We believe we have the market expertise, technological know-how and execution capabilities to develop successful new models of automotive engines. In particular, we intend to focus on expanding our product offerings of 1.0L to 2.0L gasoline engines as well as diesel engines, as we believe that customers' demand for these engines will continue to increase in the future, and enhancing our product specifications and qualities to meet higher international standards. As of the Latest Practicable Date, we were in the process of upgrading 11 existing engine models and developing four new engine models, which are in various stages of product development by our in-house research and development team. We currently plan to bring five engine models out of these 15 models to the market between 2013 and 2014, including four models of gasoline engines and one model of diesel engines.

Expand our production capacity to meet the increasing demand for our products

We plan to increase our production capacity by constructing new production facilities. We are constructing new production facilities in the Mianyang High-Tech Development Zone in Sichuan Province, approximately 11 km from our existing production facilities. Since the end of 2010, we have been in the process of transitioning all of our production to our new production facilities. We expect our new production facilities to commence full commercial production by September 30, 2013. Upon commencement of full commercial production at our new production facilities, we expect our annual production capacity to increase from the current 255,000 units to 300,000 units. Our newly-established Dongfeng JV plans to construct an engine production facility with a total planned annual production capacity of 200,000 units in Changzhou, Jiangsu Province to manufacture the joint venture branded engines for Dongfeng's light-duty vehicles. Under our engine production line management arrangement with FAW Jilin, we have agreed to manage and operate a production line of FAW Jilin to manufacture our engines exclusively for their vehicles. The production line currently has a production capacity of 40,000 units per annum. We intend to hire additional production personnel and purchase advanced equipment to facilitate this increased production capacity. We may also build new manufacturing facilities in closer geographic proximity to our customers to shorten the delivery time of our products to them.

Increase our market share by strengthening relationships with our existing customers and developing new customer relationships

We plan to further strengthen relationships with our existing customers through improving our existing products to better meet their needs, increasing the performance/price ratio advantage of our products to differentiate ourselves from our competitors, as well as providing high quality before and after sales customer services. We also plan to create and strengthen our customer relationships through joint development of new products specifically for their vehicles. Once their vehicles are bundled with our engines, it is costly and time-consuming for our customers to replace us with other engine suppliers. We have established a joint venture with our major customer Dongfeng to manufacture engines for their vehicles. We expect such joint venture arrangement to create steady demand for our engines and further align our strategic interests. We also plan to attract new customers by promoting our products through various media platforms and participating in international and domestic conferences that we believe can broaden our customer base. In addition, through engine sales or vehicle sales of our customers, we may expand into overseas markets, including Southeast Asia, the Middle East, South America and certain African countries, which have increasing demand for alternative fuels and environment friendly hybrid engines. We expect to further leverage our relationship with our

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Controlling Shareholder, Brilliance China, and other customers to increase indirect export of our engines through export of their vehicles installed with our engines.

OUR PRODUCTS

Our principal products are light-duty gasoline and diesel engines. We also manufacture and sell certain spare parts for our engines and provide testing services to external customers. As of the Latest Practicable Date, we manufacture and sell 36 models of automotive engines, including 28 models of light-duty gasoline engines in various displacement ranges, including 15 models under 1.6L (incl.), three models between 1.6L and 2.0L (incl.), eight models between 2.0L and 2.5L (incl.) and two models between 2.5L and 3.0L (incl.); and eight models of light-duty diesel engines between 2.0L and 2.5L (incl.). All 36 models have obtained necessary regulatory clearance, among which 30 models are in mass production, and six models are not in mass production pending the launch of the compatible vehicles. Some of our engines can be converted into compressed natural gas or mixed fuel engines if required by our customers. We developed the ability to manufacture these convertible engines through our in-house research and development efforts and we believe these engines have market potential due to their environment friendly features. Our diversified product portfolio allows us to meet different demands from our customers for a wide range of PVs and LCVs. Substantially all of our products are sold under our “XCE 新晨动力” brand. We believe that our “XCE 新晨动力” brand enjoys high brand recognition in the PRC automotive industry and it was named as one of the “Top 10 Brands for Diesel Engines” by China Internal Combustion Engine Industry Association and China Automotive News in 2010. We focus on producing high quality and high performance/price ratio automotive engines with low fuel consumption, emissions and noise that target the mid to low end automotive markets. All vehicles installed with our engines meet the current mandatory National Emissions Limits (III & IV) and Phase II of the Fuel Consumption Limits, or the equivalent overseas standards, and some of vehicles installed with our engines meet Phase III of the PV Fuel Consumption Limits. Our engines are in compliance with all emission standards, fuel consumption limits and noise limits required for the manufacture and sale of automotive engines in the PRC.

The following table sets forth the revenue and percentage of revenue contribution of our engines sales and other income during the Track Record Period:

	Year ended December 31,						Nine months ended	
	2009		2010		2011		September 30, 2012	
	Revenue (RMB million)	Percentage of Revenue (%)	Revenue (RMB million)	Percentage of Revenue (%)	Revenue (RMB million)	Percentage of Revenue (%)	Revenue (RMB million)	Percentage of Revenue (%)
Light-duty Gasoline Engines	983.7	76.5	1,557.8	80.1	1,803.5	78.2	1,559.9	80.2
Light-duty Diesel Engines	275.2	21.4	352.2	18.1	463.4	20.0	358.6	18.4
Engine components and service income	26.3	2.1	35.1	1.8	40.8	1.8	27.8	1.4
Total	<u>1,285.2</u>	<u>100</u>	<u>1,945.1</u>	<u>100</u>	<u>2,307.7</u>	<u>100</u>	<u>1,946.3</u>	<u>100</u>

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The following table sets forth the sales volume and revenue of our engines by fuel type and displacement range during the Track Record Period:

	Year ended December 31,						Nine months ended September 30, 2012	
	2009		2010		2011		Sales Volume (Unit)	Revenue (RMB million)
	Sales Volume (Unit)	Revenue (RMB million)	Sales Volume (Unit)	Revenue (RMB million)	Sales Volume (Unit)	Revenue (RMB million)		
Light-duty Gasoline Engines								
≤1.6L	32,292	265.8	74,182	589.9	80,326	622.3	86,564	650.5
1.6L — 2.0L	37,227	261.7	46,534	321.7	40,320	290.5	34,011	236.7
>2.0L — 2.5L	49,983	446.3	69,890	635.5	88,238	856.9	65,127	646.3
>2.5L — 3.0L	438	9.9	478	10.7	1,676	33.8	1,402	26.3
Subtotal	119,940	983.7	190,084	1,557.8	210,560	1,803.5	187,104	1,559.9
Light-duty Diesel Engines								
>2.0L — 2.5L	10,768	275.2	14,817	352.2	19,694	463.4	16,543	358.6
Total	130,708	1,258.9	205,901	1,910.0	230,254	2,266.9	203,647	1,918.5

Light-duty Gasoline Engines

As of the Latest Practicable Date, we manufacture and sell 28 models of light-duty gasoline engines, such as JM491Q-ME, XC4G19 and V19. Our gasoline engines have displacements ranging from 1.0L to 2.7L and power ratings ranging from 38.5kW to 120.0kW. Our light-duty gasoline engines are designed to have high performance, low vibration, low noise and low fuel consumption. We have adopted various advanced technologies for our light-duty gasoline engines, such as controlled burn rate (CBR), electronic throttle control (ETC) and variable valve timing-intelligent (VVT) technologies. Our 4A13 and 4A15 models received the “2010 Efficient Fuel Consumption Gold Award” from China Internal Combustion Engine Industry Association and China Automotive News.

The following table sets forth certain details of our main models of light-duty gasoline engines:

Products	Key Specifications (Displacement, Power, Torque)	Applicable Types of Vehicles	Emission Standards	Fuel Consumption Standards	Product Launch Year
4A15*	1.495L, 75kW/5600 — 6000rpm, 135Nm/4000 — 4600rpm	A-segment mini cars, mini vans, mini SUVs	National IV	Phase III	2008
V19	1.997L, 78kW/4600 — 4800rpm, 180Nm/2400 — 3600rpm	SUVs, pickup trucks, small buses, light-duty trucks	National IV	Phase II	2008

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Products	Key Specifications (Displacement, Power, Torque)	Applicable Types of Vehicles	Emission Standards	Fuel Consumption Standards	Product Launch Year
JM491Q-ME	2.237L, 76kW/4200 — 4600rpm, 193Nm/2600 — 3200rpm	SUVs, pickup trucks, small buses	National IV	Phase II	2010
4RB2	2.438L, 102kW/4600 — 5000rpm, 217Nm/2600 — 3200rpm	MPVs, SUVs, pickup trucks, small buses	National IV	Phase II	2008
JM495QF-E	2.693L, 110kW/4400 — 4800rpm, 240Nm/2800 — 3600rpm	MPVs, SUVs, medium buses	National III	Phase II	2006

* Awarded “2010 Efficient Fuel Consumption Gold Award” by China Internal Combustion Engine Industry Association and China Automotive News

Light-duty Diesel Engines

As of the Latest Practicable Date, we manufacture and sell eight models of light-duty diesel engines, such as DK4A, ZD25TCR, D20A and D22A. Our diesel engines have displacements ranging from 2.0L to 2.5L and power ratings ranging from 72kW to 85kW. We have adopted various advanced technologies for our light-duty diesel engines, such as electronic control common rail system, exhaust gas intercooler recirculation system, turbocharger and ETC. We believe that our light-duty diesel engines are compact, powerful, fuel-efficient and produce low emissions, vibration and noise.

The following table sets forth certain details of our current main models of light-duty diesel engines:

Products	Key Specifications (Displacement, Power, Torque)	Applicable Types of Vehicles	Emission Standards	Fuel Consumption Standards	Product Launch Year
DK4A	2.498L, 75kW/3600rpm, 260Nm/1600 — 2400rpm	SUVs, small buses, light-duty trucks, pickup trucks	National III	Phase III	2008
ZD25TCR	2.498L, 80kW/3800rpm, 260Nm/1600 — 2400rpm	SUVs, small buses, light-duty trucks, pickup trucks	National III	Phase III	2008
ZD25TCI	2.498L, 85kW/3800rpm, 280Nm/1800 — 2600rpm	SUVs, small buses, light-duty trucks, pickup trucks	National IV	Phase III	2011

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Our Product Pipeline

According to the Frost & Sullivan Report, market demand for low emission, high fuel-efficiency and high reliability automotive engines has increased both in the PRC in recent years. The demand is largely driven by state policies and regulations and oil price and supply. To take advantage of this market trend, we focus on developing products that have these features. Most of vehicles installed with our latest models of engines comply with National Emissions Limits (IV), and Phase III of the Fuel Consumption Limits, which is a higher standard than the current national fuel consumption limit. We believe we have the market expertise, technological know-how and execution capabilities to develop successful new models of automotive engines. In particular, we intend to focus on expanding our product offerings of 1.0L to 2.0L gasoline engines and diesel engines. As of the Latest Practicable Date, we were in the process of upgrading 11 existing engine models and developing four new engine models, which are in various stages of product development by our in-house research and development team. Among these 15 models, we currently plan to bring five models to the market between 2013 and 2014, including four models of gasoline engines and one models of diesel engines. The table below sets forth the details of these five engine models:

Products	Type of Engine	Key Technology	Emission Standards	Fuel Consumption Standards	Applicable Types of Vehicles	Expected Time to Market
4A15T	1.5L turbocharged gasoline engine	Turbo charger, intercooler, independent cylinder ignition, lightweight piston, ETC, DOHC, VVT	National IV/V	Phase III	Sedans, mid/high-end SUVs	[April 2013]
4A15H	1.5L hybrid gasoline engine	Independent cylinder ignition, lightweight piston, low-tension piston ring, ETC, offset crankshaft	National IV/V	Phase III	Mixed fuel vehicle	October 2014
V22	2.2L VVT gasoline engine	ETC, lightweight piston, low-tension piston ring, VVT	National IV/V	Phase II	SUVs, MPVs, pickups, light-duty buses	April 2014
3TZ	2.7L VVT gasoline engine	Double balance shaft, multi-point fuel injection, ETC, DOHC	National IV/V	Phase III	SUVs, MPVs and small buses	June 2013
DK5	3.0L high pressure common rail system diesel engine	Third generation high pressure common rail system, increased pressure intercooler, EGR, ETC, DOHC, double balance shaft	National IV/V	Phase III	SUVs, MPVs	October 2013

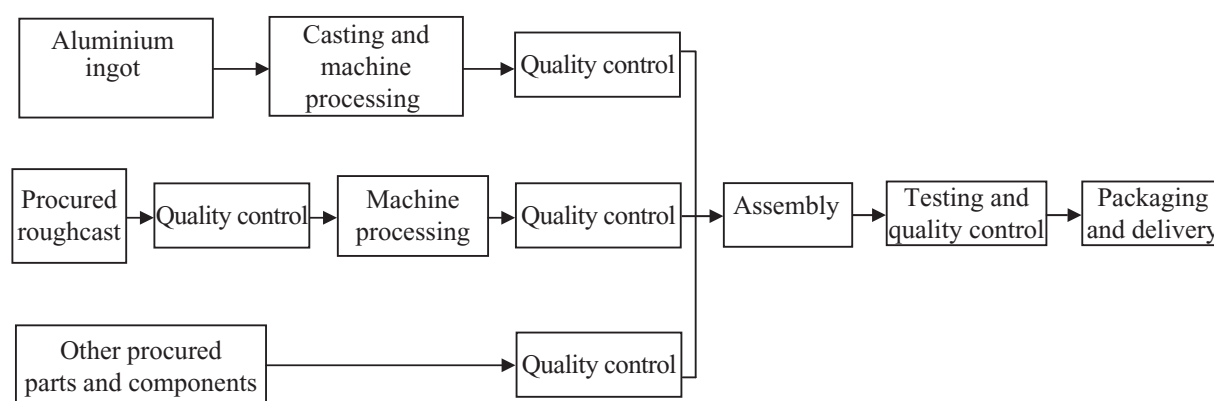
PRODUCTION

Production of our engines generally requires one principal raw material and over 200 kinds of engine components. We source most of the raw material and engine components used in our production from external suppliers. We manufacture a portion of the key engine components, such as cylinder chambers and cylinder heads to control their quality, to protect our proprietary technology and to save costs. The engine components we produce are mainly used for the manufacture of our engines and sale to our

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customers for repair and maintenance purposes. Sales of our engine components accounted for less than 5% of total revenue for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012. Our main raw material is aluminum ingots. We cast and refine aluminum ingots into roughcast, which are then processed and machined into engine components. We also purchase roughcast from third parties which we process and machine into engine components that fit the specifications of our products. All the engine components either purchased directly from third parties or manufactured by us before being assembled must pass quality control and testing to ensure the quality of the final products. The final products are further tested before delivery to the customer.

The following diagram sets forth the manufacturing process of our engines:



We carry out all of our manufacturing activities at our production facilities located in Mianyang, Sichuan Province. Our current production facilities occupy an aggregate site area of approximately 59,043.94 sq.m. with an aggregate floor area of approximately 32,184.86 sq.m. As of the Latest Practicable Date, we had 15 production lines, including three for casting, seven for machining and five for assembly and testing. Our production lines at our production facilities generally operate 16 hours a day, five days a week, with stoppages for routine repairs and maintenance. Our manufacturing employees generally work eight hours a day and two shifts per day.

The following table sets forth the designed engine production capacity and actual engine production volume and utilization rates of our production facilities for the periods indicated:

	Year ended December 31,			
	2009	2010	2011	2012
Designed engine production capacity ⁽¹⁾ (Units)	139,200	200,000	220,800	255,000
Actual engine production volume (Units)	140,323	212,200	220,013	257,093
Utilization rate (%) ⁽²⁾	100.8 ⁽³⁾	106.1 ⁽³⁾	99.6	100.8 ⁽³⁾

(1) Our designed engine production capacity is calculated based on 251 working days per year and two workshifts of eight hours each per day and is the weighted average of the production capacity based on the month of the year in which the production capacity was realized.

(2) Our utilization rate is calculated based on our actual engine production volume divided by our designed engine production capacity.

(3) Over 100% utilization rate was due to the addition of a third workshift during the period.

We maintained an efficient level of facility utilization throughout the Track Record Period due to our prudent capital investment style and ability to design and build flexible production capacity that can be adjusted based on our needs.

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We source our core production equipment from leading international machinery manufacturers from countries such as Germany, U.S., Japan and Austria. We also source some of our production equipment from advanced local machinery manufacturers. We select our equipment suppliers mainly through bidding processes to compare their prices, technologies, delivery times and other factors in order to select the best overall terms for us. We also have the capabilities of designing and assembling our own production lines based on our product design, which we believe can shorten the lead time from product design to the start of production.

Production Capacity Expansion

Mianyang High-Tech Development Zone

We plan to increase our production capacity by constructing new production facilities, improving our manufacturing technologies and acquiring additional equipment. Currently, we are constructing new production facilities located in the Mianyang High-Tech Development Zone in Sichuan Province, approximately 11 km from our current production facilities. Our whole operation, including our current research and development facilities, will be relocated to the new production facilities as encouraged by Mianyang government after the Wenchuan Earthquake. Construction of the new production facilities commenced in April 2010. Since the end of 2010, we have been in the process of transitioning all of our production lines, equipment and personnel to the new location while minimizing the interruption to our operations. The relocation is expected to be completed by September 30, 2013. The estimated capital expenditures in relation to the land acquisition for, and construction of, the new production facilities is approximately RMB245 million, of which RMB[●] million had been spent up to January 31, 2013 and funded by cash flows from our operations and bank borrowings. We expect to fund the remaining RMB[●] million also by cash flows from our operations and bank borrowings. As of the Latest Practicable Date, a part of our production facilities have been relocated and our total production capacity has reached 255,000 units per annum through production technology improvement. Upon full commercial production at our new production facilities, which we currently estimate to be by September 30, 2013, we expect our designed annual engine production capacity to increase from the current 255,000 units to 300,000 units. As during the Track Record Period, the demands for our products had exceeded our production capacity and based on our estimation of the increasing customer demands for our products and the general market environment, we believe that we can sufficiently utilize the expanded capacity.

Upon commencement of full commercial production at our new production facilities, our old production facilities will cease operation. As all of our production and research and development facilities and equipment will be moved to the new site, the old factory and ancillary buildings which have sustained structural damages during the Wenchuan Earthquake will no longer be in use and, although we have no plans yet, we expect to demolish them according to Mianyang city planning as the land has been designated for real estate or other commercial purposes in general. We have no intention to engage in the real estate business even though the old site may be designated for real estate purposes. The local government may claim the land for development and compensate us accordingly, or we may dispose of the land in other ways if necessary. But since Mianyang city has no final plan on how to develop this area, it is impossible for us to evaluate the financial impact at this stage. We do not expect the relocation to new site would result in material write-off of fixed assets and other provisions, as we will relocate substantially all of the equipment and machinery to the new production facilities and the remaining carrying values of buildings and other fixed assets at the old production facilities are immaterial after years of depreciation. As of September 30, 2012, the carrying value of buildings and fixed assets at the old production facilities was approximately RMB5.9 million.

Furthermore, subject to market conditions and the growth of our operations, we plan to construct three new production lines and improve our existing production lines at the new Mianyang production site

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by investing an additional RMB281.7 million between 2013 and 2016, which will be funded entirely with the net proceeds from the [●].

Dongfeng Joint Venture

New production facilities will also be constructed for the Dongfeng JV in Changzhou, Jiangsu Province with a planned production capacity of 200,000 units per annum, to manufacture engines for Dongfeng’s light-duty vehicles. Pursuant to the joint venture agreement entered into between Dongfeng and us in December 2011, the production facility construction is expected to be completed in two phases, with the first phase began in July 2012, and currently is expected to be completed by June 2013, and the second phase expected to finish within 12 months from the commencement of construction. Upon the completion of the phase one construction, the production capacity will reach 100,000 units per annum. Pursuant to the joint venture agreement and articles of association of the Dongfeng JV, the board of Dongfeng JV consists of eight members, four from Dongfeng and four from us. The parties will take turns in nominating the chairman of the board and the general manager of the Dongfeng JV, with Dongfeng nominating the first chairman of the board and us nominating the first general manager. The parties will nominate equal numbers of senior management members of the Dongfeng JV to manage its daily operations. The parties shall share the profits and obligations as shareholders in equal proportion. No party can transfer its interest in the Dongfeng JV without prior consent of the other party and each party enjoys pre-emptive rights in acquiring such interest in the Dongfeng JV. The products manufactured by the Dongfeng JV will include our existing engine models compatible with Dongfeng’s vehicles or new engine models to be developed for Dongfeng’s vehicles. Pursuant to the joint venture agreement, Dongfeng shall ensure Dongfeng JV’s production capacity is fully utilized by procuring sufficient orders. The manufacturing technologies used in the production may be introduced by either party or independently developed by the Dongfeng JV or acquired from third parties. The engines manufactured by the Dongfeng JV will display the independent brand of the Dongfeng JV. Dongfeng JV will be accounted as a jointly controlled entity of our Group.

The total estimated capital expenditures in relation to the construction of the new production facilities is approximately RMB800 million, of which RMB250 million will be funded by the joint venture parties through capital injections in equal proportions and the remaining by joint venture itself by cash flows from its operations and bank borrowings. We estimate that our capital expenditures in relation to the Dongfeng JV is approximately RMB125 million, of which RMB50.0 million was incurred for the nine months ended September 30, 2012 as capital injection to the joint venture by us and funded by cash flows from our operations and bank borrowings. We expect to fund the remaining RMB75.0 million also by cash flows from our operations and bank borrowings. Dongfeng JV was established on January 9, 2012 and has a term of 20 years. The parties to the Dongfeng JV are still in the process of finalizing the details of the JV’s management and operations.

FAW Jilin Production Line Management Arrangement

Furthermore, we entered into a cooperation agreement with FAW Jilin in August 2011 and a subsequent engine production line management agreement in November 2011, pursuant to which we will be a designated engine supplier for FAW Jilin to help satisfy their increasing engine demand. To achieve this strategic cooperation, initially, we will manage, operate and maintain an engine production line owned by FAW Jilin located in Jilin Province. The production line has current annual production capacity of 40,000 units. The engine production line management agreement has a term of five years subject to extension, during which we will manufacture on the production line two of our engine models exclusively for FAW Jilin’s vehicles at a supply price that will be accounted as our revenue, with a discount for the benefit of FAW Jilin. We do not pay any separate fees to FAW Jilin to manage and operate its production line. We will provide raw materials and engine components and key employees and are responsible for daily management of the operations. We are not allowed to transfer,

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sublease or create pledge or guarantee on the production line. We do not expect to incur any capital expenditures in relation to this arrangement as the production facilities belong to FAW Jilin. This operation is currently at production preparation stage. We expect it to commence full production by September 30, 2013.

We plan to manage our production capacity growth by leveraging our experience in managing our existing production facilities and expanding our production capacity cost-efficiently. Our additional production capacity will mainly be applied to satisfy increasing customer demand of our products, especially designated engine models to be installed in Dongfeng and FAW Jilin’s vehicles. The new production facilities will be staffed with our existing experienced management staff and employees and newly recruited employees from local labor market. We will continue to provide various trainings to our employees. We believe that most of our current suppliers are companies who provide their products to multiple customers nationally or even internationally. Therefore, we are confident that they will have sufficient production capacities themselves to provide raw material and engine components to facilitate our production capacity expansion. We will consider procuring from new suppliers based on our production needs who need to comply with our supplier selection process. We will continue to examine our suppliers’ production capacities and product quality to ensure that they will be able to support our production capacity growth. Furthermore, we plan to adopt our existing logistics and quality control systems at our new production facilities. For details of such systems, see “— Logistics” and “— Quality Control.”

PVM Engine Production Line

On December 12, 2012, we entered into an engine assembly license agreement and related agreements with a leading European passenger vehicle manufacturer (“PVM”) and BMW Brilliance Automotive, which authorizes us to manufacture a specific PVM engine model primarily for supply to Shenyang Jinbei for installation into a Jinbei MPV model under an engine supply agreement to be entered into between Shenyang Jinbei and us. Under this agreement, PVM will grant us a non-exclusive license of its technology to enable us to manufacture the PVM engines, and provide us with relevant technical consulting services in relation to the installation of a production line at our production facilities and training of our employees in the production of the engines. In consideration, we will pay royalties to PVM and relevant remuneration and expenses. Furthermore, pursuant to this agreement, we will procure all related engine parts exclusively from BMW Brilliance Automotive.

As of the Latest Practicable Date, further details of this production plan are yet to be finalized by the parties. We expect the production of this engine model will commence around June 2014 and, we expect to install a new production line at our production facilities with an estimated annual production capacity of 50,000 units. The estimated total capital expenditure related to this production plan is approximately RMB100.6 million, which we expect to incur between 2013 and 2016.

RAW MATERIAL AND ENGINE COMPONENTS AND SUPPLIERS

Our production involves one principle raw material and over 200 kinds of engine components which we source from over 200 suppliers. Our principal raw material is aluminum ingots and our engine components include cylinder casting, electronic fuel injection systems, crankshafts and other parts and components. We do not have a single raw material or engine component that accounted for more than 10% of our total costs of raw material and engine components during the Track Record Period. We mainly source our raw material and engine components from various independent third-party suppliers in the PRC, and to a lesser extent, from our related companies. Our suppliers include many well-known parts and components suppliers such as Beijing Delphi Automotive Co., Ltd. (“Beijing Delphi”) and Wuxi Bosch. These reputable suppliers can provide us with a steady supply of quality engine components, such as ETC and high pressure common rail system, which are crucial to the functionality

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and performance of our engines. Most of our major suppliers are located within 200 km of our production facilities, which facilitates the timely delivery of our supplies and reduces transportation costs.

We had one supplier of aluminum ingots during the Track Record Period, with whom we have maintained long-term and stable relationship over the years. We did not experience any shortage or delay of aluminum ingots supply during the Track Record Period. However, we have in the past experienced delays by our suppliers in the delivery of some of the engine components during peak seasons. These delays had no material adverse effect on our operations and we did not receive any compensation from the suppliers or make any compensation to our customers, because only small quantities of certain engine components were delayed by a few days. On these occasions, we adjusted our production plan to use the production lines to manufacture other engine models temporarily. We have more than one supplier for most types of our key engine components. If there is only one current supplier for any type of key engine component, we strive to ensure that there are suitable alternatives available on short notice if required. We believe that this policy allows us to reduce our reliance on single suppliers and minimizes the risk of supply shortage. We may also adjust our production plan if necessary to avoid any suspension of production caused by any potential delays in delivery of raw material and engine components. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, purchases from our top five suppliers represented 32.0%, 34.1%, 30.8% and 35.9% of our total cost of sales respectively, and purchases from our single largest supplier accounted for 9.3%, 9.1%, 7.7% and 9.9% of our total cost of sales, respectively. These top five suppliers mainly include parts and components suppliers, such as Beijing Delphi, Wuxi Bosch and Xinhua Combustion Engine. Save as disclosed in the “Connected Transactions” section of this document, none of our Directors or substantial Shareholders has any interest, direct or indirect, in our major suppliers.

We procure aluminum ingots and engine components from our list of pre-approved suppliers that meet our quality standards. We normally select suppliers based on their quality assurance, prices, technology capabilities, production capacities and delivery time in order to secure the best terms for us. Before confirming the selection of a supplier, our quality assurance team performs background checks on the supplier’s operating history and market reputation, makes on-site visits to the supplier’s production facilities, obtains product samples for inspection and testing by our quality assurance team and conducts interviews with the supplier to assess its suitability and ability to meet our quality requirements. In addition, our quality assurance team conducts on-site assessments of the supplier’s quality assurance systems. We conduct annual reviews of pre-approved suppliers and evaluate them on the basis of, among other factors, quality of goods, speed of delivery, availability of supply and price. Currently, substantially all our suppliers have obtained ISO/TS16949:2009 or ISO9000 certification for their quality management systems.

We normally enter into supply contracts with our suppliers on a yearly basis at the beginning of the year, which provide for, among others, the unit prices of engine components procured under the contracts which remain valid and effective throughout the year. Such unit prices are usually not adjustable. Our purchase price of aluminum ingots is determined based on the market prices of aluminum ingots of the week of delivery. Under the supply contracts, we give periodic purchase quantity orders, which are based on our customer orders and internal forecast, to our suppliers, normally one to two months before the delivery time at the determined contract prices. Our suppliers are responsible to provide us with aluminum ingots and engine components meeting the determined quality, specification and delivery time requirements. Depending on the bargaining powers of the parties and the ownership of intellectual properties contained in the engine components, the supply contracts may be mutually or unilaterally exclusive. Our suppliers are normally required to provide product warranty and indemnify us for the damages and losses caused by defects of their supplies or

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delay in their delivery. Although we do not enter into long-term supply contracts with our suppliers, we are able to maintain long-term business relationships with most of our suppliers. We have on average 11 years of relationships with our top five suppliers. Our economies of scale also allow us, in many cases, to negotiate and secure favorable pricing terms with our suppliers. Such favorable pricing terms include discounts, most favorable prices and marked-to-market prices. We believe that these favorable pricing terms allow us to achieve low production costs.

We also entered into strategic cooperation agreements with some of our suppliers, such as Wuxi Bosch, to secure competitive pricing terms and ensure stable and quality supplies. Pursuant to these strategic cooperation agreements, such suppliers will develop and supply engine components suitable for our engines, assist us to develop new product models, to establish our engine brand in China and overseas markets, and to expand our market share through technology sharing, service training and advertising support. In return, we agree to use their products in certain models of our engines.

Our raw material and engine component suppliers generally offer us credit terms of three months from issuing invoices with a further three to six months for payment by bank promissory notes. The credit term extended by our suppliers may vary, depending on, among others, our relationship with the particular supplier and the volume and prices of our purchases.

INVENTORY MANAGEMENT

Our inventories comprise mainly aluminum ingots and engine components, work-in-progress and finished goods. As of the Latest Practicable Date, we have four warehouses located within the area of our production facilities in Mianyang, and one warehouse located in Shenyang pursuant to a warehouse management agency agreement entered into between us and an independent third party, with a total storage space of approximately 14,000 sq.m.

We conduct regular assessments on our inventories. We generally manufacture our products and purchase aluminum ingots and engine components according to confirmed purchase orders as well as projected sales, which are determined by our management after taking into account the previous month's sales orders, current inventory levels and the sales department's sales forecast for the next one to two months. Our customers routinely provide us with their monthly orders for the coming month and 15 to 20 days' notice for temporary increases in their demand. We collect, on a daily basis, cumulative product sales information, which enables us to adjust our production and inventory levels accordingly. We also closely monitor the inventory levels of our customers on a monthly basis through feedback we receive from them. Furthermore, we have finished products warehouse in Shenyang located close to our large customers to ensure timely delivery of our products to reduce our inventory levels. We require those of our suppliers who are located within 100 km from our production facilities or have warehouses nearby to deliver engine components on a daily basis according to our production schedule. This reduces the time period we need to prepare our inventories of engine components and therefore reduces our own inventory levels. We also have a quota system to control our inventory levels for aluminum ingots and engine components, work-in-progress and finished goods, respectively. Meeting the inventory quota requirements is a factor in evaluating the performance of our relevant personnel.

We have established inventory control procedures to track in-coming and out-going inventory. We have adopted the cycle counting method of physical inventory management. We conduct regular physical counting of our inventory. The results of each stock-take are verified against and reconciled with inventory records in our accounts and warehouse. Any discrepancies are thoroughly investigated by our finance and inventory personnel and corrective measures are implemented by our inventory personnel. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our inventory turnover days were 61, 51, 47 and 40 days, respectively. We adapt and recycle

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unused engine components. Engine components or finished goods that are obsolete are generally written off and disposed of according to relevant environment protection regulations. During the Track Record Period, we wrote off obsolete engine components and finished goods, but the amount of write-offs was insignificant.

LOGISTICS

Generally, we engage independent third-party logistics companies to deliver our products to our customers, with the logistics companies bearing the risks associated with the delivery. All of our products are delivered by truck from our production facilities directly to the locations of our customers in the PRC and then despatched to their production facilities according to their requirements. We normally bear the entire delivery cost. Occasionally, our customers choose to pick up the products from our facilities and bear the transportation costs themselves. During the Track Record Period, we did not experience any material disruption in the delivery of our products and we did not suffer any loss or pay any compensation as a result of delays in delivery or poor handling by the independent third-party logistics companies. In the future, as our sales network expands, we may build production facilities near the locations of our customers to shorten the delivery time to our customers.

Our suppliers, except for those located within 100 km from our production facilities, generally ship aluminum ingots and engine components to Mianyang and have them stored in warehouses of independent third-party logistics companies engaged by our suppliers. These logistics companies subsequently deliver aluminum ingots and engine components from their warehouses in Mianyang directly to our production lines or, in limited instances, other places designated by us. The deliveries to our production lines or other places designated by us are made on a daily basis based on our production plans. Upon such deliveries, aluminum ingots and engine components are recorded as our inventories. This practice reduces our logistics and storage costs as compared to maintaining our own transportation team and storage space, because these logistics companies can provide the delivery services at lower costs. It also reduces our inventory levels, because before they are delivered from the logistics companies' warehouses to our production lines or other places designated by us, aluminum ingots and engine components in the logistics companies' possession are considered properties of the suppliers instead of our inventories.

We have stringent criteria for the selection of independent third-party logistics companies, such as market reputation, business scale, track record and cost. We evaluate their performance on a monthly basis. The engagement of independent third-party logistics companies to deliver our products to our customers allows us to reduce our capital investment in establishing our own logistics team and reduce the risk of liability for transportation accidents, delivery delays and loss.

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our total transportation costs were RMB19.9 million, RMB33.3 million, RMB19.0 million and RMB20.5 million, respectively, accounting for 38.3%, 50.6%, 39.2% and 51.1% of our total selling and distribution expenses for the same periods, respectively.

RESEARCH AND DEVELOPMENT

We believe research and development is the cornerstone of our competitiveness, growth and development. Our research and development activities focus on designing and developing new models of automotive engines as well as improving various aspects of the engine performance, such as emission levels, fuel efficiency and reliability. As of the Latest Practicable Date, we had independently developed and commercially launched over 36 gasoline and diesel engines with displacement ranging from 1.0L to 2.7L, which are widely used in PVs and LCVs. We were certified as a High and New Technology Enterprise by the Sichuan Province branch of MST and other applicable authorities in

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December 2008 for a term of three years, which entitled us to enjoy a reduced enterprise income tax rate of 15%. This certification was renewed in 2011, allowing us to continue to enjoy this reduced tax rate for another three years until December 31, 2014. As of the Latest Practicable Date, we had [56] effective patents and [16] pending patent applications. During the Track Record Period, we submitted [49] patent applications in the PRC, of which [32] have been granted, one was withdrawn and [16] are still pending approval. No patent application was rejected during the Track Record Period. Our PRC legal adviser, Jingtian & Gongcheng, has advised us that there is no legal impediment for us to obtain the approvals for the pending patent registration if these patent applications pass the substantive examination where applicable and meet the patentability criteria as set out in the PRC Patent Law and other applicable rules.

We undertake all of our research and development activities in-house. We perform thorough market analysis and feasibility studies before commencing any product research and development project and focus on engines that have the potential to gain widespread market acceptance or become the best among similar classes of products on the market. We reach out to potential customers as early as their product development stage and communicate with our customers on a regular basis to understand their needs. From time to time, we design engines that are compatible with their specific vehicle models through entering into joint development contracts with our customers and third parties. This allows us to secure target customers at the research and development stage. The intellectual property resulting from such research and development may belong to us or our customers, and our customers may bear part or all of the development costs. In February 2009, our D20 light-duty diesel engine development project was included in the National High-Tech Development Plan, or the “863 Plan”, in the modern transportation technology, energy efficiency and new energy automotive areas by the MST as recognition of our strong research and development capabilities. We have successfully developed the D20 engine. In the future, our research and development activities will be focused on improvement of existing products, development of new models of light-duty engines, as well as fuel-efficient and environmental friendly fuel-electricity hybrid engines. For example, our research and development projects include developing a less than 1.5L displacement fuel-electricity hybrid engine. As of the Latest Practicable Date, we were in the process of upgrading 11 existing engine models and developing four new engine models, which are in various stages of product development by our in-house research and development team.

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our research and development costs, which included research expenses and amortization of capitalized development costs, amounted to RMB24.7 million, RMB31.5 million, RMB29.8 million and RMB14.0 million, respectively, which accounted for 1.9%, 1.6%, 1.3% and 0.7% of our revenue, respectively.

Our In-house Research and Development Capabilities

We have established an advanced research and development team comprising over 160 research and development personnel, including our employees and external consultants. Our research and development personnel have on average over 12 years of relevant industry experience in mechanical engineering, internal combustion and other related areas. We believe that our research and development personnel have deep understanding of the PRC automotive industry and regulatory environment, which allows us to maintain our existing position among our peers while responding quickly to market changes. Our research and development center was recognized as a “state-certified enterprise technology center” by the NDRC and other government authorities in 2004 and our laboratory gained accreditation qualification of the China National Accreditation Service for Conformity Assessment in 2007. Our research facilities are equipped with 50 advanced design software, equipment and instruments from leading international machinery, auto parts and automotive manufacturers to strengthen our research and development capabilities and to improve the performance of our products in areas such as power, fuel consumption, emissions and reliability. Our lead-time for

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development of a new model of automotive engine is typically not more than two years, which has allowed us to develop and commercially market at least one new product each year during the Track Record Period.

We have entered into confidentiality agreements with our research and development personnel that secure our rights to relevant intellectual property developed by them during their term of employment.

Our research and development track record has been acknowledged by the PRC Government and we have received government funding in recognition of these proven capabilities. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, we recognized government grant income of RMB1.4 million, RMB1.9 million, RMB1.4 million and RMB0.3 million, respectively, in the form of government funding or subsidies in relation to various research and development projects to enhance our competitiveness in our industry and to promote our new products. These government grants are non-recurring in nature.

To further strengthen our research and development capabilities and take advantage of the support and incentives offered by the local government, we intend to establish a new research and development center in Chengdu, Sichuan Province, which we expect to start operation in 2014. Chengdu is the capital of Sichuan Province with convenient transportation network and developed infrastructure. In 1993, Chengdu was identified as the Southwest China science and technology, commerce, transportation and financial center and communications hub by the PRC Government. We believe choosing Chengdu as the location of our new research and development center will help us to attract and recruit qualified research and development personnel, to have access to convenient transportation network for communicating with our customers and research and development partners, and to benefit from favorable local government policies. We plan to gradually relocate our current research and development facilities and activities to the Chengdu research and development center once it is completed. We plan to purchase a piece of land with an area of approximately 100,000 sq.m. in Chengdu for our new research and development center. In the future, we also plan to purchase additional advanced equipment and hire additional qualified research and development staff to support the expansion of our research and development activities. We believe our plan to build the Chengdu research and development center is consistent with the industry practice that the manufacturing branch of an auto engine company is located at low labor cost cities whereas its research and development center is located at major cities. The total estimated capital expenditures in relation to the new Chengdu research and development center through 2016 are approximately RMB115.2 million, including RMB11.0 million for acquiring research equipment, RMB99.2 million for construction works and RMB5.0 million for relocating and adjusting existing research equipment which will be funded by cash flows from our operations and the net proceeds from the [●]. As of the Latest Practicable Date, the construction of the new Chengdu research and development center is in the planning stage and has not commenced yet. We expect to start investing in and commence the construction of the center in 2013. For further information on our research and development initiatives, see “— Our Products — Our Product Pipeline” in this document.

Collaborations with Other Institutions

In addition to our independent product development, historically we have also entered into collaboration arrangements with leading international machinery, auto parts and automotive manufacturers and consulting firms, such as Wuxi Bosch and Global Optima to develop new technologies to improve the performance of our products in areas such as fuel consumption, emissions and reliability. Such collaborations have enabled us to develop new engine models such as the V19 gasoline engine with CBR, VVT and ETC technologies and the DK4 series diesel engines with electronic control common rail system, EGR (intercooler), turbocharger and ETC technologies. The terms of our collaboration arrangements with leading international machinery manufacturers vary,

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depending on the subject and nature of the research and our commercial arrangements with them. We provide the necessary equipment and personnel and our research partners offer their expertise. We generally provide funding for these joint research and development projects and we are entitled to receive the proceeds from the sales of these products and other benefits resulting from the successful development and commercialization of the products. Normally, the intellectual property rights developed during the process, if independently developed by one party, are owned by that party, and if jointly developed, are jointly owned by us and our research partners. We plan to increase our collaborations with our existing research partners as well as new research partners. We believe these collaborations will help us to further strengthen our research and development capabilities and expand our product portfolio and pipeline.

CUSTOMERS

Our customers include local and foreign-invested automotive manufacturers and automotive components companies in China. End customers of our products are automotive manufacturers that install our engines in their vehicle. Our top customers during the Track Record Period include Brilliance China, our Controlling Shareholder, Huachen Group, and their subsidiaries and affiliates, and other well-known automotive manufacturers in China, such as Zhengzhou Nissan, Xiamen Golden Dragon and GAC Changfeng. We have maintained stable and long-term relationships with our customers, with our average relationship with major customers spanning five years. As of December 31, 2009, 2010 and 2011 and September 30, 2012, apart from our Controlling Shareholders and Huachen, we had 24, 26, 24 and 31 customers, respectively. Our engines also reach overseas markets through sales of vehicles installed with our engines, however such sales overseas are not directly conducted by us.

We believe that our core competency lies in our ability to establish stable customer relationships as early as in the product development stage. As engine compatibility is part of the whole vehicle development plan, we strive to become the designated engine supplier to our customers when they develop their vehicle models. Once their vehicles are bundled with our engines, it is costly and time-consuming for our customers to replace us with other engine suppliers, because of the extensive testing required of new engines to be compatible with their vehicles and related registration requirements with relevant regulatory authorities.

Consistent with industry practice in the PRC, before embarking on the sale of new products or sales to new customers, we must first undergo customer approval processes and become an approved supplier of our target customers. Such approval process may take months, during which we are required to submit our sample engines and related specifications and qualifications to our potential customers, who will conduct a series of tests to determine whether the functionality, compatibility and quality of our engines are in compliance with their requirements. This approval process may be carried out in conjunction with joint product development by our customers and us. During the Track Record Period, we did not fail to pass any existing customer's approval process for a new product or fail to maintain existing customer approvals due to our product quality.

Supply Agreement

Once we become a selected engine supplier, we normally enter into a one-year supply agreement with our customer at the beginning of the year. Our supply agreements are normally on a non-exclusive basis. As we are an independent branded engine supplier, we supply our engines to multiple related and unrelated automotive manufacturers in the market. The key terms of the supply agreement generally include but are not limited to the prices of our products, estimated annual purchases, warranty, credit period and return policy. Our customers provide us with an estimate of their annual purchases at the beginning of the year and place orders with us on a periodic basis. Failure to reach the

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estimated annual purchases does not constitute a breach of the supply agreement by the customer. The unit prices set out in the supply agreement at the beginning of the year usually remain valid and effective throughout the term of the supply agreement. We may give favorable pricing terms to our customers, including discounts, most favorable prices and marked-to-market prices. We normally cannot adjust product prices once they are determined in the contracts, unless the contracts have provided for price adjustments in the event of significant fluctuations in engine component costs, in which case, we attempt to adjust the engine prices through good faith negotiation with our customers. Our customers may also ask us to lower the engine prices if they increase order quantities significantly. We generally extend a credit period between 30 to 60 days to our non-related customers and three months to our related companies customers with a further three to six months for payment by bank promissory notes. In certain circumstances, we may require our customer to make a deposit with us before we deliver our products.

Warranty Policy

We provide warranties on our products to all of our customers. Under the warranty, we typically agree to repair and replace defective parts for a period of two to three years or until the product has been running for over 50,000 km to 60,000 km, whichever is earlier. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our warranty costs amounted to RMB4.5 million, RMB12.3 million, RMB8.1 million and RMB7.8 million, respectively.

Product Return Policy

Our product return policy only allows products to be returned due to product defects as assessed and agreed upon by our quality assurance team. During the Track Record Period, we did not receive any material product returns or make any large-scale product recalls due to any quality defects, which would have a material adverse impact on our business and results and operations.

Major Customers

Our single largest customer during the Track Record Period was our connected person, Mianyang Ruian, who is a wholly-owned subsidiary of Brilliance China, for 2009 and 2010, and an independent third-party, Zhengzhou Nissan, for 2011 and the nine months ended September 30, 2012. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our sales to our single largest customer accounted for 29.2%, 23.2%, 27.9% and 26.4% of our revenue, respectively. Our engines purchased by Mianyang Ruian are primarily installed in vehicles manufactured by Brilliance China Group. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, sales to the top five customers of our Group, accounted for 82.9%, 77.8%, 76.0% and 75.3%, of our revenue, respectively.

We sell a substantial portion of our engines to our related companies. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our sales to Brilliance China Group on a group basis accounted for 48.8%, 41.4%, 18.0% and 19.6% of our revenue, respectively, sales to Huachen Group on a group basis accounted for 2.8%, 13.9%, 28.7% and 25.0% of our revenue and sales to our top five customers on a group basis accounted for 86.8%, 86.1%, 84.9% and 81.7% of our revenue, respectively. Such top five customers on a group basis include Brilliance China Group and Huachen Group. The key terms of the supply agreements with our related companies are comparable to those contained in the supply agreements we enter into with other non-related customers. Our Company has been a jointly controlled entity of Brilliance China during the Track Record Period and we have been and expect to continue to leverage on the growth of Brilliance China Group to sustain our future sales revenue and generate a significant portion of our revenue from sales to Brilliance China Group. We believe that our close relationship with our Controlling Shareholders

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has provided and will continue to provide us with a competitive edge in our industry. For further details, see “Connected Transactions” in this document.

Strategic Alliances With Key Customers

From time to time, we enter into strategic alliance agreements with our key customers to strengthen our existing relationships, to provide for future cooperation and to secure future demands for our products.

We entered into a non-binding strategic alliance agreement with Dongfeng in January 2007 to jointly develop engines compatible with Dongfeng’s vehicles. Under the agreement, Dongfeng shall give us priority when selecting engine suppliers based on quality, cost, delivery time and development standards. To solidify this strategic alliance, in January 2012, we established the Dongfeng JV with Dongfeng to manufacture engines primarily for their light-duty vehicles. For further details, see “— Production” in this document.

We entered into a strategic alliance agreement with Zhengzhou Nissan in February 2007 to jointly pursue the research and development and production of advanced engines for Zhengzhou Nissan SUVs and pickups. Pursuant to the strategic alliance agreement, the strategic cooperation is spear-headed by senior managements from both parties who meet every six months and discuss and decide the cooperation plans and operations. We are responsible for the research, manufacture and improvement of the project engines and providing technical support and after-sales services to Zhengzhou Nissan. The project engines are based on our existing engine models but adapted to Zhengzhou Nissan’s vehicles to differentiate from our engines supplied to other automotive manufacturers. Intellectual property developed that relates to engine component differentiation shall belong to Zhengzhou Nissan. Our existing cooperations include the installment of DK4 diesel engines and 4RB and 4A15 gasoline engines in Zhengzhou Nissan’s National III emission standard-compliant vehicles. Pursuant to the strategic alliance agreement, we provide the project engines exclusively to Zhengzhou Nissan and in return, Zhengzhou Nissan guarantees an unspecified minimum order amount from us. Subsequently, we have entered into sales and purchase agreements with Zhengzhou Nissan on an annual basis, which provide for detailed terms, including the selling prices and quantities of the engines to be procured from us.

We entered into an operation agreement with FAW Jilin in August 2011 and a subsequent engine production line management agreement in November 2011, pursuant to which we will manage, operate and maintain an engine production line owned by FAW Jilin to manufacture on the production line two of our engine models exclusively for FAW Jilin’s vehicles. This arrangement fortifies our supplier-customer relationship with FAW Jilin and, to a certain extent, secures our future production quantity under this arrangement. For details of this arrangement, see “— Production” of this document.

One of our strategies is to increase our market share by strengthening relationships with our existing customers and developing new customer relationship. See “— Our Strategies” of this document for more details.

SALES AND MARKETING

Sales Team

As of the Latest Practicable Date, our sales team consisted of 77 sales personnel located in 14 sales regions across China covering local customers in different geographic regions. All of our sales personnel have experience in the automotive and engine industries and are familiar with industry practice and trends. Our local sales teams are managed by our sales department located at our headquarters in Mianyang. Our sales department and our local sales teams are primarily responsible for

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developing new customers, enhancing relationships with our existing customers, obtaining sales orders, providing after sales services to engine service stations and collecting market information. Our regional sales offices foster strong working relationships with our customers by maintaining regular contact with them and conducting on-site discussions and inspections. Through such communications, we are able to better understand the latest market developments and our customers' businesses and requirements. This helps us to serve them better and to fulfil their needs in a timely manner.

Service Stations

As of the Latest Practicable Date, our local sales teams supported a national network of over 250 engine service stations operated by independent third parties that are designated by us to provide engine repair and maintenance services. We enter into renewable yearly non-exclusive service contracts with these service stations, pursuant to which they provide engine repair and maintenance services to the end-users, such as automotive drivers and owners, for automobiles installed with our engines during our engine's warranty period. To qualify as our designated service stations, the service station need to locate in an area where there is a sufficient amount of end-users of our engines. It also need to demonstrate sufficient technical and financial capabilities to provide engine repair and maintenance services in accordance with the engine repair and maintenance procedures and standards set out by us. Under these contracts, we mainly provide them with spare parts, technical support, and regular training. We settle our payments to the service stations on a monthly basis. The payments include, based on the detailed repair and maintenance reports submitted by the service stations to our after-sales department, labor costs calculated on an hourly rate, spare parts costs, traveling costs for traveling to customer locations, old parts shipping fees and accessories fees.

Pricing Policy

We determine and adjust our product prices on the basis of market supply and demand, production costs, pricing of comparable products in the market and prevailing market conditions. Pricing is considered as early as in the product development stage when we propose our engine prices to the automotive manufacturers, who take such pricing into consideration when they choose engine suppliers and price their own products. We may price our products at a premium for our reputation and product quality when competing with other domestic manufacturers. For products facing intense competition, we price our products to remain competitive against comparable products in the market and to obtain new market share. We have experienced downward pressure on our product prices as our competitors lower their product prices and at the request of our customers as part of their cost control efforts. We strive to maintain our competitiveness through providing high-quality products and before and after-sales services. We conduct periodic reviews of our pricing strategy. We offer discounts to customers that purchase in large quantities.

Marketing

We conduct both product-specific and more general brand marketing activities as part of our overall marketing strategy. We discover potential customers through market research and then conduct targeted marketing activities, such as customer visits, new technology seminars, product demonstrations and free customer services, to secure such potential customers. We also collect market information and develop products at our customers' requests to increase our brand recognition and product development success rate. We regularly participate in international and domestic industry exhibitions and conferences to identify new customers, promote our products and brand and to keep up to date with market and industry trends and new technologies. We also conduct advertising campaigns through various media, including newspapers, magazines and outdoor advertisements, to raise our brand awareness.

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Our current marketing focus is on promoting our light-duty gasoline engines, as we believe that demand for these engines will continue to increase in the future. As customers and potential customers become increasingly environmentally conscious, they tend to purchase more light vehicles with lower emissions, high fuel efficiency and reliable engines. Our light-duty gasoline engines are well positioned to benefit from this trend and we expect to continue to focus on our light-duty gasoline engines in the future.

Customer Service

We provide a comprehensive range of before and after-sales customer services from engine selection to end-user services. We offer consultation services to our customers as early as at the pre-sale stage. We work closely with our customers and potential customers to understand their needs and offer advice to them to help them select the engine models that are suitable to their requirements and specifications. We carry out joint product development efforts with our customers to satisfy their specific requirements, which we believe gives us a competitive advantage over other engine manufacturers, particularly when we are selected as our customers' designated engine supplier. We offer on-site and off-site technical support from the pre-sale to after-sale stages through over 250 authorized third-party service stations throughout the country. This large service station network ensures that our customers are able to optimize their use of our products and are satisfied that our products are suitable for their requirements and specifications. For our newly developed or custom-designed engines, we visit our customers on a regular basis to follow up on the adaption of our engines to their vehicles. Our customer service strategy also enables us to obtain feedback from our customers and potential customers which helps us to introduce new products or improve our existing products to meet their needs.

QUALITY CONTROL

We believe that effective quality control is critical to ensuring the quality of our products and maintaining our reputation and success. We seek to ensure that our products consistently meet high industry standards and requirements. We obtained ISO/TS16949:2002 certification and ISO/TS16949:2009 certification for our quality management systems in 2005 and 2010, respectively, which indicates our compliance with internationally recognized standards for quality control. Each year we review the operation of our quality management systems and make appropriate adjustments to maintain the effectiveness of our quality management systems. We have a strict quality control system to monitor and control each stage of our production process, including raw material and engine components procurement, manufacturing and inspection of finished products, to ensure the quality of the final products. As of the Latest Practicable Date, our quality assurance team had 53 employees, including one senior engineer. They are required to become familiar with the relevant PRC national standards, applicable ISO standards, industry standards and the legal and regulatory requirements applicable to our products. They are also required to attend professional training before performing certain quality assurance tasks. We also strive to improve our quality control system and practice by engaging outside consultants and cooperating with leading PRC and overseas vehicle manufacturers. At each stage of the production process, dedicated quality inspectors are assigned to inspect each process according to pre-determined standards and inspection conditions and to record inspection results. Our major customers also conduct periodic review of our quality control system to ensure we comply with their quality standards. As a result of our stringent quality assurance system, we had not experienced any significant product returns, received any material complaints regarding quality or recalled any of our products during the Track Record Period.

Raw Material and Engine Components Quality Control

We select qualified suppliers during the product development stage. Potential suppliers need to pass preliminary, sampling and pre-production testing before becoming our approved suppliers for mass

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production. All externally supplied raw material and engine components are checked for conformity with the required quality and specifications, either through routine inspection or sample testing, depending on whether the supplier has strong quality control capabilities and has consistently provided us with high quality supplies. Defective supplies are returned to the suppliers at their cost. We also send our quality control personnel to our suppliers’ sites to oversee the manufacturing process and ensure the quality of certain safety-related and other key engine components.

Production Quality Control

Throughout the production process, our products are subject to the inspections of our manufacturing personnel, workshop supervisors and quality assurance department. At each stage of our production process, dedicated quality inspectors are assigned to inspect each process according to pre-determined standards and inspection conditions. Any abnormalities discovered are rectified immediately and recorded. Our production equipment operators are required to adhere strictly to standard equipment operating procedures.

Finished Product Quality Control

All our finished products are subject to engine test runs. In addition, every batch of our finished products is subject to a sample inspection by our quality assurance personnel prior to dispatch to our customers. If no defect is detected, a product approval certificate will be issued and such product will be sent to the warehouse. Our warehouse only releases products that have obtained the product approval certificate.

INTELLECTUAL PROPERTY

We recognize the importance of intellectual property rights to our business and are committed to the development and protection of our intellectual property rights. As of the Latest Practicable Date, we had three registered trademarks in the PRC, and one registered trademark in Hong Kong, [60] effective patents and [9] pending patent applications. During the Track Record Period, we submitted [49] patent applications in the PRC, of which [36] have been granted, four were withdrawn and [9] are still pending approval.

The validity period for our utility patents is 10 years and the validity period for our invention patents is 20 years, starting from the date the relevant application is filed. All of these patents were issued in the PRC. A patent holder in the PRC enjoys the exclusive right to exclude others from using, licensing and otherwise exploiting the patent in the PRC.

Under PRC law, we have the exclusive right to use a trademark for products and services that we have registered with the PRC Trademark Office of the SAIC. Trademark registration in the PRC is valid for 10 years, starting from the day the registration is approved. If we believe that a third party has infringed upon the exclusive right of our registered trademarks, we may, through appropriate administrative and civil procedures, institute proceedings to request an injunction from the relevant authority or resolution of the infringement through consultation. The relevant authority can also impose fines, and confiscate or destroy the infringing products or equipment used to manufacture the infringing products.

We believe that our primary trademark is well recognized in the PRC automotive engine industry. Our “XCE 新晨动力” brand was named as one of the “Top 10 Brands for Diesel Engines” by the China Internal Combustion Engine Industry Association and China Automotive News in 2010. As our brand name is becoming more recognized in the PRC automotive engine industry, we are devoting our efforts

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to increasing and enforcing our intellectual property rights, which are critical to our overall branding strategy and reputation.

During the Track Record Period, we did not experience any infringement of our intellectual property rights, including incidents involving counterfeit or imitation products, that had a material adverse effect on our business.

Some of our manufacturing methods or processes involve unpatented, proprietary technology, processes, know-how or data. With respect to such proprietary know-how that is not patentable and processes for which patents are difficult to enforce, we rely on trade secret protection and confidentiality agreements in order to safeguard our interests. All of our research and development personnel have entered into confidentiality, non-competition and proprietary information agreements with us. These agreements require such employees to assign to us all of their inventions, designs and technologies that they may develop during their periods of employment with us.

COMPETITION

Our Directors consider the automotive engine industry in which we operate to be highly competitive. Although the industry has high entry barriers, such as technology requirements, equipment requirements and customer recognition, the competition among existing market players is intense in terms of product quality, pricing, performance, reliability, timeliness of delivery, product development capabilities, customer service and overall management. According to the Frost & Sullivan Report, domestic engine brands occupied 43.4% of the Chinese PV and LCV engine market in 2011. We believe that the increase in the market share of local automotive manufacturers encourages the development of local engine suppliers such as us, because local automotive manufacturers in general prefer to source engines from local engine manufacturers. In comparison, global automotive manufacturers in China generally prefer to source engines from their captive brand suppliers.

Our key competitors consist of local automotive engine manufacturers as well as large foreign-invested automotive engine manufacturers in China. In the LCV engine sector, we believe our main competitors include Dongfeng Chaoyang Diesel Engine Co., Ltd. and Beijing Foton Cummins Engine Co., Ltd, both of which are captive brand engine suppliers. In the PV engine sector, we believe our main competitor is Shenyang Xinguang Brilliance. Shenyang Xinguang Brilliance is an independent brand Sino-foreign equity joint venture held as to 50% by Brilliance China. See “Relationship with Our Controlling Shareholders and Huachen — Excluded Business of Brilliance China” in this document. Although our brand may not be as well recognized as some of the foreign-invested automotive engine manufacturers and many of them have substantially greater financial resources than we do, we believe we have advantages in terms of low production costs, better understanding of the PRC market and favorable government support provided to PRC local automotive engine manufacturers. We expect to keep benefiting from these advantages in the future when competing against foreign-invested automotive engine manufacturers. We were one of the first companies in our industry and our brand name and reputation are well recognized in the PRC market. Also, compared with those captive brand engine manufacturers who supply exclusively to the same brand automotive manufacturers, our independent branding strategy allows us to sell our engines to multiple automotive manufacturers and gives us the flexibility to capture the fast-growing PV and LCV engine segment of the automotive industry in China. We believe that the PRC automotive engine industry will remain intensely competitive going forward.

PROPERTY INTERESTS

Our current production facilities, administrative facilities, research and development facilities, warehouses and employee’s dormitories are primarily located in Mianyang, Sichuan Province and

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occupy six parcels of land with an aggregate site area of approximately 59,043.94 sq.m., with an aggregate floor area of approximately 32,184.86 sq.m.. We have obtained the land use rights for substantially all the site area and the building title certificates for the entire floor area. In addition, we also have several properties for residential purposes located in Mianyang, Guangzhou, Changsha and Shenyang with an aggregate floor area of 1,067.4 sq.m. used by our local sales staff.

The Wenchuan Earthquake in May 2008 caused damage to our factory buildings and other damage to our equipment and inventories. Our operations were suspended for three days and product deliveries to our customers were temporarily delayed. By the end of 2009, our production capacity had substantially recovered to the pre-earthquake level. The actual impairment loss on our assets caused by the Wenchuan Earthquake was mainly related to scrapped engine components of RMB2.3 million (included in provision of inventories in 2008) and fixed assets slightly damaged by the earthquake. The loss of business due to the Wenchuan Earthquake was estimated to be RMB118 million, which was not accounted for in our financial statements. See “Risk Factors — Our business may be significantly affected because of factors beyond our control” in this document. In early 2009, the Mianyang local government offered us a piece of land in the Mianyang High-Tech Development Zone, approximately 11 km from our existing factory, for the relocation of our production plant. Owing to our need to increase our production capacity and encouraged by the local government as part of the post-earthquake city planning, we decided to relocate to the Mianyang High-Tech Development Zone to construct new production facilities and signed the relevant agreement with the local government in October 2009. The new production facilities occupy two parcels of land with an aggregate site area of approximately 202,588.14 sq.m. and construction area of approximately 88,474 sq.m. We obtained the land use rights for these lands from the Mianyang Bureau of State-owned Land and Resources for a term of 50 years for a total consideration of approximately RMB50.6 million. The new factory buildings are constructed using a steel structure designed to withstand strong earthquakes. We have obtained the necessary construction permits related to this project. We currently expect our new production facilities to finish construction and commence full commercial production by September 30, 2013. Although we have no concrete plans yet, we plan to demolish the old factories and ancillary buildings and dispose of the land where the old factories and buildings are located according to Mianyang city planning.

We do not engage in any property activities as defined in [●] of the [●]. The total carrying value of our property interests accounted for approximately 7.6% of our total assets as of September 30, 2012 (calculated by reference to the book value of the relevant property interest, including land costs, buildings and construction in progress, as a percentage of the value of our total assets, both as shown in the Accountants’ Report in Appendix I to this document). Calculated on the same basis, no single property had a carrying value exceeding 15% of our total assets as of September 30, 2012. No property valuation report in respect of the Group’s property interests is required in reliance upon the exemption provided by [●].

We confirm that there has not been any major acquisitions or disposals of properties since September 30, 2012.

For further details of the owned and leased properties of our Group, see “Statutory and General Information — B. Further Information about our Business — 5. Properties” in Appendix V to this document.

ENVIRONMENTAL COMPLIANCE

We are subject to national and local environmental protection regulations in China. Under the relevant PRC laws, we are not allowed to start any projects until we have obtained the required approvals from relevant environmental authorities and such authorities are satisfied with our environmental impact

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assessments. Under the Environmental Impact Appraisal Law effective from September 1, 2003, we must submit environmental impact assessment reports to the Ministry of Environmental Protection at the relevant national, provincial or local levels with respect to any environmentally sensitive projects, which, as set forth in the catalogue published by the Ministry of Environmental Protection, include engine and equipment production. For any environmentally sensitive project, we must engage a qualified environmental appraiser to assess the environmental impact of such project and prepare a report for submission to the relevant environmental authorities. In addition, PRC laws do not permit any environmentally sensitive project to begin construction until the government regulators are satisfied with the environmental impact assessment. Further, upon completion of the construction project, we are required to apply for inspection of the completed project with the relevant environmental protection authority. Meanwhile, we must also obtain the relevant emission permits and are required to discharge only the pollutants of the types and quantities specified in the emission permits.

In order to comply with the applicable environmental protection laws, we have engaged qualified agencies to prepare the relevant environmental impact assessment documents, obtained the required approvals from relevant environmental protection authorities, passed relevant inspections, obtained the necessary emissions permits and complied with the terms of such permits. During the Track Record Period, we have complied with applicable national and local environmental protection laws and regulations, and we have not received any warning or sanctions or fines imposed by the PRC environmental authorities for incidents of non-compliance with respect to our production facilities.

The pollutants that we discharge primarily consist of exhaust fumes, solid waste, waste oil and water and noise. We have obtained necessary pollutant discharge permits and complied with applicable PRC laws and regulations in treating and disposing of these pollutants. We believe the pollutions discharged are within the permitted emissions standards and will not have any material impact on the environment.

We strive to reduce the environmental impact from our products and production processes and have adopted a number of measures to achieve this objective. Waste water is processed by our own waste water treatment station to reach national safety standards for disposal. Other wastes are collected and disposed of by qualified industrial waste processing and environmental protection entities. We believe the nature of our operations does not create material risks that give rise to environmental protection issues and the above-mentioned measures taken by us are sufficient to maintain our compliance with applicable environmental protection laws and regulations.

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our cost of compliance with the applicable environmental rules and regulations was approximately RMB0.05 million, RMB0.07 million, RMB0.08 million and RMB0.1 million, respectively. We expect that the annual cost of compliance with such rules and regulations will amount to approximately RMB0.1 million, RMB0.1 million and RMB0.1 million in years 2012, 2013 and 2014, respectively.

HEALTH AND SAFETY COMPLIANCE

Pursuant to national and local health and safety laws and regulations in China, we are required to ensure a safe production and working environment for our employees by providing them with adequate protective clothing and gear, safety education and training and having dedicated safety management personnel, among other requirements. In addition, operators of some of our heavy equipment must undergo special training and obtain special work permits. In order to comply with such laws and regulations, we have developed and implemented a comprehensive safety guidelines and have established a production safety management committee, which is responsible for the supervision and implementation of the safety guidelines and the investigation and analysis of any employee injury or fatality and workplace accidents. We have also provided safety training for all of our personnel and

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have ensured that the operators of the heavy equipment have undergone the required special training. During the Track Record Period, we have complied with all applicable state and local health and safety laws and regulations in all material respects.

During the Track Record Period, we had six incidents resulting in material injuries to our employees during the production process. The injuries were caused by the non-compliance of our safety guidelines by the injured employees or accidents. In addition, there were two employee deaths, neither of which was related to workplace safety. The first case was related to an employee who died at home as a result of carbon monoxide poisoning, and the other case was related to the sudden death of an employee at work due to his own illness. The employees and their families were compensated by the social insurance and welfare fund and relevant payments have been settled in full. As of the Latest Practicable Date, there was no outstanding claims from the employees or their families against us. As a result of the accidents, we added protective parts to the machinery to prevent human errors. We will also continue our employee safety training and enforce our safety guidelines to avoid occurrence of similar incidents. We did not make any payment to the employees or suffer any government investigation or penalty as a result of the above incidents. See “Risk factors — We are subject to safety and health laws and regulations in the PRC and our production operations entail significant risks of workplace injury or death” in this document for the risk of workplace injury or fatality during our production process.

EMPLOYEES

As of the Latest Practicable Date, we had 1,020 full-time employees. In addition, we also had eight part-time technology experts. The following table sets forth the breakdown of our full-time employees as of the Latest Practicable Date:

Function	Number of Employees	Percentage of Total (%)
Management and administration	137	13.4
Manufacturing and quality assurance	626	61.4
Sales and marketing	77	7.5
Research and development	164	16.1
Technical support	16	1.6
Total	1,020	100

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, we incurred total staff costs (including salaries, benefits and allowances) of RMB52.7 million, RMB67.6 million, RMB63.2 million and RMB51.6 million, respectively.

Training and Remuneration

We place significant emphasis on staff training and development. We invest in continuing education and training programs for our management personnel and other employees with a view to constantly upgrading their skills and knowledge. Our staff training is either conducted internally by our management and various department heads or externally by training providers. We have adopted a “multi-function” training model for our production line operation personnel. The objective is to equip them with multiple skills to ensure that they can switch between different positions and we have trained personnel available for every position on our production lines and to upgrade the overall skill set of our manufacturing personnel. In addition, we send our manufacturing personnel to other industry-leading automotive engine manufacturers to observe and gain experience and techniques. We also provide regular training programs for our sales and after-sales personnel which include

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promotional skills, operational knowledge and product knowledge training, all of which seek to improve their sales and after-sales skills to better serve our customers.

We conduct periodic performance reviews for all of our employees and their salaries and bonuses are performance-based.

Employee Relations

We believe we maintain a good working relationship with our personnel. We have not experienced any strikes or significant labor disputes which have materially affected our business, financial condition or results of operations during the Track Record Period.

Our employees (excluding temporary and part-time employees) are members of a trade union affiliated with the All China Federation of Trade Unions. As of the Latest Practicable Date, we have not experienced any major labor dispute or other labor disturbances that have interfered with our operations.

Employee Benefits

In accordance with applicable PRC laws and regulations, we have made contributions to social security insurance funds (including pension plans, medical insurance, work-related injury insurance, unemployment insurance, and maternity insurance) and housing funds for our employees. We also provide medical care subsidies and emergency funds for our employees. As of the Latest Practicable Date, we have complied with all statutory social insurance and housing fund obligations applicable to us under PRC laws and regulations in all material aspects.

INSURANCE

We currently maintain social welfare insurance in accordance with the relevant PRC laws and regulations, personal accident insurance for our employees and insurance that covers our major fixed assets against damage caused by accidents and natural disasters such as fires, earthquakes and floods. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our expenditures for insurance policy premiums were RMB4.6 million, RMB6.0 million, RMB8.8 million and RMB8.5 million, respectively.

We do not maintain any product liability insurance arising from the manufacture and sale of our products in the PRC. We also do not carry any business interruption insurance for losses or damage arising from accidents relating to our operations. Such insurances are not required under the PRC laws and regulations and we believe our practice in this regard is consistent with industry practices in the PRC. To minimize our product liability risk, we have instituted stringent quality control measures in order to avoid or reduce the incidence of product defects. See “— Quality Control” in this document. Please also see “Risk Factors — Our insurance coverage may not be sufficient to cover the risks related to our operations or any losses” in this document.

Our Directors believe that our current insurance policies provide sufficient coverage of the risks to which we may be exposed, relating to loss of or damage to our equipment, inventory and goods-in-transit and claims from our employees, and are comparable to other manufacturers in our industry in China whose business operations and size are similar to us. During the Track Record Period, we did not submit any material insurance claims.

LEGAL PROCEEDINGS AND COMPLIANCE

During the Track Record Period, we were not involved in any litigation, arbitration or administrative proceeding that, individually or in the aggregate, could have had a material adverse effect on our

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business, financial condition or results of operations, and as of the Latest Practicable Date, there was no existing or threatened litigation, arbitration or administrative proceeding against us or any of our Directors that, individually or in aggregate, could have a material adverse effect on our business, financial condition or results of operations.

Our Directors, as advised by our PRC legal adviser, Jingtian & Gongcheng, confirm that during the Track Record Period and, as of the Latest Practicable Date, our Group was in compliance with all relevant PRC laws and regulations in all material respects and had obtained all material permits and licenses required for the Group’s operations in the PRC.

Internal Control

We have adopted certain internal control measures to facilitate the effective operation of our business which includes (i) engaging Hong Kong legal advisor and compliance advisor to facilitate compliance with the relevant requirements under the [●] after [●]; (ii) engaging PRC legal advisor to facilitate compliance with the relevant requirements under the PRC laws and regulations after [●]; (iii) our Hong Kong legal advisor, compliance advisor or other relevant professional parties will provide regular trainings on, among others, corporate governance and [●] requirements to our Directors and senior management after [●]; and (iv) our audit committee which comprises all of our independent non-executive Directors will review the internal control systems and procedures for compliance with the relevant [●] requirements on a regular basis and our audit committee will, upon due and careful inquiries, disclose its view regarding our compliance and internal control related matters in the Company’s annual report after [●].

DIRECTORS AND SENIOR MANAGEMENT

BOARD OF DIRECTORS

Our Board consists of eight Directors, including two executive Directors, two non-executive Directors and three independent non-executive Directors. Our Board has the general powers and duties for the management and conduct of our business. The table below sets forth information regarding our current Directors:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Date of appointment</u>	<u>Roles and responsibilities</u>
Mr. Wu Xiao An (also known as Mr. Ng Siu On) (吳小安)	51	Chairman and executive Director	March 10, 2011	Overall strategic planning and business development
Mr. Wang Yunxian (王運先)	58	Chief executive officer and executive Director	March 10, 2011	Business operation
Mr. Qi Yumin (祁玉民)	53	Non-executive Director	November 16, 2011	As a non-executive Director
Mr. Li Peiqi (李培奇)	61	Non-executive Director	August 29, 2012	As a non-executive Director
Mr. Chi Guohua (池國華)	38	Independent non-executive Director	November 22, 2012	As an independent Director
Mr. Wang Jun (王隽)	51	Independent non-executive Director	April 24, 2012	As an independent Director
Mr. Huang Haibo (黃海波)	58	Independent non-executive Director	November 30, 2011	As an independent Director
Mr. Wang Songlin (王松林)	61	Independent non-executive Director	April 24, 2012	As an independent Director

EXECUTIVE DIRECTORS

Mr. Wu Xiao An (also known as Mr. Ng Siu On), (吳小安), aged 51, is our chairman, he was appointed as our Director on March 10, 2011 and designated as our executive Director on April 24, 2012. He has over 18 years of experience in the automotive industry and is primarily responsible for the overall strategic planning and business development of our Group. Since April 1998, he has been serving as a director of Southern State, our direct wholly-owned subsidiary. From April 1998 to September 2005, Mr. Wu had been a director of Mianyang Xinchun, and he was re-appointed as a director of Mianyang Xinchun in July 2011. Since February 2011, he has been a director of Brilliance Investment. Since 2002, Mr. Wu has served various positions in Brilliance China, including the chairman of Brilliance China since June 2002, an executive director since January 1994 and vice chairman and the chief financial officer from January 1994 to June 2002. He has also been a director of Huachen since October 2002, a director of Shenyang Jinbei since January 1994, and the chairman of BMW Brilliance Automotive, since May 2003. From 1988 to 1993, he was the deputy manager of the Bank of China, New York Branch. Mr. Wu obtained a bachelor’s degree of arts from Beijing Foreign Languages Institute (北京外國語學院) (now known as Beijing Foreign Studies University (北京外國語大學)) in 1985 and a master of business administration degree from Fordham University in New York in 1992.

Mr. Wang Yunxian (王運先), aged 58, is our chief executive officer, he was appointed as our Director on March 10, 2011 and designated as our executive Director on April 24, 2012. He has over 36 years

DIRECTORS AND SENIOR MANAGEMENT

of experience in the PRC automotive industry and is primarily responsible for the business operation of our Group. Since May 2011, he has been the director of Xinhua Investment. Since 1998, Mr. Wang held various positions in Mianyang Xinchun, including the director and managing vice general manager from April 1998 to March 2000, the director and general manager since March 2000 and supervisor of the national enterprise technology center of Mianyang Xinchun since March 2004. Since 1976, Mr. Wang held various positions in Xinhua Combustion Engine, including director, party secretary, general manager, vice general manager, head of sales department, production supervisor and technician, and he has resigned from his positions of director and general manager in Xinhua Combustion Engine on March 22, 2012 and March 23, 2012, respectively. Since January 2005, Mr. Wang has been the director and general manager of Mianyang Huarui. In October 2004, Mr. Wang received the special government expert allowances (engineering class) (特殊津貼 (工程類)) from the State Council (國務院). In 2005, Mr. Wang received the National Model Worker Award (全國勞動模範) issued by the State Council, as well as the title of Ten Outstanding Innovative Talents of Sichuan Province (四川省十大傑出創新人才) in December 2005. He graduated from Sichuan University of Science and Technology (四川工業學院) (now merged into Xihua University (西華大學)) in July 1986, and graduated from a postgraduate course in finance from the Chinese Academy of Social Sciences (中國社會科學院) in July 1998.

NON-EXECUTIVE DIRECTORS

Mr. Qi Yumin (祁玉民), aged 53, was appointed as our Director on November 16, 2011, and designated as our non-executive Director on April 24, 2012. Since January 2006, Mr. Qi has served as the executive director, president and the chief executive officer of Brilliance China and as the chairman and president of Huachen since December 2005. Since 2009, he has been appointed chairman and a director of Shenyang Jinbei and two companies listed on the Shanghai Stock Exchange, namely Shenyang JinBei Automotive Company Limited (金杯汽車股份有限公司) and Shanghai Shenhua Holdings Co., Ltd. (上海申華控股股份有限公司). Mr. Qi has been a director of BMW Brilliance Automotive since November 2006. From 1982 to 2004, Mr. Qi held various positions in Dalian Heavy Industries Co., Ltd. (大連重工集團有限公司), including chairman and general manager. From October 2004 to December 2005, he was the vice mayor of Dalian municipal government. Mr. Qi graduated from Xi'an University of Technology (西安理工大學) (formerly known as Shanxi Institute of Mechanical Engineering (陝西機械學院)) Department of engineering and economics, with a major in machinery manufacturing management and engineering, in July 1982 and a master's degree in business administration from Dalian University of Technology (大連理工大學) in April 2004. He was qualified as a senior engineer (professor level) by the Personnel Department of Liaoning Province (遼寧省人事廳) in December 1992.

Mr. Li Peiqi (李培奇), aged 61, was appointed and designated as our non-executive Director on August 29, 2012. He had been our Director from July 4, 2011 to April 24, 2012. Since May 2011 and October 2006, he has been serving as a director of Xinhua Investment and an executive director of Mianyang Xinchun, respectively. From 1989 to 2011, Mr. Li assumed various positions in Wuliangye Group. From January 2005 to November 2011, he was a director of Wuliangye. From July 2003 to September 2012, he was the chief executive officer of the Pushi Group. From May 1998 to July 2003, he served as general manager of Pushi Group. Since September 2006, he has been serving as the chairman of Xinhua Combustion Engine. Mr. Li was qualified as a senior engineer in January 2006 by the Sichuan Province Title Reform Leading Group Office (四川省職稱改革工作領導小組辦公室).

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Chi Guohua (池國華), aged 38, was appointed and designated as our independent non-executive Director on November 22, 2012. Mr. Chi is a certified public accountant (non-practicing member) in the

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PRC. Since March 2000, Mr. Chi has been serving as the teaching assistant, lecturer, associate professor and professor in the School of Accounting of Dongbei University of Finance and Economics (東北財經大學會計學院). Since March 2010, he has been the deputy head of Internal Control Research Center of the PRC (中國內部控制研究中心). Furthermore, since April 2012, Mr. Chi has been serving as an independent director of Dalian Tianbao Green Foods Co., Ltd. (大連天寶綠色食品股份有限公司), a company listed on the Shenzhen Stock Exchange. From February 2005 to February 2006, Mr. Chi was the head of the strategic investment department of Shenyang Machine Tool (Group) Co., Ltd. (瀋陽機床(集團)有限公司); and from March 2006 to March 2007, he was the financial advisor of Shenyang Machine Tool (Group) Group Ltd. (瀋陽機床(集團)集團公司). From January 2009 to December 2010, Mr. Chi was a consultant in the Committee on Internal Control Standards of Enterprise for the Ministry of Finance of the PRC (中國財政部企業內部控制標準委員會). Mr. Chi currently also holds positions in certain academic and professional organizations, including serving as a member of the Accounting Education Committee of Accounting Society of China (中國會計學會會計教育專業委員會) since 2010 and a councillor of the Finance Cost Branch of Accounting Society of China (中國會計學會財務成本分會) since August 2010. Mr. Chi was awarded Qianren-level of the “Liaoning Baiqianwan Talents Program” (遼寧省“百千萬人才工程”千人層次) in November 2007, the leading (reserve) accounting representative of the Ministry of Finance (中國財政部全國會計學術領軍(後備)人才) in October 2007, and an outstanding representative of tertiary education institution of Liaoning Province (遼寧省高等學校優秀人才) in August 2007. Mr. Chi obtained a post doctorate in Business Administration from the Xiamen University (廈門大學) in January 2008 and a doctorate in management (accounting studies) from Dongbei University of Finance and Economics (東北財經大學) in April 2005.

Mr. Wang Jun (王隽), aged 51, was appointed as our independent non-executive Director on April 24, 2012. Mr. Wang has over 22 years of experience in the legal field, especially in corporate compliance operation, risk control, corporate law, litigation and arbitration. Since February 2009, Mr. Wang has been practising law at the Beijing Office of Dacheng Law Offices (北京市大成律師事務所). From April 2000 to February 2009, he practised law at the Beijing Jian Yuan Law Offices (北京市建元律師事務所). From September 1987 to March 2000, he was employed by China University of Petroleum (中國石油大學) as a teacher. From September 1983 to September 1985, he served as the cadre of the Railway Transport High Court (鐵路運輸高級法院). Mr. Wang obtained a postgraduate degree in economic law in July 1987 and a bachelor’s degree in law from the department of law in July 1983, both from the China University of Political Science and Law (中國政法大學).

Mr. Huang Haibo (黃海波), aged 58, was appointed as our Director on November 30, 2011, and designated as our independent non-executive Director on April 24, 2012. Mr. Huang has spent over 28 years researching and applying his expertise in automotives technology. Since July 2008, he has served as the independent non-executive director of Hunan Jiangnan Red Arrow Co. Ltd. (湖南江南紅箭股份有限公司), a company listed on the Shenzhen Stock Exchange. From January 2004 to April 2012, he has held the position of the dean of the Transport and Automotives Engineering School in Xihua University (西華大學). He is also the president of the Chengdu Automotive Engineering Society (成都市汽車工程學會) since May 2002, the chairman of the Sichuan Xihua Vehicle Authentication Institution (四川西華機動車司法鑑定所) since August 2005 and a member of National Technical Committee on Operating Safe Technology and Testing Equipment of Motor Vehicles and of Standardization Administration of China (全國機動車運行安全技術檢測設備標準化技術委員會) since June 2008. Mr. Huang has extensive experience in the areas of alternative fuel engines and controlled emissions, and has been recruited to lead certain government-funded research projects. He was awarded by People’s Government of the Sichuan Province (四川省人民政府) two second-class Technology Progress Awards in 2007 and 2011, respectively, and three third-class Technology Progress Awards in 1989, 2006 and 2009, respectively. Mr. Huang published two books, and about 80

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theses. He graduated from Chengdu Institute of Agriculture and Machinery (成都農業機械學院) (now merged into Xihua University (西華大學)) in July 1977 and received a master’s degree in Beijing Institute of Agricultural Mechanization (北京農業機械化學院) (now merged into China Agriculture University (中國農業大學)) in December 1983 and a doctorate degree in Sichuan University (四川大學) in December 2004. Mr. Huang was awarded the qualification of professor by the Title Reform Leading Group of the Sichuan Province (四川省職稱改革工作領導小組) in December 1999, and was qualified as a judicial forensic authenticator by the Sichuan Judiciary in August 2005.

Mr. Wang Songlin (王松林), aged 61, was appointed as our independent non-executive Director on April 24, 2012. Mr. Wang has over 33 years of experience in the PRC automotive industry. From 2000 to 2011, May 2005 to March 2011, August 2007 to March 2012, and July 2009 to September 2010, Mr. Wang had been serving as the chairman of each of Beijing Zhongqi Jingtian Auto Trading Co., Ltd. (北京中汽京田汽車貿易有限公司), Beijing Guoji Longsheng Automobile Co., Ltd. (北京國機隆盛汽車有限公司), Beijing Guoji Fengsheng Automobile Co., Ltd. (北京國機豐盛汽車有限公司) and Changsa Qidian Automotive Products Co., Ltd. (長沙汽電汽車零部件有限公司), respectively. Mr. Wang served as the deputy chief executive officer of China National Automotive Industry Corporation (中國汽車工業總公司) and the vice president of China National Machinery Industry Corporation (中國機械工業集團有限公司). He is also currently a director of Sinomach Automobile Co., Ltd. (國機汽車股份有限公司), a company listed on the Shanghai Stock Exchange. From June 2005 to April 2012, he served as a non-executive director of Guangzhou Automobile Group Co., Ltd. (廣州汽車集團股份有限公司), a company listed on the Stock Exchange. From June 2004 to December 2011, Mr. Wang served as the deputy general manager of China National Machinery Industry Corporation (中國機械工業集團有限公司). From August 1998 to June 2000, he was the party secretary and deputy general manager of China National Automotive Industry Import and Export Corporation (中國汽車工業進出口總公司). He is currently the vice president of China Association of Automobile Manufacturers (中國汽車工業協會), and the vice chairman of each of the Seventh Standing Council of the Society of Automotive Engineers of China (中國汽車工程學會第七屆常務理事會) and the Council of China Auto Talents Society (中國汽車人才研究會理事會). Mr. Wang obtained a professional graduation certificate in casting technology and equipment from Harbin Institute of Technology (哈爾濱工業大學) in September 1978 and a postgraduate diploma in a master’s course of technology and economics from Harbin Institute of Technology (哈爾濱工業大學) in April 1995.

Save as disclosed above, each of our Directors has confirmed that he has not held any other directorships in listed companies during the three years immediately prior to the date of this document and that there is no other information in respect of our Directors to be disclosed pursuant to [●] and there is no other matter that needs to be brought to the attention to our Shareholders.

SENIOR MANAGEMENT

The table below sets forth certain information regarding our senior management members (excluding executive Directors):

<u>Name</u>	<u>Age</u>	<u>Position</u>
He Xuzong (何旭宗)	46	Vice general manager (product development)
Song Ning (宋寧)	49	Vice general manager (production and safety management)
Lai Yong (賴勇)	57	Vice general manager (strategic planning, human resources and business management)
Ma Li (馬力)	53	Vice general manager (marketing and spare parts business)
Xu Bingchu (徐炳初)	52	Chief financial officer (financial management)

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Mr. He Xuzong (何旭宗), aged 46, is the vice general manager of Mianyang Xincheng. Mr. He has over 22 years of experience in the automotive industry and is primarily responsible for product development of our Group. From November 2008 to January 2012, he served as the vice general manager of Xinhua Combustion Engine, and since January 2008, he has been the vice general manager of Mianyang Xincheng. From February 2004 to January 2008, he had been the assistant to the general manager and director of technology and quality of Mianyang Xincheng. From July 1989 to February 2004, he held various positions in Xinhua Combustion Engine, including technical engineer, managing deputy head of technology department, head of the technical center, and head of the product development department. Mr. He obtained a bachelor's degree in automotive engineering from Sichuan University of Science and Technology (四川工業學院) (now merged into Xihua University (西華大學)) in July 1989. Mr. He was qualified by Sichuan Province Title Reform Leading Group Office (四川省職稱改革工作領導小組辦公室) as a senior engineer in January 2002.

Mr. Song Ning (宋寧), aged 49, is the vice general manager of Mianyang Xincheng. Mr. Song has over 26 years of experience in the automotive industry and is primarily responsible for production and safety management of our Group. From October 2001 to January 2012, he served as the vice general manager of Xinhua Combustion Engine, and since March 2000, he has been the vice general manager of Mianyang Xincheng. From April 1998 to October 2006, he was a director, and from May 1998 to March 2000, he was the head of the production support department of Mianyang Xincheng. From September 1985 to May 1998, he held various positions in Xinhua Combustion Engine, including technician, vice chief engineer, deputy head of workshop, head of technology and quality control department, head of workshop, head of chief engineer's office, head of technology development center, vice chief engineer and head of quality control. From March 2003 to August 2006, he served as the director of Xinhua Combustion Engine. Mr. Song is an engineering graduate from Sichuan University of Science and Technology (四川工業學院) (now merged into Xihua University (西華大學)) in 1985. He was qualified by Sichuan Province Title Reform Leading Group Office (四川省職稱改革工作領導小組辦公室) as a senior engineer in February 2001.

Mr. Lai Yong (賴勇), aged 57, is the vice general manager of Mianyang Xincheng. Mr. Lai has over 33 years of experience in the engineering industry and is primarily responsible for strategic planning, human resources and business management of our Group. From August 2006 to March 2012, he was the director of Xinhua Combustion Engine. Since February 2001, Mr. Lai has been the vice general manager of Mianyang Xincheng, and during the period from October 2001 to January 2012, he served as the vice general manager of Xinhua Combustion Engine. From March 2000 to February 2001, he was the chief engineer and member of the management committee of Xinhua Combustion Engine. From April 1998 to December 2006, he was the secretary of the board of Mianyang Xincheng. From June 1978 to May 1998, he held various positions in Xinhua Combustion Engine, including worker, technician, director of the products technology research institute, head of the quality control station, deputy head of the sales department, head of quality control department of the petrol depot, vice chief engineer of the petrol depot and head of technology department of the gasoline engine factory. Mr. Lai obtained a diploma in mechanical engineering from Sichuan Radio and TV University (四川廣播電視大學) in July 1982. Mr. Lai was qualified as a senior engineer in May 1996 by Sichuan Province Title Reform Leading Group* (四川省職改領導小組).

Mr. Ma Li (馬力), aged 53, is the vice general manager of Mianyang Xincheng. Mr. Ma has over 29 years of experience in the automotive industry and is primarily responsible for marketing and spare parts business of our Group. Since March 2000, he has been the vice general manager of Mianyang Xincheng, and during the period from October 2001 to January 2012, he served as the vice general manager of Xinhua Combustion Engine concurrently. From January 2005 to March 2009, he also served as an executive director of Mianyang Huarui. From August 1982 to May 1998, he held various positions in Xinhua Combustion Engine, including technician, deputy head of supply office, managing

DIRECTORS AND SENIOR MANAGEMENT

deputy head of sales department and the head of sales department. Mr. Ma obtained a bachelor’s degree in internal combustion engines in Chengdu Institute of Agriculture and Machinery (成都農業機械學院) (now merged into Xihua University (西華大學)) in July 1982, and received a postgraduate diploma in business management from Sichuan University (四川大學) in 1999. Mr. Ma was qualified as a senior engineer in May 1996.

Mr. Xu Bingchu (徐炳初), aged 52, is our chief financial officer and the chief financial officer of Mianyang Xincheng. Mr. Xu has over 29 years of experience in financial management and is primarily responsible for financial management of our Group. Since April 2009, he has served as the chief financial officer of Mianyang Huarui, and since May 2002, he has been the chief financial officer of Mianyang Xincheng and Mianyang Ruian. From May 2002 to July 2002, he was the chief financial officer of Xinhua Combustion Engine. From November 2000 to May 2002, Mr. Xu was the chief financial officer’s assistant and the manager of finance department of Mianyang Xincheng and Mianyang Ruian concurrently. Prior to that, from September 1982 to October 2000, he assumed various positions in China State Shipbuilding Corporation (中國船舶工業總公司), including head of the financial department and financial supervisor. Mr. Xu graduated from the Shanghai Maritime University (上海海事大學) (formerly known as Shanghai Harbor College (上海港灣專科學校)) in 1982, and obtained a master’s degree in financial management from Chinese Academy of Social Sciences in July 1998.

COMPANY SECRETARY

Ms. Fung Sam Ming (馮心明), is our company secretary. Ms. Fung is an associate of The Institute of Chartered Secretaries and Administrators. Ms. Fung graduated from The University of Buckingham in the United Kingdom with a Bachelor of Science (Honors) degree in Business Studies. Prior to joining our Company, Ms. Fung served as the company secretary of APAC Resources Limited (stock code: 1104) from May 2008 to April 2011 and Central China Enterprises Limited (stock code: 0351, now renamed as Asia Energy Logistics Group Limited) from October 2004 to January 2005. She served as the company secretarial manager of Digital China Holdings Limited (stock code: 0861) from June 2005 to July 2007 and China Overseas Land & Investment Ltd. (stock code: 688) from November 2001 to November 2003. She also served as the assistant company secretary of Winsan (China) Investment Group Company Limited (stock code: 0085, now renamed as China Electronics Corporation Holdings Company Limited) from December 1998 to October 1999 and Tem Fat Hing Fung (Holdings) Limited (stock code: 661, now renamed as China Daye Non-Ferrous Metals Mining Limited) from September 1997 to October 2008.

BOARD COMMITTEE

Audit Committee

We have established an audit committee on April 25, 2012 with effect from the [●], with written terms of reference in compliance with [●] of the [●] as set out in [●]. The primary duties of the audit committee are to assist the Board in providing an independent view of the effectiveness of the financial reporting process, the internal control and risk management system of our Group, to oversee the audit process and to perform other duties and responsibilities as assigned by the Board.

The audit committee currently comprises Mr. Chi Guohua, Mr. Wang Jun, Mr. Huang Haibo and Mr. Wang Songlin, our independent non-executive Directors. Mr. Chi Guohua is the chairman of the audit committee.

Remuneration Committee

We have established a remuneration committee on April 25, 2012 with effect from the [●], with written terms of reference in compliance with [●]. The primary duties of the remuneration committee are to

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evaluate and make recommendations to our Board regarding the compensation of our executive Directors and senior management. In addition, the remuneration committee conducts reviews of the performance, and determines the compensation structure of our senior management.

The remuneration committee currently comprises Mr. Wu Xiao An, our chairman and executive Director, and Mr. Huang Haibo, Mr. Wang Jun and Mr. Wang Songlin, our independent non-executive Directors. Mr. Huang Haibo is the chairman of the remuneration committee.

Nomination Committee

We have established a nomination committee on April 25, 2012 with effect from the [●], with written terms of reference in compliance with [●]. The primary functions of the nomination committee are to formulate nomination policies for consideration of our Board, implement the nomination policies laid down by our Board, and make recommendations to our Board to fill vacancies on the same.

The nomination committee currently comprises Mr. Wu Xiao An, our chairman and executive Director, and Mr. Wang Jun, Mr. Huang Haibo and Mr. Wang Songlin, our independent non-executive Directors. Mr. Wang Jun is the chairman of the nomination committee.

Compensation of Directors and Senior Management

Our executive Directors receive, in their capacity as our employees, compensation in the form of salaries, bonus, other allowances and benefits in kind, including our contribution to the pension scheme for our executive Directors, in their capacity as employees, according to the law of the relevant jurisdiction.

The aggregate amount of salaries, allowances, discretionary bonus and retirement benefits scheme contributions paid and benefits in kind granted to our Directors for the three years ended December 31, 2011 and the nine months ended September 30, 2012 were approximately RMB0.8 million, RMB0.8 million, RMB0.8 million and RMB0.6 million, respectively.

The aggregate amount of remuneration (including fees, salaries, contributions to pension schemes, housing allowances and other allowances and benefits in kind and discretionary bonuses) which were paid by our Group to our five highest paid individuals for the three years ended December 31, 2011 and the nine months ended September 30, 2012 were approximately RMB1.6 million, RMB1.9 million, RMB1.9 million and RMB0.9 million, respectively.

No remuneration was paid by our Group to the Directors or the five highest paid individuals as an inducement to join or upon joining our Group or as a compensation for loss of office in respect of the three years ended December 31, 2011 and the nine months ended September 30, 2012. No Director has waived or has agreed to waive any emoluments during the three years ended December 31, 2011 and the nine months ended September 30, 2012.

Under arrangements currently in force, the estimated aggregate remuneration payable to, and benefits in kind receivable by (excluding any discretionary bonus), our Directors in respect of the year ending December 31, 2013 will be approximately RMB0.7 million.

For information on Directors’ remuneration during the Track Record Period as well as information on the highest paid individuals, see Note 11 of our consolidated financial statements included in the Accountants’ Report set out in Appendix I to this document and “Statutory and General Information” set out in Appendix V to this document.

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS AND HUACHEN

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS AND HUACHEN

Immediately following the [●] and assuming the [●] is not exercised, each of Brilliance China, Brilliance Investment, Wuliangye, Pushi Group, Xinhua Combustion Engine and Xinhua Investment will be interested, directly or indirectly, in approximately [31.908]% of the issued share capital of our Company.

Brilliance China

Brilliance China, a company listed on the Stock Exchange (stock code: 1114.HK), engages in the automotive manufacturing business in China. It operates largely by two segments: manufacturing and sale of minibuses and automotive components. Brilliance China also established a joint venture, BMW Brilliance Automotive, with BMW Holding B.V. to produce BMW sedans. The automotive components manufactured by Brilliance China were mainly for its own consumption and for sale to its customers for maintenance and repair purposes. It also sells certain automotive components to Huachen Group and its other customers. Brilliance China was formerly known as Brilliance Holdings (Bermuda) Company Limited and changed its name to Brilliance China Automotive Holdings Limited in 1992. Brilliance China was founded in 1992 and listed on the Stock Exchange in 1999.

Certain subsidiaries of Brilliance China are our suppliers of engine components. The engine components supplied to us are solely used for the production of our engines or sell to our customers for repair and maintenance purposes. Brilliance China sold engine components to parties other than our Group during the Track Record Period and may continue to do so in the future. In addition, certain subsidiaries and an associate of Brilliance China are our customers and purchase engines and engine components from us.

Huachen

Huachen is a state-owned limited liability company which was established under the PRC laws on September 16, 2002 and is wholly and beneficially owned by the People’s Government of Liaoning Province of the PRC. The principal activities of the Huachen Group include but not limited to investment holding, and manufacture and sale of Zhonghua (“中華”) branded sedans. Huachen is an investment holding company and did not sell any engine components to us during the Track Record Period. Huachen may, through Brilliance China Group, sell engine components to parties other than our Group in the future. Huachen Group manufactures a small volume of automotive engines, as compared to the total volume of engines produced by our Group, for its own consumption. It did not and does not sell its engines outside the Huachen Group.

As at the Latest Practicable Date, Huachen owned [42.48]% of the issued share capital of Brilliance China and Huachen treats Brilliance China as an associate in its financial statements, which are prepared in accordance with the PRC generally accepted accounting principles. Huachen cannot single handedly pass a resolution at a general meeting of Brilliance China. In addition, all decisions of Brilliance China in relation to voting at the general meeting of our Company are determined by the board of directors of Brilliance China. Despite the fact that some of the directors of Brilliance China are also directors or senior management of Huachen, Brilliance China is a Hong Kong listed company and its directors are subject to extensive corporate governance rules and fiduciary duties. Thus, the voting decisions made by the board of directors of Brilliance China are independent from Huachen. Further, on the assumptions that the [●] not exercised, and there is no change in Huachen’s interest in Brilliance China, upon [●], Huachen will be interested in approximately [42.48]% of the issued share capital of Brilliance China, which, through its wholly-owned subsidiary Brilliance Investment, will be interested in approximately [31.908]% of the issued share capital of our Company. In addition, Huachen does not have control over the Board of our Company. Based on the above, Huachen is not

RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS AND HUACHEN

entitled to exercise nor control the exercise of 30% or more of the voting power at the general meeting of our Company and therefore Huachen is not a Controlling Shareholder of our Company under the [●]. Notwithstanding the above, the [●] has deemed Huachen as a connected person of our Company.

Xinhua Combustion Engine

Xinhua Combustion Engine was founded in 1994 and is primarily engaged in the manufacturing and sale of engine components for engines, sale of automobiles and provision of related services and logistic services.

Xinhua Combustion Engine is one of our suppliers of engine components. The engine components supplied by Xinhua Combustion Engine are produced based on the specifications we provided to Xinhua Combustion Engine and they are solely used for our engines or sold to our customers for repair and maintenance purposes. Xinhua Combustion Engine did not sell its engine components to parties other than our Group during the Track Record Period. It may sell its engine components to parties other than our Group in the future. Xinhua Combustion Engine is not engaged in the sales of automotive engines. Commencing from 2012, we have been selling engine components to Xinhua Combustion Engine for its after-sale automotive repair and maintenance business they conduct. These engine components are different from those they supply to us.

Pushi Group

Pushi Group is a wholly-owned subsidiary of Wuliangye, and is principally engaged in various industries including manufacture of machinery, polymeric materials and civil technology development. In particular, the major products of Pushi Group’s machinery manufacturing business include precision injection molds, automotive panel dies and engine components. We purchased crankshafts from a subsidiary of Pushi Group during the Track Record Period.

Wuliangye

Wuliangye principally engages in the production and sales of a series of wine including “wuliangye (五糧液)” branded wine. It also engages in a wide range of other businesses including industrial packaging, optical glass, logistics, rubber products and pharmacy.

EXCLUDED BUSINESSES OF BRILLIANCE CHINA

Shenyang Xinguang Brilliance

Shenyang Xinguang Brilliance is a joint venture owned as to 50% by Brilliance China and 50% by China Aerospace, a state-owned enterprise incorporated in the PRC and an independent third party of Brilliance China.

Shenyang Xinguang Brilliance primarily manufactures and sells light-duty gasoline engines and engine components (the “Excluded Business of Shenyang Xinguang Brilliance”). In particular, Shenyang Xinguang Brilliance is engaged in the manufacture and sale of four models of 1.6L to 2.5L gasoline engines under the brand name “Bao Pai” (“豹牌”). The main customers of Shenyang Xinguang Brilliance include PV and LCV manufacturers such as Shenyang Jinbei, a subsidiary of Brilliance China, Xiamen King Long United Automotive Industry Co., Ltd.* (廈門金龍聯合汽車工業有限公司) and Hebei Zhongxing Automobile Co., Ltd.* (河北中興汽車製造有限公司), all of which are also our customers. During the Track Record Period, the revenue contributed by overlapping customers to our Group amounted to approximately RMB452.4 million, RMB559.3 million, RMB504.7 million and

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RMB393.8 million, respectively. Shenyang Xinguang Brilliance's current production capacity is approximately 80,000 units, and its sales volume totaled 60,185 units and 44,088 units in 2011 and the nine months ended September 30, 2012, respectively. Since China Aerospace is an independent third party of Brilliance China, Shenyang Xinguang Brilliance cannot be injected into our Group without consent from China Aerospace.

Shenyang Jinbei, based on its production needs, market reputation and engine quality and price, procures engines from Shenyang Xinguang Brilliance and us. During the Track Record Period, we sold more engines to Shenyang Jinbei than Shenyang Xinguang Brilliance in terms of sales volume. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, total sales of our engines to Shenyang Jinbei (including those sold to Xing Yuan Dong and Mianyang Ruian, which subsequently sold their products to Shenyang Jinbei) was approximately RMB386.6 million, RMB460.0 million, RMB416.2 million and RMB381.8 million, respectively, which accounted for approximately 30.1%, 23.6%, 18.0% and 19.6% of our revenue during the same periods, respectively. These sales mainly represented sales of light-duty gasoline engines with displacement between 1.6L to 2.5L.

We understand that Shenyang Xinguang Brilliance will continue to sell its existing products and Brilliance China has no immediate plan for Shenyang Xinguang Brilliance to develop new products due to its current financial and technological limitation. Based on our understanding, if Shenyang Xinguang Brilliance develops new products, it will not develop products which may compete, directly or indirectly, with those produced or to be produced by our Group. We also understand that Brilliance China currently has no plan to make new capital contributions to Shenyang Xinguang Brilliance to expand its business operations.

One of the directors of Mianyang Xinchun, who does not hold any directorship in our Company, hold directorship in Shenyang Xinguang Brilliance. To avoid any potential conflict of interest arising from common directorship or leakage of sensitive information in relation to our Group's products or customers, the sole overlapping director undertakes (i) to declare his interests prior to any board meeting of Mianyang Xinchun; (ii) if he is an interested director, he shall not be counted towards any quorum and shall abstain from voting in respect of the transactions or matters that he is interested in during Mianyang Xinchun's board meeting and (iii) not to disclose any price-sensitive information in connection with the business and operations of Mianyang Xinchun to any third parties, including the Controlling Shareholders.

Reasons for not including the Excluded Business of Shenyang Xinguang Brilliance in our Group

Our Directors have considered that it is neither in the best interest of, nor feasible for, our Group to include the Excluded Business of Shenyang Xinguang Brilliance in our Group, on the following basis:

- (i) although our products which compete with Shenyang Xinguang Brilliance's products mentioned above accounted for a significant portion of our revenue during the Track Record Period, the percentage of our revenue generated from sales of these products to Shenyang Jinbei, Xing Yuan Dong and Mianyang Ruian, in aggregate, has declined from approximately 30.1% in 2009 to approximately 18.0% in 2011, and maintained at a steady level for the nine months ended September 30, 2012 which accounted for approximately 19.6%. This was primarily due to our Group having (a) upgraded our products and introduced new products which allowed us to penetrate into new market segments; and (b) diversified our customer base as a result of the upgraded and new products. It is expected that our revenue generated from sales of these products will remain low, and we believe we will have less reliance on our products which compete with Shenyang Xinguang Brilliance's products going forward; and

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- (ii) Shenyang Xinguang Brilliance recorded a net loss for the years ended December 31, 2009 and 2011 and the nine months ended September 30, 2012, and its financial performance may not improve significantly in the near future.

We have no intention and we believe that Brilliance China currently has no intention to include the Excluded Business of Shenyang Xinguang Brilliance in our Group. In the event that the Excluded Business of Shenyang Xinguang Brilliance is to be included in our Group, consent will need to be obtained from China Aerospace. Brilliance China has not been given any consent from China Aerospace.

Undertaking from Huachen and Brilliance China

Each of Huachen and Brilliance China has entered into a deed of undertaking in favor of our Company (the “First Huachen and Brilliance China Undertaking”), pursuant to which each of Huachen and Brilliance China has unconditionally and irrevocably undertaken to our Company (for itself and for the benefit of each other member of our Group) that it will procure its respective subsidiaries (i) to first purchase products from us if the products offered by our Group and Shenyang Xinguang Brilliance are of similar quality, specifications and price; and (ii) to maintain or increase the purchases of the products mentioned in (i) above from our Group going forward.

Our Directors consider that the First Huachen and Brilliance China Undertaking will not affect the interest of Brilliance China’s shareholders as a whole on the basis that (i) neither Shenyang Xinguang Brilliance nor our Group is wholly-owned by Brilliance China and their revenues will not be consolidated into the accounts of Brilliance China, thus purchasing from our Group instead of Shenyang Xinguang Brilliance will not have a material impact on the financial performance of Brilliance China; and (ii) this arrangement will not have an adverse effect on the quality of the products produced by Brilliance China since Brilliance China will procure its subsidiaries to first purchase the products from us only if the products offered by our Group and Shenyang Xinguang Brilliance are of similar quality. In addition, we believe that the entering into of the First Huachen and Brilliance China Undertaking by Brilliance China does not breach any duties and obligations Brilliance China owes to Shenyang Xinguang Brilliance and/or China Aerospace.

Aerospace Mitsubishi

Aerospace Mitsubishi is a sino-foreign joint venture owned as to 30% by China Aerospace, 25% by Mitsubishi Locomobiles Industry Co., Ltd.* (三菱自動車工業株式會社), 21% by Shenyang Jianhua Motors Engine Co., Ltd.* (瀋陽建華汽車發動機有限公司) (“Shenyang Jianhua”), 14.7% by Malaysia-China Investment Holdings Co., Ltd.* (馬中投資控股有限公司), and 9.3% by Mitsubishi Commerce and Administration Co., Ltd.* (三菱商事株式會社) (collectively, the “Shareholders of Aerospace Mitsubishi”). Shenyang Jianhua is owned as to 20% by Xing Yuan Dong, a wholly-owned subsidiary of Brilliance China, and 80% by Shenyang Jinbei, a 60.9% owned subsidiary of Brilliance China. As such, Brilliance China has an effective equity interest of 14.43% in Aerospace Mitsubishi. Aerospace Mitsubishi is reported as an associate of Brilliance China in Brilliance China’s 2011 Annual Report. Except for Shenyang Jianhua, the other Shareholders of Aerospace Mitsubishi are independent third parties of Brilliance China and our Company.

Aerospace Mitsubishi is principally engaged in the manufacture and sale of gasoline automotive engines and matching transmissions (the “Excluded Business of Aerospace Mitsubishi”) with its headquarters in Shenyang, the PRC. Aerospace Mitsubishi primarily manufactures and sells two series of gasoline engines with displacement ranges of less than 1.6L, 1.6L to 2.0L and 2.0L to 2.5L under the brand name “Mitsubishi”. The customers of Aerospace Mitsubishi include medium or premium edition PV and LCV manufacturers, such as Huachen, Zhengzhou Nissan, GAC Changfeng, Hebei

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Zhongxing Automobile Co., Ltd.* (河北中興汽車製造有限公司) and Dandong Huanghai Automotive Company Limited* (丹東黃海汽車有限責任公司), which are also our customers. During the Track Record Period, the revenue contributed by the overlapping customers to our Group amounted to approximately RMB665.8 million, RMB1,119.7 million, RMB1,189.0 million and RMB925.2 million respectively. Aerospace Mitsubishi’s revenue and net profits in 2011 amounted to approximately RMB3,877 million and RMB423 million, respectively.

As set out in “Industry Overview — The Competitive Landscape in the PRC PV and LCV Engine Market — Engine supplier selection process and criteria” in this document, according to the Frost & Sullivan Report, automotive manufacturers usually select their system and parts suppliers based on the market positioning and cost structure of a new vehicle model. Typically, during the product development process, the research and development department of an automotive manufacturer will design a model based on its market positioning strategy and evaluation of the cost structure and functions of the new model. Afterwards, the production planning department will evaluate the proposals for cost structure made by the research and development department, and together with the procurement department, identify potential suppliers from different pools of suitable system and parts suppliers based on certain criteria, including manufacturing cost, market positioning and final product pricing. For instance, if a new vehicle model is positioned as a premium edition model, the automotive manufacturers will generally select relatively higher quality engine and components, which in turn will increase the manufacturing cost, and they will sell the vehicle at a higher price to the end-users. On the other hand, if a new vehicle model is positioned as a basic edition model, the automotive manufacturers will generally select relatively lower quality engine and components which in turn lower the manufacturing cost, and they will sell the vehicle at a lower price to the end-users. As a result, an automotive manufacturer may have different engine supplier pools for the basic edition and premium edition of one automotive series and it typically does not invite bidding from the engine suppliers from different pools at the same time. As such, even within the same displacement range and supplying to the same automotive manufacturers, two engine suppliers may not directly compete against each other due to the fact that they are separated into different pools of suitable engine suppliers. According to the Frost & Sullivan Report, we currently do not compete directly with Aerospace Mitsubishi, even though we had overlapping customers. This is due to the fact that our overlapping customers produced both basic edition models and medium or premium edition models. However, our overlapping customers treat us and Aerospace Mitsubishi as engine suppliers in two different supplier pools. Generally, our overlapping customers will purchase engines from us for their basic edition models, and they will purchase engines from Aerospace Mitsubishi for their medium or premium models. Also, historically, we supplied engines for basic edition models to our customers while Aerospace Mitsubishi mainly supplied engines for medium or premium edition models to its customers. We believe Aerospace Mitsubishi is able to leverage on its premium brand “Mitsubishi” to capture customers who are in the medium and premium vehicle sectors. Based on this distinction, we believe that our customers, including the overlapping customers, when they develop a new vehicle model, would not reach out to both of us for engine supplies. End-users often compare basic edition models with medium and premium edition models before they purchase a vehicle. Such comparison of different edition models may lead to indirect competition between us and Aerospace Mitsubishi. In addition, given that both Aerospace Mitsubishi and our Group are engaged in the manufacture and sale of automotive engines and have overlapping customers, there can be no guarantee that Aerospace Mitsubishi and our Group will not directly compete in the future. Based on currently available information, our Company and Brilliance China are not aware that Aerospace Mitsubishi plans to manufacture and/or sell same type of automotive engines as our Company in the near term.

We understand from Brilliance China, which currently owns equity interests in Aerospace Mitsubishi through its subsidiaries, that it has been a passive investor since it first invested in Aerospace Mitsubishi. Brilliance China also informed us that it has not been involved in the day-to-day operation

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of Aerospace Mitsubishi and has not been in a position to single handedly formulate the overall strategy of Aerospace Mitsubishi which may lead to competition with our Group. Currently, two of the nine directors of Aerospace Mitsubishi were nominated by Brilliance China. Brilliance China therefore does not have control over the board of directors of Aerospace Mitsubishi. These two directors are neither directors nor senior management of Brilliance China or our Company, but one of them is a director of Mianyang Xincheng. To avoid any potential conflict of interest arising from such common directorship or leakage of sensitive information in relation to our Group’s products or customers, the sole overlapping director [has signed] an undertaking to our Company, pursuant to which he undertakes (i) to declare his interests prior to any board meeting of Mianyang Xincheng; (ii) if he is an interested director, he shall not be counted towards any quorum and shall abstain from voting in respect of the transactions or matters that he is interested in during Mianyang Xincheng’s board meeting; and (iii) not to disclose any price-sensitive information in connection with the business and operations of Mianyang Xincheng to any third parties, including the Controlling Shareholders.

Reasons for not including the Excluded Business of Aerospace Mitsubishi in our Group

Our Directors have considered that it is neither in the best interest of, nor feasible for, our Group to include the Excluded Business of Aerospace Mitsubishi in our Group for the following reasons:

- (i) our Directors believe that there is currently no direct competition between our existing products and the existing products of Aerospace Mitsubishi on the basis that our Group and Aerospace Mitsubishi offer products with a different cost structure and target different vehicle models;
- (ii) our Group has no current plan to develop and manufacture products which have the same or similar cost structure as those produced by Aerospace Mitsubishi or target vehicles within the same or similar price ranges;
- (iii) our Group operates independently from Aerospace Mitsubishi;
- (iv) our Group’s current plan is to focus on the organic growth of its operation and retain all resources to achieve that. Any resources allocated for the acquisition of the 14.43% interest in Aerospace Mitsubishi currently held by Brilliance China may adversely affect the expansion plan of our Group; and
- (v) a minority interest of 14.43% would not give us any meaningful control over the management of Aerospace Mitsubishi to influence its business for the benefit of our Group or include it within our Group.

Based on the due diligence performed by the [●] on the Excluded Business of Aerospace Mitsubishi, including due diligence performed with the Group, the overlapping customers of Aerospace Mitsubishi and the Group, and the industry consultant, the [●] considers that the potential for competition between the Group and Aerospace Mitsubishi is not of such magnitude as to affect the Company’s suitability for [●]. In addition, Brilliance China [has entered into] an undertaking pursuant to which it will adopt measures to address the potential conflicts of interest in the event that there is competition between the Group and Aerospace Mitsubishi, and the [●] considers that these measures are sufficient to address potential conflicts of interest.

We have no intention and we believe that Brilliance China currently has no intention to include Brilliance China’s stake in Aerospace Mitsubishi in our Group. In the event that Brilliance China plans to transfer its stake in Aerospace Mitsubishi to our Group, the other Shareholders of Aerospace Mitsubishi have a first refusal right. No consent has been sought from other Shareholders of Aerospace Mitsubishi by Brilliance China relating to the transfer of its stake in Aerospace Mitsubishi.

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Undertaking from Huachen and Brilliance China

Each of Huachen and Brilliance China [has entered] into a deed of undertaking in favor of our Company (the “Second Huachen and Brilliance China Undertaking”), pursuant to which each of Huachen and Brilliance China has unconditionally and irrevocably undertaken to our Company (for itself and for the benefit of each other member of our Group) that it shall abstain from voting in the event that there are discussions on matters that involve both Aerospace Mitsubishi and our Group during Aerospace Mitsubishi’s board meetings and that it will procure its respective subsidiaries (i) to first purchase products from us if the products offered by our Group and Aerospace Mitsubishi are of similar quality, specifications and price; and (ii) to maintain or increase the purchases of the products mentioned in (i) above from our Group going forward.

To the best of our Directors’ knowledge, as at the [Latest Practicable Date], other than the Excluded Business of Shenyang Xinguang Brilliance and the Excluded Business of Aerospace Mitsubishi, none of the Controlling Shareholders, Huachen nor their respective associates was engaged in the manufacture or sale of automotive engines (including trading activities) which may directly or indirectly compete with the products manufactured and sold by our Group.

INDEPENDENCE FROM OUR CONTROLLING SHAREHOLDERS AND HUACHEN

Having considered the following factors, we are satisfied that we can conduct our business independently of our Controlling Shareholders, Huachen and their respective associates (other than our Company) after completion of the [●].

Operational Independence

We have full control over our assets to continue our business independently of our Controlling Shareholders and Huachen. We do not rely on our Controlling Shareholders or Huachen for our operations, technology, product development, production, staffing or marketing, save as certain sale and purchase transactions with our Controlling Shareholders, Huachen and/or their respective associates disclosed in this document. For instance, we develop new technologies and enhance our existing products through our own research and development team at our research and development centre. We produce our products at our own production facilities, which are established independently of our Controlling Shareholders, Huachen and their respective associates.

Our Directors and senior management conduct our business with established systems and arrangements in place. Our organizational structure is made up of functional departments, each with specific areas of responsibility. We have also established a set of internal control measures to facilitate the effective operation of our business.

During the Track Record Period, we had entered into certain transactions with the Controlling Shareholders and Huachen which are expected to continue after [●], and they will constitute continuing connected transactions for our Company upon [●]. Those transactions are set out as follow:

Transactions with Brilliance China Group

- (i) Mianyang Ruian, a wholly-owned subsidiary of Brilliance China, has sold and will continue to sell various types of engine components to us;
- (ii) Shenyang Jinbei, a non wholly-owned subsidiary of Brilliance China, has purchased and will continue to purchase automotive engines and various types of engine components from us; and

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- (iii) Xing Yuan Dong, a wholly-owned subsidiary of Brilliance China, has purchased and will continue to purchase engines from us.

During the Track Record Period, our aggregate purchases from Brilliance China Group were approximately RMB24.2 million, RMB36.0 million, RMB39.3 million and RMB35.4 million, respectively, representing approximately 2.2%, 2.2%, 2.1% and 2.3% of our total cost of sales for the same periods, respectively. We expect our purchases from Brilliance China Group in aggregate will not exceed RMB55.8 million, RMB65.6 million and RMB78.0 million for the three years ending December 31, 2015, respectively.

During the Track Record Period, our aggregate sales to Brilliance China Group were approximately RMB627.0 million, RMB805.2 million, RMB416.2 million and RMB381.8 million, respectively, representing approximately 48.8%, 41.4%, 18.0% and 19.6% of our total revenue for the same periods, respectively. Our sales to Brilliance China Group during the Track Record Period included the sales of our engines to Shenyang Brilliance Power and Shenyang ChenFa, which were then subsidiaries of Brilliance China. These two entities ceased to be the subsidiaries of Brilliance China in 2009 and 2011, respectively. We expect our sales to Brilliance China Group in aggregate will not exceed RMB501.0 million, RMB574.9 million and RMB667.6 million for the three years ending December 31, 2015, respectively.

Transactions with Wuliangye Group

- (i) Xinhua Combustion Engine has provided and will continue to provide (a) a trademark license for the use of one of the trademarks of Xinhua Combustion Engine registered in the name of Xinhua Combustion Engine on our engines; and (b) various gasoline and diesel engine components such as crankshafts, exhaust manifolds and cylinders chambers and cylinder heads to us; and it has purchased and will continue to purchase engine components from us. Xinhua Combustion Engine has provided equipment maintenance and repair services to us during the Track Record Period and such services will not continue going forward;
- (ii) Mianyang Jianmen Real Estate, a wholly-owned subsidiary of Xinhua Combustion Engine, has provided and will continue to provide construction and building maintenance services to us; and
- (iii) Sichuan Pushi, a direct wholly-owned subsidiary of the Pushi Group, the holding company of Xinhua Combustion Engine, has sold and will continue to sell crankshafts to us.

During the Track Record Period, our aggregate procurement and purchases from Wuliangye Group, including the construction and maintenance costs charged by Wuliangye Group, were approximately RMB112.3 million, RMB164.0 million, RMB160.1 million and RMB114.3 million, respectively, representing approximately 10.1%, 10.0%, 8.7% and 7.3% of our total cost of sales for the same periods, respectively. We expect our procurement of the above services and/or products from Wuliangye Group, including the construction and maintenance costs charged by Wuliangye Group, in aggregate will not exceed RMB206.1 million, RMB242.6 million and RMB279.5 million for the three year ending December 31, 2015, respectively (excluding the transactions set out under sub-sections 1 to 3 in "Connected Transactions — Exempt continuing connected transactions" of this document). During the nine months ended September 30, 2012, our aggregate sales to Wuliangye Group were approximately RMB182,000, representing approximately 0.01% of our total revenue for the same period.

Transactions with Huachen Group

- (i) Huachen has purchased and will continue to purchase engines and engine components from us;

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- (ii) Mianyang Huarui, a wholly-owned subsidiary of Huachen, has purchased and will continue to purchase engines and engine components from us. Mianyang Huarui has also sold and will continue to sell engine components to us;
- (iii) Mianyang Huaxiang, an indirect wholly-owned subsidiary of Huachen, has purchased and will continue to purchase engines and engine components from us; and
- (iv) Shenyang Brilliance Power, a non wholly-owned subsidiary of Huachen, has purchased and will continue to purchase engines from us.

We have been purchasing engine components and automotive components, which are not produced by us from Huachen Group since 2011. During the year ended December 31, 2011 and the nine months ended September 30, 2012, our aggregate purchases from Huachen Group were approximately RMB7,290 and RMB9,910, respectively, representing approximately 0% and 0% of our total cost of sales for the same periods, respectively.

During the Track Record Period, our aggregate sales to Huachen Group were approximately RMB36.4 million, RMB270.4 million, RMB661.6 million and RMB485.4 million, respectively, representing approximately 2.8%, 13.9%, 28.7% and 25.0% of our total revenue for the same periods, respectively. We expect our sales to Huachen Group in aggregate will not exceed RMB774.1 million, RMB868.6 million and RMB1,044.3 million for the three years ending December 31, 2015, respectively.

Please refer to “Connected Transactions” in this document for details of the above transactions.

The increase in our sales to Huachen Group during the Track Record Period is mainly due to (i) the increase in demand for our products from Huachen Group; and (ii) the transfer of certain businesses and subsidiaries of Brilliance China, e.g. Zhonghua sedan business, which purchased our products, to Huachen for the purpose of reorganization. Shenyang JinBei, a non-wholly owned subsidiary of Brilliance China, obtained an approval from the Chinese government to produce and sell Zhonghua sedans in the PRC in May 2002, and our Group began supplying engines to Zhonghua sedan in 2009. The transfer of the Zhonghua sedan business (the “Transfer”) took place on December 31, 2009 as disclosed in the annual report of Brilliance China for the year ended December 31, 2009. According to the circular of Brilliance China dated December 1, 2009, the reasons for the Transfer are as follows:

- (i) Zhonghua sedan had consumed substantial resources of Brilliance China Group in terms of its brand building and product development. The high upfront development costs coupled with the relatively low sales volume of Zhonghua sedans in the past had resulted in substantial losses generated from this business segment. Therefore, Brilliance China considered that further development of this business would require significant additional investment thus putting considerable financial burden on Brilliance China in the short to medium term;
- (ii) the then directors of Brilliance China considered that the poor performance of the Zhonghua sedan business had adversely influenced and suppressed the true potential value of Brilliance China Group. Thus, the then directors of Brilliance China believed that the Transfer would provide immediate earnings enhancement to Brilliance China Group, uplift the profile of Brilliance China and unlock the true intrinsic value of Brilliance China Group so that the value of Brilliance China Group’s remaining businesses could be fully recognized by the market and better reflected in Brilliance China’s share price; and

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- (iii) the Transfer would enable Brilliance China to refocus its management and financial resources on its then existing profitable businesses, as well as to develop other new downstream service-related automotive aftermarket businesses.

To our understanding, Huachen Group was interested in acquiring the Zhonghua sedan business in 2009, notwithstanding that it was loss-making and had high upfront development costs, because Huachen believed that by operating the Zhonghua sedan business as a wholly-owned business rather than indirectly owned through Huachen Group’s 42.48% ownership in Brilliance China, the Zhonghua sedan business would be able to enjoy additional government concessions and grants which it would not have been able to access without being a wholly-owned business of Huachen Group. Such benefits included fleet sales to government entities, and various tax rebates and allowances. In addition, by becoming a wholly-owned subsidiary of a state-owned entity, the PRC government would be more receptive to purchasing and using Zhonghua branded sedans, which offered an opportunity for the Zhonghua sedan business to penetrate into the government sector and open up an additional source of income. We understand that Huachen Group was confident that with more time and resources, which Huachen Group was willing to commit, and additional government support and concessions, it had the ability to eventually turnaround the Zhonghua sedan business.

We believe that Huachen, a major customer of our Group, relies on us for the supply of engines for the manufacture of its products on the basis that (i) the quality and price of our products are competitive to our competitors; and (ii) Huachen has been purchasing automotive engines from us since 2009. The engines that we supply to Huachen are developed and produced according to the specifications required by Huachen. We believe that if Huachen intends to purchase automotive engines from other engine manufacturers, it will incur time and cost to identify engine manufacturers which can develop and produce automotive engines that are compatible to Huachen’s products and with similar, if not the same, quality as our engines.

Although our expected total sales to and/or total purchases from Brilliance China Group and/or Wuliangye Group and/or Huachen Group will continue to increase after [●], given the expected rapid growth of the PV and LCV engine market in the PRC and the anticipated growth in similar sale and purchase transactions with other third parties, we expect the proportion of our transactions with Brilliance China Group, Wuliangye Group and Huachen Group, as compared to the total value of all such sale and purchase transactions, to remain largely stable or decrease.

We did not reduce our sales to non-related customers during the Track Record Period, and our sales to non-related customers during the same periods accounted for approximately 48.4%, 44.7%, 53.3% and 53.0% of our total revenue, respectively.

The following table sets forth our total sales to Brilliance China Group, Huachen Group and Wuliangye Group during the Track Record Period:

Sale	Year ended December 31,						Nine months ended September 30, 2012	
	2009		2010		2011		RMB'000	% of total revenue
	RMB'000	% of total revenue	RMB'000	% of total revenue	RMB'000	% of total revenue		
Brilliance China Group	627,041	48.8	805,233	41.4	416,192	18.0	381,755	19.6
Huachen Group	36,430	2.8	270,414	13.9	661,627	28.7	485,440	25.0
Wuliangye Group	—	—	—	—	—	—	182	0.0
Total:	<u>663,471</u>	<u>51.6</u>	<u>1,075,647</u>	<u>55.3</u>	<u>1,077,819</u>	<u>46.7</u>	<u>867,377</u>	<u>44.6</u>

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We currently estimate, based on the reasons set forth below, that our sales to Brilliance China Group, Huachen Group and Wuliangye Group for the three years ending December 31, 2015 are not expected to exceed the amounts set forth in the following table:

	Year ending December 31,		
	2013	2014	2015
	RMB million	RMB million	RMB million
Estimated Maximum Sale			
Brilliance China Group	501.0	574.9	667.6
Huachen Group	774.1	868.6	1,044.3
Wuliangye Group	0.3	0.4	0.4

The 2013 amounts for each of Brilliance China Group and Huachen Group are determined with reference to their expected number of vehicles to be produced by vehicle models, new vehicle models to be launched and vehicle models expected to cease production in 2013 based on both discussions with Brilliance China Group and Huachen Group regarding their respective plans for 2013 and their respective plans for 2013 furnished to us.

The 2014 and 2015 amounts for each of Brilliance China Group and Huachen Group are determined with reference to (i) the anticipated increase in the demand of our products in 2013, (ii) the historical trend of our sales to each of them; (iii) the outlook of the PV and LCV engine market in the PRC in 2014 and 2015; and (iv) the new vehicle models expected to be launched by each of them in 2014 and 2015. For the purpose of these estimates we have assumed that the per unit prices of our products would remain stable throughout the three years ending December 31, 2015.

The amounts for Wuliangye Group are determined with reference to, (i) in the case of 2013, the volume of engine components to be purchased by Wuliangye Group based on discussions with Wuliangye Group regarding its plans for 2013; and (ii) in the case of 2014 and 2015, an expected increase in demand based on such discussions with Wuliangye Group and the expected business growth of Wuliangye Group’s business.

The estimates above are forward-looking and reflect the current views of our Directors with respect to future events and are subject to certain risks, uncertainties and assumptions, including but not limited to the risk factors described in this document. The estimates above are made as at the date of this document and may potentially change in light of future developments. For further details, please see “Forward-looking Statements” in this document.

The following table sets forth our total purchases from Brilliance China Group, Huachen Group and Wuliangye Group during the Track Record Period:

Purchase	Year ended December 31,						Nine months ended September 30, 2012	
	2009		2010		2011		RMB’000	% of total cost of sales
	RMB’000	% of total cost of sales	RMB’000	% of total cost of sales	RMB’000	% of total cost of sales		
Brilliance China Group	24,204	2.2	36,035	2.2	39,274	2.1	35,431	2.3
Huachen Group	—	—	—	—	7	0.0	10	0.0
Wuliangye Group	109,712	9.8	162,738	9.9	154,639	8.5	107,425	6.9
Total:	<u>133,916</u>	12.0	<u>198,773</u>	12.1	<u>193,920</u>	10.6	<u>142,866</u>	9.2

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We are operating independently from our Controlling Shareholders, Huachen and their respective associates on the basis that the above transactions are governed by agreements entered into in the ordinary course of our business and on terms which are fair and reasonable and in the event that the Controlling Shareholders and/or, Huachen are unable to provide their services upon reasonable terms, we are entitled to choose third parties who can provide such products or services upon comparable terms. Given the above, our Board is satisfied that we have been operating independently from our Controlling Shareholders, Huachen and their respective associates during the Track Record Period and will continue to do so.

Huachen Group and Brilliance China Group are two of our major customers during the Track Record Period due to (i) the history of our Group and its relationship with Huachen Group and Brilliance China Group and (ii) Huachen Group and Brilliance China Group are two of the major players in the PRC PV market. We expect our revenue percentage generated from the sale of our products to Huachen Group and Brilliance China Group will remain largely stable or decline in the next couple of years. In addition, we believe our Group has the production flexibility to adjust our existing production lines to accommodate the production requirements of different engine models to cater for the needs of our existing and new customers. Although the reliance on sales of our products to Huachen Group and Brilliance China Group is expected to remain largely stable or decline in the future, it is unlikely that a company in our line of business would be able to break off reliance on either one of them as a major customer.

Our Directors consider that there is no significant risk of reliance on the Controlling Shareholders and Huachen Group that would render our Company unsuitable for [●], taking into consideration the above and for the following reasons:

- (i) our sales to the Controlling Shareholders and Huachen Group, on a group basis, accounted for less than 50% of our total revenue for the year ended December 31, 2011 and the nine months ended September 30, 2012. Further, during the Track Record Period, our sales to Brilliance China Group and Huachen Group, in aggregate, amounted to approximately 51.6%, 55.3%, 46.7% and 44.6%, respectively. Such decreasing trend shows that we have been reducing our reliance on Brilliance China Group and Huachen Group by diversifying our focus from sales to Brilliance China Group and Huachen Group to independent third party customers;
- (ii) our purchases from the Controlling Shareholders, on a group basis collectively accounted for less than 11% of our total cost of sales for the year ended December 31, 2011 and the nine months ended September 30, 2012, respectively. In addition, during the Track Record Period, we had over 200 suppliers and did not rely on our Controlling Shareholders or Huachen Group for supplying any of our key engine components. We have the ability to find substitute suppliers in the market if necessary;
- (iii) we have been actively developing our business relationship with our existing and new independent third party customers in the PRC market, and expanding our production capacity and increasing our sales and marketing resources to diversify our customer base and gradually reduce the percentage of total revenue attributable to our Controlling Shareholders and Huachen Group. During the Track Record Period, our sales to non-related customers accounted for approximately 48.4%, 44.7%, 53.3% and 53.0% of our total revenue, respectively, and seven of our top ten customers were independent third party automotive manufacturers, and we are trying to develop new customer relationships with other independent third parties going forward;
- (iv) we have the necessary skill, technology and production flexibility to adjust our existing production lines to accommodate the production requirements of different engine models to cater for the need of third party customers;

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- (v) Huachen Group and Brilliance China Group are two of the major players in the PRC PV market and we expect that they will remain our major customers. Although we have been in the process of and are continuing to reduce the percentage of our overall sales attributable to Huachen Group and Brilliance China Group, it is not practical for us to significantly reduce such percentage in a short period of time. However, given our expected increase in overall sales and our concerted effort to increase sales to third party customers, the percentages of our overall sales attributable to Huachen Group and Brilliance China Group, in the aggregate, are expected to remain stable or decline in the next couple of years;
- (vi) the business relationships are mutual and complementary. We believe that each of Brilliance China Group and Huachen Group uses our engines for the manufacture of its products because (a) the quality and price of our products are competitive; and (b) we have a good and stable track record as each of Brilliance China Group and Huachen Group has been purchasing automotive engines from us since 1998 and 2009, respectively. Based on information provided to us by Brilliance China, in terms of the actual amount of engines purchased, during the Track Record Period, the aggregate purchase of our engines by Huachen Group amounted to approximately Nil, 58%, 77% and 60%, respectively, of Huachen Group’s total purchase amount of automotive engines, and the aggregate purchase of our engines by Brilliance China Group amounted to approximately 30%, 45%, 48% and 63%, respectively, of Brilliance China Group’s total purchase amount of automotive engines. If Brilliance China Group and Huachen Group intend to purchase automotive engines from new engine manufacturers, they will incur time and cost to identify engine manufacturers which can develop and produce automotive engines that are compatible to their products and with similar, if not the same, quality as our engines. We understand from Brilliance China Group and Huachen Group that there is at least one alternative engine supplier for each of their products, depending on the model and specification of the engines they need;
- (vii) we entered into one-year supply agreements with Brilliance China Group and Huachen Group at the beginning of the year in order to maintain flexibility with other customers, which is in line with the industry practice in the PRC PV and LCV engine market; and
- (viii) given the expected increase in local demand for our engines due to the growth of the PV and LCV engine market in the PRC in recent years (for details, please refer to “Industry Overview — Overview of the PRC PV and LCV Engine Market”), we consider that we are capable of expanding and diversifying our customer base.

Our arrangements to reduce the percentage of overall revenue attributable to our Controlling Shareholders and Huachen Group going forward are as follows:

- (i) actively pursuing independent third party customers in the PRC market to diversify our customer base;
- (ii) expanding our production capacity to cater for the needs of additional customers; and
- (iii) increasing our sales and marketing resources and activities to gain more market share from independent third party customers.

Further, Brilliance China Group’s revenue for the year ended December 31, 2011 was approximately RMB6,442.9 million according to its 2011 annual report publicly available on its website and the Stock Exchange’s website, and its revenue for the six months ended June 30, 2012 was approximately RMB2,810.3 million according to its 2012 interim report publicly available on its website and the Stock Exchange’s website. Given the financial strength of the Controlling Shareholders and Huachen and their track record of gradual and frequent repayments, our Company considers that our transactions

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with the Controlling Shareholders and Huachen Group would not lead to any material receivables collection or cash flow issues, pressure on profit margin or significant decline in orders in the foreseeable future. For details of the settlement records from, among others, Brilliance China Group and Huachen Group, please see “Financial Information — Description of Certain Items from Our Consolidated Statements of Financial Position — Amounts due from related companies”.

Financial Independence

Our financial auditing system is independent from our Controlling Shareholders and Huachen and we employ a competent and well-staffed team of financial accounting personnel. We have our own accounting and finance department, and our accounting systems, treasury function for cash receipts and payment and access to third party financing are independent of our Controlling Shareholders and Huachen. We make financial decisions according to our own business needs.

On October 18, 2011, (i) a loan agreement entered into between Brilliance Investment as the lender and our Company as the borrower, and (ii) a loan agreement entered into between Xinhua Investment as the lender and our Company as the borrower, pursuant to which each of Brilliance Investment and Xinhua Investment agreed to lend to our Company HK\$20,000,000 for the sole purpose of onward lending to Lead In for Lead In’s purchase of the Lead In Subscribed Shares. Since the process involved in order for Mianyang Xinchun to obtain approval to exchange RMB for HK dollars would be lengthy, this arrangement was implemented to facilitate our Group to obtain sufficient HK dollars to complete the arrangement in time to meet the requirements set out in the Guidance on [●] Investments issued on October 13, 2010 by the [●]. The loans will be repaid before the [●]. We consider that the arrangement will have no implication on our Group’s financial dependence on our Controlling Shareholders. Other than these loans, our Controlling Shareholders and Huachen have not provided any financial assistance, security and/or guarantee in favor of our Group as at the [Latest Practicable Date.]

Based on the above, our Directors believe that we are able to maintain financial independence from our Controlling Shareholders and Huachen, and do not place undue reliance on them.

Management Independence

Our Board consists of eight Directors, including two executive Directors, two non-executive Directors and four independent non-executive Directors. Two of our Directors hold positions in Brilliance China and/or Huachen, namely, Mr. Wu Xiao An, the chairman and executive director of Brilliance China, and the director of Huachen, and Mr. Qi Yumin, the chief executive officer, president and executive director of Brilliance China, and the chairman, president and executive director of Huachen. As at the Latest Practicable Date, each of Mr. Wu Xiao An and Mr. Qi Yumin was interested in [7,750,000] shares and [4,500,000] share options of Brilliance China, respectively, representing approximately [0.15]% and [0.09]% of the issued share capital of Brilliance China, respectively. Further, Mr. Li Peiqi, our non-executive Director, is the chairman of Xinhua Combustion Engine. Mr. Wang Yunxian, our Director, was the then director and general manager of Xinhua Combustion Engine and he has resigned from his roles as director and general manager of Xinhua Combustion Engine on March 22, 2012 and March 23, 2012, respectively.

The three overlapping Directors shall abstain from voting on discussions that may be entered into with the relevant Controlling Shareholder and/or Huachen, and shall not vote on such matters. Our Company believes that only if there is an unlikely event which involves all of Brilliance China, Huachen, Xinhua Combustion Engine and Wuliangye would all the three overlapping Directors be required to abstain from voting simultaneously during Board discussions. In such event, our Board will then comprise Mr. Wang Yunxian and our independent non-executive Directors. We are satisfied that Mr. Wang Yunxian, our chief executive officer and executive Director, and our four independent non-

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executive Directors who possess sufficient and competent industry knowledge and experience, and with the support of our qualified senior management team, are capable to vote on such matters which is in the best interests of the Shareholders as a whole. Please refer to “Directors and Senior Management” for detailed biographies.

Name	Position in our Group upon [●]	Directorship in Brilliance China/Huachen upon [●]	Directorship in Xinhua Combustion Engine/ Pushi Group/ Wuliangye upon [●]
Wu Xiao An (also known as Ng Siu On) (吳小安)	Chairman and executive Director	Chairman and executive director of Brilliance China, and director of Huachen	None
Wang Yunxian (王運先)	Chief executive officer and executive Director	None	None
Qi Yumin (祁玉民)	Non-executive Director	Chief executive officer, president and executive director of Brilliance China, and chairman, president and executive director of Huachen	None
Li Peiqi (李培奇)	Non-executive Director	None	Chairman of Xinhua Combustion Engine
Chi Guohua (池國華)	Independent non-executive Director	None	None
Wang Jun (王隽)	Independent non-executive Director	None	None
Huang Haibo (黃海波)	Independent non-executive Director	None	None
Wang Songlin (王松林)	Independent non-executive Director	None	None

Each of Brilliance China and Xinhua Combustion Engine has nominated two Directors from its respective groups to our Board. This arrangement was adopted to (i) jointly manage and operate the business of our Company, which was originally a joint-stock company between Brilliance China and Xinhua Combustion Engine; and (ii) enhance the cooperation between Brilliance China and Xinhua Combustion Engine. Our Directors believe that the above arrangement has proven beneficial to our Company and is in the best interests of our Shareholders as a whole.

Most members of our senior management have, for all or substantially all of the Track Record Period, undertaken senior management supervisory responsibilities in our business. The responsibilities of our senior management team include dealing with operational and financial matters, making general capital expenditure decisions and daily implementation of the business strategy of our Group. This ensures the

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independence of the daily management and operations of our Group from those of our Controlling Shareholders and Huachen. Certain of our senior management has resigned from their respective management roles in Xinhua Combustion Engine. None of the senior management of our Group holds any directorship or senior management roles in our Controlling Shareholders or Huachen.

All of our Directors and members of senior management possess relevant management and/ or industry-related experience to act as Directors or senior management of our Company. Further details are set out in “Directors and Senior Management” in this document. Each of our Directors is aware of his fiduciary duties as a Director of our Company which requires, among other things, that he acts for the benefit and in the best interests of our Company and does not allow any conflict between his duties as a Director and his personal interest. Under our Articles of Association, where a Director has a material interest in any contract, arrangement or other proposal considered by our Board, the interested Director(s) shall abstain from voting at the relevant Board meetings of our Company in respect of such transactions and shall not be counted in the quorum. In addition, we have a senior management team to make business decisions independently. Our independent non-executive Directors have sufficient and competent industry knowledge and experience. Our independent non-executive Directors will also bring independent judgment to the decision making process of our Board, taking into account the advice of our senior management. Our Directors and the [●] are of the view that Mr. Wang Yunxian and the independent non-executive Directors will be able to function effectively in the unlikely event that all other Directors are required to abstain from voting at the relevant Board meetings of our Company.

Based on the above, our Board is satisfied that our Board as a whole, together with our senior management team, are able to perform the managerial role in our Group independently of the Controlling Shareholders and Huachen.

DEED OF NON-COMPETITION

The Controlling Shareholders and Huachen entered into a deed of non-competition (the “Deed of Non-competition”) on [●], 2013 in favor of our Company, pursuant to which each of the Controlling Shareholders and Huachen has unconditionally and irrevocably agreed, undertaken and covenanted with our Company (for itself and for the benefits of each other member of our Group) that it would not, and would procure that its associates (other than any members of our Group) would not, directly or indirectly, either on its own account or in conjunction with or on behalf of any person, firm or company, among other things, carry on, participate or be interested or engaged in or acquire or hold (in each case whether as a shareholder, director, partner, agent, employee or otherwise, and whether for profit, reward or otherwise) any activity or business which competes or is likely to compete, directly or indirectly, with the business referred to in this document and any other business from time to time conducted, carried on or contemplated to be carried on by any member of our Group or in which any member of our Group is engaged or has invested or which any member of our Group has otherwise publicly announced its intention to enter into, engage in or invest in (whether as principal or agent and whether undertaken directly or through any body corporate, partnership, joint venture, or other contractual or other arrangement) (the “Restricted Business”).

Each of the Controlling Shareholders and Huachen has further unconditionally and irrevocably agreed, undertaken to and covenanted with our Company the following:

- (i) to provide all information requested by our Company which is necessary for an annual review by our independent non-executive Directors of its compliance with the Deed of Non-competition and the enforcement of the Deed of Non-competition;
- (ii) to procure our Company to disclose decisions on matters reviewed by the independent non-executive Directors relating to the compliance and enforcement of the Deed of Non-

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competition either through the annual report, or by way of announcements to the public; and

- (iii) to make an annual declaration on compliance with its undertaking under the Deed of Non-competition in the annual reports of our Company as the independent non-executive Directors think fit and/or as required by the relevant requirements under the [●].

The Controlling Shareholders and Huachen have further unconditionally and irrevocably agreed, undertaken to and covenanted with our Company to procure that any business investment or other commercial opportunity which directly or indirectly competes, or may lead to competition with the Restricted Business (the “New Opportunities”) given, identified or offered to it and/or any of its associates (other than any members of our Group) (the “Offeror”) is first referred to us in the following manner:

- (i) each of the Controlling Shareholders and Huachen is required to, and shall procure its associates (other than members of our Group) to, refer, or to procure the referral of, the New Opportunities to us, and shall give written notice to us of any New Opportunities containing all information reasonably necessary for us to consider whether (a) such New Opportunities would constitute competition with our core business; and (b) it is in the interest of our Group to pursue such New Opportunities, including but not limited to the nature of the New Opportunities and the details of the investment or acquisition costs (the “Offer Notice”); and
- (ii) the Offeror will be entitled to pursue the New Opportunities only if (a) the Offeror has received a notice from us declining the New Opportunities and confirming that such New Opportunities would not constitute competition with our core business; or (b) the Offeror has not received such notice from us within 10 Business Days from our receipt of the Offer Notice. If there is a material change in the terms and conditions of the New Opportunities pursued by the Offeror, the Offeror will refer the New Opportunities as so revised to us in the manner as set out above.

Upon receipt of the Offer Notice, we shall seek opinions and decisions from our independent non-executive Directors who do not have a material interest in the matter as to whether (i) such New Opportunities would constitute competition with our core business; and (ii) it is in the interest of our Company and our Shareholders as a whole to pursue the New Opportunities.

The Deed of Non-competition does not apply to:

- (i) the holding of or interests in the shares of any member of our Group;
- (ii) the Excluded Business of Shenyang Xinguang Brilliance and the Excluded Business of Aerospace Mitsubishi;
- (iii) the holding of or interests in the shares of a company other than our Group, whose shares are listed on a recognized stock exchange provided that:
 - (a) the relevant Restricted Business conducted or engaged in by such company (and assets relating thereto) accounts for less than 10% of that company’s consolidated revenue or consolidated assets, as shown in that company’s latest audited accounts; or
 - (b) the total number of the shares held by the relevant Controlling Shareholder, Huachen and/or its associates does not exceed 5% of the issued shares of that class of the

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company in question, and such Controlling Shareholder, Huachen and its respective associates, whether acting singly or jointly, are not entitled to appoint a majority of the directors of that company and at any time there should exist at least another shareholder of that company (together, where appropriate, with its associates) whose shareholdings in that company should be more than the total number of shares held by the Controlling Shareholder and Huachen in aggregate and/or its associates in aggregate.

The undertakings given by each of the Controlling Shareholders and Huachen under the Deed of Non-competition shall lapse and each of the Controlling Shareholders and Huachen shall be released from the restrictions imposed on it upon occurrence of the earlier of either of the following events or circumstances:

- (i) the date on which the Shares cease to be [●] on the [●]; or
- (ii) the date on which all of the Controlling Shareholders and their respective associates cease to be Controlling Shareholders of our Company within the meaning of the [●] in force from time to time.

CORPORATE GOVERNANCE MEASURES

Our Company will adopt the following measures to manage the conflict of interests arising from the possible competing business of the Controlling Shareholders and Huachen Group and to safeguard the interests of our Shareholders:

- (i) our independent non-executive Directors will review, on an annual basis, the compliance with the Deed of Non-competition by the Controlling Shareholders and Huachen, and the First Huachen and Brilliance China Undertaking and the Second Huachen and Brilliance China Undertaking by Huachen and Brilliance China;
- (ii) our Company will disclose decisions on matters reviewed by our independent non-executive Directors relating to compliance and enforcement of the Deed of Non-competition by the Controlling Shareholders and Huachen, and the First Huachen and Brilliance China Undertaking and the Second Huachen and Brilliance China Undertaking by Huachen and Brilliance China, in the annual reports of our Company;
- (iii) in the event that connected transactions between our Group and the Excluded Businesses or other business in which any of our Directors or their respective associates has any interest are submitted to the Board for consideration, the relevant interested Director will not be counted in the quorum and will abstain from voting on such matters, and majority votes by non-conflicted Directors are required to decide on such connected transactions;
- (iv) our Directors operate in accordance with the Articles which require the interested Director not to vote (nor be counted in the quorum) on any resolution of the Board approving any contract or arrangement or other proposal in which he/she or any of his or her associates is materially interested; and
- (v) pursuant to the Corporate Governance Code and Corporate Governance Report (the “Code”) in accordance with Appendix 14 of the [●], our Directors, including the independent non-executive Directors, will be able to seek independent professional advice from external parties in appropriate circumstances at our Company’s cost.

Our Company is expected to comply with the Code which sets out principles of good corporate governance in relation to, among others, Directors, the chairman, Board composition, the appointment,

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re-election and removal of Directors, their responsibilities and remuneration and communications with our Shareholders. Our Company will state in its interim and annual reports whether we have complied with the Code, and will provide details of, and reasons for, any deviations from it in our corporate governance report which will be included in our annual report.

CONNECTED TRANSACTIONS

OVERVIEW

We have entered into various transactions which will continue after [●] with various connected persons of ours. Details of such continuing connected transactions of our Company are as follows:

Connected Person	Nature of Transaction
<i>Exempt continuing connected transactions</i>	
1. Xinhua Combustion Engine	License of trademark to Mianyang Xincheng from Xinhua Combustion Engine
2. Xinhua Combustion Engine	Sale of our engine components to Xinhua Combustion Engine
3. Xinhua Combustion Engine	Procurement of equipment maintenance and repair services from Xinhua Combustion Engine
4. Mianyang Huarui	Procurement of engine components from Mianyang Huarui
<i>Continuing connected transactions exempt from the independent Shareholders’ approval requirements</i>	
5. Mianyang Ruian	Purchase of engine components from Mianyang Ruian
6. Mianyang Jianmen Real Estate	Procurement of construction and building maintenance services from Mianyang Jianmen Real Estate
<i>Non-exempt continuing connected transactions</i>	
<i>A. Transactions with Brilliance China Group</i>	
7. Shenyang Jinbei and Xing Yuan Dong	Sale of our engines and engine components to Shenyang Jinbei, and our engines to Xing Yuan Dong
<i>B. Transactions with Wuliangye Group</i>	
8. Sichuan Pushi and Xinhua Combustion Engine	Purchase of crankshafts from Sichuan Pushi, and engine components from Xinhua Combustion Engine
<i>C. Transactions with Huachen Group</i>	
9. Huachen, Mianyang Huarui, Mianyang Huaxiang and Shenyang Brilliance Power	Sale of our engines and engine components to Huachen, Mianyang Huarui and Mianyang Huaxiang, and sale of our engines to Shenyang Brilliance Power

CONNECTED TRANSACTIONS

CONTINUING CONNECTED TRANSACTIONS

Exempt continuing connected transactions

1. License of trademark from Xinhua Combustion Engine

Xinhua Combustion Engine is a connected person of our Company since it is a substantial Shareholder of our Company. Xinhua Combustion Engine is primarily engaged in the manufacturing and sale of engine components for engines, sale of automobiles and provision of related services and logistic services. Xinhua Combustion Engine also provides equipment maintenance and repair services to us.

Pursuant to a trademark licence agreement (the “Trademark License Agreement”) entered into on December 10, 2012 between Xinhua Combustion Engine and Mianyang Xincheng, Xinhua Combustion Engine granted Mianyang Xincheng a non-exclusive licence, on a royalty-free basis, to use one of the trademarks of Xinhua Combustion Engine registered in the PRC under the name of Xinhua Combustion Engine (the “Trademark License”) on our engines. The Trademark License is valid for a term consistent with the expiration date of the validity period of the trademark (as renewed, as applicable). Mianyang Xincheng is allowed to use the trademark licensed under the Trademark License Agreement worldwide.

[●] Implications

As the grant of the right to use the above trademark by Xinhua Combustion Engine to Mianyang Xincheng is on a royalty-free basis, each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] (including those for the three years ending December 31, 2015) on an annual basis was, and is expected to be, less than 0.1%. Accordingly, such continuing connected transaction is a de minimis transaction which is exempt from reporting, annual review, announcement and independent Shareholders’ approval requirements under Chapter 14A of the [●].

2. Sale of our engine components to Xinhua Combustion Engine

Xinhua Combustion Engine is a connected person of our Company as set out in sub-section 1 above.

During the nine months ended September 30, 2012, we sold our engine components to Xinhua Combustion Engine for its after-sale automotive repair and maintenance business, and our aggregate sales amounts to Xinhua Combustion Engine amounted to approximately RMB182,000 during the same period. As such transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] for the above transactions set out in this sub-section 2 (including the expected transaction amounts for the three years ending December 31, 2015) in aggregate on an annual basis was, and is expected to be, less than 0.1%, such continuing connected transactions are de minimis transactions which are exempt from reporting, annual review, announcement and independent Shareholders’ approval requirements under Chapter 14A of the [●].

3. Procurement of equipment maintenance and repair services from Xinhua Combustion Engine

Xinhua Combustion Engine is a connected person of our Company as set out in sub-section 1 above.

During the Track Record Period, we procured equipment maintenance and repair services from Xinhua Combustion Engine in respect of our machineries and equipment. For the three years ended

CONNECTED TRANSACTIONS

December 31, 2011 and the nine months ended September 30, 2012, the aggregate procurement from Xinhua Combustion Engine amounted to approximately RMB0.2 million, RMB74,800, RMB1.2 million and RMB0.3 million, respectively. As these transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] for the above transactions set out in this sub-section 3 (including the expected transaction amounts for the three years ending December 31, 2015) in aggregate on an annual basis was, and is expected to be, less than 0.1%, such continuing connected transactions are de minimis transactions which are exempt from reporting, annual review, announcement and independent Shareholders' approval requirements under Chapter 14A of the [●].

4. Procurement of engine components from Mianyang Huarui

Mianyang Huarui is a connected person of our Company since it is a wholly owned subsidiary of Huachen. The principal business activities of Mianyang Huarui include the manufacture and sale of automotive components, sale of vehicles and provision of maintenance and repair services for vehicles. Mianyang Huarui purchases automotive engines and engine components from our Group, and it assembles those purchased engines with additional automotive components, such as transmission, into powertrains. Mianyang Huarui does not manufacture automotive engines.

Since 2011, we have been procuring engine components, which are not produced by us, from Mianyang Huarui for supplying to our repair and maintenance service providers for their provision of repair and maintenance services to their customers, and our aggregate procurement from Mianyang Huarui amounted to approximately RMB7,290 and RMB9,910 during the year ended December 31, 2011 and the nine months ended September 30, 2012. As such transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] for the above transactions set out in this sub-section 4 (including the expected transaction amounts for the three years ending December 31, 2015) in aggregate on an annual basis was, and is expected to be, less than 0.1%, such continuing connected transactions are de minimis transactions which are exempt from reporting, annual review, announcement and independent Shareholders' approval requirements under Chapter 14A of the [●].

Continuing connected transactions exempt from the independent Shareholders' approval requirements

5. Purchase of engine components from Mianyang Ruian

Mianyang Ruian is a connected person of our Company since it is a wholly-owned subsidiary of Brilliance China, a substantial Shareholder of our Company. The principal business activities of Mianyang Ruian include (i) the resale of automotive engines purchased from our Group to subsidiaries of Brilliance China; and (ii) the manufacture and sale of engine components to our Group and third parties. The engine components purchased by our Group from Mianyang Ruian are either for the production of our products or sold by our Group to our customers, including but not limited to Brilliance China Group, for repair and maintenance of our products. Mianyang Ruian had transferred its trading operations to Xing Yuan Dong in 2012, but remains as an engine component manufacturer.

CONNECTED TRANSACTIONS

We purchased various types of engine components from Mianyang Ruian during the Track Record Period. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, the aggregate purchase amounts were approximately RMB24.2 million, RMB36.0 million, RMB39.3 million and RMB35.4 million, respectively. As these transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

It is expected that our total purchases from Mianyang Ruian for the three years ending December 31, 2015 will not exceed RMB55.8 million, RMB65.6 million and RMB78.0 million, respectively. The proposed annual caps for the three years ending December 31, 2015 are determined with reference to (i) our 2013 production plan prepared based on the expected number of vehicles to be purchased by our customers from discussions with our customers regarding their plans in 2013 and/or the plans for 2013 furnished to us by our customers; (ii) the shift of our purchases of engine components from third party manufacturers to Mianyang Ruian starting from the end of 2012 as our Company considers that Mianyang Ruian produces better quality products and offers better services than other third party suppliers; (iii) the new structural design of our engines requires more camshafts which leads to an increase in demand of camshafts; and (iv) the anticipated increase in demand for the engine components manufactured by Mianyang Ruian in 2014 and 2015 for the production of our engines, with reference to the historical trend of our purchases from Mianyang Ruian, and the expected increase in demand for our products from our customers in light of the forecast increase in the PV and LCV engine sales in the PRC at a CAGR of 17.5% from 2012 to 2016 (please refer to “Industry Overview — Overview of the PRC PV and LCV Engine Market” of this document).

Framework Agreement

On [●], 2013, we entered into a purchase agreement with Brilliance China (the “Brilliance China Purchase Agreement”), pursuant to which we will continue to purchase various types of engine components from Brilliance China Group for an initial period commencing from the [●] until December 31, 2015. Unless such agreement is terminated prior to its expiry date, the Brilliance China Purchase Agreement is renewable for additional terms of three years.

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] of the above transactions set out in this sub-section 5 (including the expected transaction amounts for the three years ending December 31, 2015) on an annual basis exceeded 0.1% but was less than 5%, and is expected to be exceeding 0.1% but less than 5%, such transactions constitute continuing connected transactions for our Company which are subject to reporting, annual review and announcement requirements, but are exempt from independent Shareholders’ approval requirements under Rule 14A.34 of the [●].

6. Procurement of construction and building maintenance services from Mianyang Jianmen Real Estate

Mianyang Jianmen Real Estate is a connected person of our Company since it is a wholly-owned subsidiary of Xinhua Combustion Engine, a substantial Shareholder of our Company. The principal business activities of Mianyang Jianmen Real Estate are development of real estate and civil construction and services.

During the Track Record Period, we procured construction services for the real properties at our production site, including roads and walls, as well as the maintenance of the same from Mianyang Jianmen Real Estate during the Track Record Period. Commencing from 2012, we have also been procuring from Mianyang Jianmen Real Estate construction and maintenance services in respect of our

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real properties at our new production site in the Mianyang High-Tech Development Zone in Sichuan Province. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, the aggregate procurement from Mianyang Jianmen Real Estate amounted to approximately RMB2.5 million, RMB1.2 million, RMB4.4 million and RMB6.5 million, respectively. As these transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

It is expected that our total procurement from Mianyang Jianmen Real Estate for the three years ending December 31, 2015 will not exceed RMB12.7 million, RMB10.8 million and RMB10.8 million, respectively. The above proposed annual caps are determined with reference to (i) historical transaction values; (ii) our anticipated increase in demand for the services from Mianyang Jianmen Real Estate, in particular, Mianyang Jianmen Real Estate’s provision of construction and maintenance services for some of our new projects in the Mianyang High-Tech Development Zone in Sichuan Province; and (iii) anticipated increases in prices of the services to be provided by Mianyang Jianmen Real Estate to us.

Framework Agreement

On [●], 2013, we entered into a procurement framework agreement with Wuliangye (the “Wuliangye Procurement Agreement”), pursuant to which we agreed to procure construction and maintenance services from Wuliangye Group for an initial period commencing from the [●] until December 31, 2015. Unless such agreement is terminated prior to its expiry date, the Wuliangye Procurement Agreement is renewable for additional terms of three years.

[●] Implications

As the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] of the above transactions set out in this sub-section 6 (including the expected transaction amounts for the three years ending December 31, 2015) on an annual basis exceeded 0.1% but was less than 5%, and is expected to be exceeding 0.1% but less than 5%, such transactions constitute continuing connected transactions for our Company which are subject to reporting, annual review and announcement requirements, but are exempt from independent Shareholders’ approval requirements under Rule 14A.34 of the [●].

Non-exempt continuing connected transactions

A. Transactions with Brilliance China Group

7. Sales of our engines and engine components to Shenyang Jinbei and our engines to Xing Yuan Dong

Shenyang Jinbei is a connected person of our Company since it is a non wholly-owned subsidiary of Brilliance China, a substantial Shareholder of our Company. The principal business activities of Shenyang Jinbei include the manufacture and sale of minibuses and the provision of after-sale services. Shenyang Jinbei does not engage in the manufacture and sale of automotive engines. The automotive components produced by Shenyang Jinbei are solely for its own consumption.

Xing Yuan Dong is a connected person of our Company since it is a wholly-owned subsidiary of Brilliance China, a substantial Shareholder of our Company. The principal business activities of Xing Yuan Dong include the manufacture and sale of engine components and the sale of powertrains. It mainly purchases automotive engines from our Group and assembles them with additional automotive components, such as transmission, purchased from third parties and sells the end products directly to a subsidiary of Brilliance China. Mianyang Ruian, which used to purchase automotive engines from us and resell to the subsidiaries of Brilliance China, transferred its trading operations to Xing Yuan Dong in 2012.

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During the Track Record Period, we supplied light-duty gasoline engines and various types of engine components to Shenyang Jinbei, and our 1.6L-2.5L gasoline engines to Xing Yuan Dong. In addition, we supplied 1.6L-2.5L gasoline engines to Mianyang Ruian during the Track Record Period. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, the aggregate sales to Shenyang Jinbei, Xing Yuan Dong and Mianyang Ruian from our Group were approximately RMB386.6 million, RMB460.0 million, RMB416.2 million and RMB381.8 million, respectively. Due to the transfer of the trading operations from Mianyang Ruian to Xing Yuan Dong in 2012, we have been supplying our engines, which were previously supplied to Mianyang Ruian, to Xing Yuan Dong commencing from 2012. As these transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

It is expected that our total sales to Shenyang Jinbei and Xing Yuan Dong for each of the three years ending December 31, 2015 in aggregate will not exceed RMB501.0 million, RMB574.9 million and RMB667.6 million, respectively. The annual caps for the three years ending December 31, 2015 are determined with reference to (i) the estimated number of vehicles to be produced for each vehicle model, new vehicle models to be launched and vehicle models that will cease production in 2013 based on discussions with Brilliance China Group regarding its plans for 2013 and its plans for 2013 furnished to us; (ii) the anticipated increases in average unit price of our products due to the expected sale of more high-value engines to Brilliance China Group based on discussions with Brilliance China Group regarding its plans for 2013 and its plans for 2013 furnished to us; (iii) the historical trend of our sales to Brilliance China Group, in particular, our transacted amount during the nine months ended September 30, 2012 compared to that for the year ended December 31, 2011; and (iv) the expected increase in Brilliance China Group’s demand for our engines in light of the forecast increase in the PV and LCV engine sales in the PRC at a CAGR of 17.5% from 2012 to 2016 (please refer to “Industry Overview — Overview of the PRC PV and LCV Engine Market” of this document).

Framework Agreement

On [●], 2013, we entered into a sale framework agreement with Brilliance China (the “Brilliance China Sale Agreement”), pursuant to which we agreed to sell engine components and engines to Brilliance China Group for an initial period commencing from the [●] until December 31, 2015. Unless such agreement is terminated prior to its expiry date, the Brilliance China Sale Agreement is renewable for additional terms of three years.

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] the above transactions set out in this sub-section 7 (including the expected transaction amounts for the three years ending December 31, 2015) in aggregate on an annual basis exceeded, and is expected to exceed, 5%, such transactions constitute non-exempt continuing connected transactions for our Company which are subject to reporting, annual review, announcement and independent Shareholders’ approval requirements under Chapter 14A of the [●].

B. Transactions with Wuliangye Group

8. Purchases of crankshafts from Sichuan Pushi and engine components from Xinhua Combustion Engine

Sichuan Pushi is a connected person of our Company since it is a direct wholly-owned subsidiary of Pushi Group, the holding company of Xinhua Combustion Engine, a substantial Shareholder of our Company. The principal business activities of Sichuan Pushi are the process and sale of automotive components and engine components. Xinhua Combustion Engine is also a connected person of our Company as set out in sub-section 1 above.

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During the Track Record Period, we purchased crankshafts from Sichuan Pushi and various gasoline and diesel engine components such as crankshafts, exhaust manifolds, cylinder chambers and cylinder heads from Xinhua Combustion Engine. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, the aggregate purchase amounts from Sichuan Pushi and Xinhua Combustion Engine were approximately RMB109.7 million, RMB162.7 million, RMB154.6 million and RMB107.4 million, respectively. As these transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

It is expected that our total purchases from Sichuan Pushi and Xinhua Combustion Engine for the three years ending December 31, 2015 will not exceed RMB192.9 million, RMB231.8 million and RMB268.7 million, respectively. The above proposed annual caps are determined with reference to (i) historical transaction values; (ii) our 2013 production plan prepared based on discussions with our customers regarding their plans in 2013 and/or the plans for 2013 furnished to us by our customers, pursuant to which we anticipate that there will be an increase in our demand for their products in 2013 for the production of our engines; (iii) the historical trend of our purchases from Sichuan Pushi and Xinhua Combustion Engine; and (iv) our expected increase in purchases of their products in 2014 and 2015 due to the anticipated growth in our sales in light of the forecast increase in the PV and LCV engine sales in the PRC at a CAGR of 17.5% from 2012 to 2016 (please refer to “Industry Overview — Overview of the PRC PV and LCV Engine Market” of this document); and (v) anticipated prices of the products to be supplied to us.

Framework Agreement

On [●], 2013, we entered into a purchase framework agreement with Wuliangye (the “Wuliangye Purchase Agreement”), pursuant to which we agreed to purchase various gasoline and diesel engine components such as crankshafts, exhaust manifolds, cylinder chambers and cylinder heads from Wuliangye Group for an initial period commencing from the [●] until December 31, 2015. Unless such agreement is terminated prior to its expiry date, the Wuliangye Purchase Agreement is renewable for additional terms of three years.

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] for the above transactions set out in this sub-section 8 (including the expected transaction amounts for the three years ending December 31, 2015) in aggregate on an annual basis exceeded, and is expected to exceed, 5%, such transactions constitute non-exempt continuing connected transactions for our Company which are subject to reporting, annual review, announcement and independent Shareholders’ approval requirements under Chapter 14A of the [●].

C. Transactions with Huachen Group

9. Sale of our engines and engine components to Huachen, Mianyang Huarui and Mianyang Huaxiang and sale of our engines to Shenyang Brilliance Power

Huachen is deemed as a connected person of our Company under [●] of the [●] by the [●].

Mianyang Huarui is a connected person of our Company as set out in sub-section 4 above.

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Mianyang Huaxiang is a connected person of our Company since it is an indirect wholly-owned subsidiary of Huachen. The principal business activities of Mianyang Huaxiang include the manufacture and sale of automotive components. Mianyang Huaxiang purchases automotive engines and engine components from our Group, and it assembles those purchased engines with additional automotive components, such as transmission, into powertrains. Mianyang Huaxiang does not manufacture automotive engines.

Shenyang Brilliance Power is a connected person of our Company since it is a non-wholly owned subsidiary of Huachen. The principal business activities of Shenyang Brilliance Power include the trading of automotive engines. Shenyang Brilliance Power purchases automotive engines from our Group and engages Shenyang ChenFa to assemble additional automotive components to the engines, such as transmission. Shenyang Brilliance Power then sells the end products assembled by Shenyang ChenFa to Huachen Group, the end-user of such products. Shenyang Brilliance Power does not possess automotive engine manufacturing capabilities.

During the Track Record Period, we supplied (i) our gasoline engines with less than 1.6L displacement to Shenyang Brilliance Power and Mianyang Huaxiang; (ii) 1.6L-3.0L gasoline engines to Mianyang Huarui; and (iii) 2.0-2.5L gasoline engines to Huachen. We also supplied engine components to Huachen, Mianyang Huarui and Mianyang Huaxiang during the same period. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our aggregate sales to Huachen, Mianyang Huarui, Mianyang Huaxiang and Shenyang Brilliance Power were approximately RMB36.4 million, RMB270.4 million, RMB661.6 million and RMB485.4 million, respectively. As these transactions will continue after [●], they will constitute continuing connected transactions for our Company upon [●].

It is expected that our total sales to Huachen, Mianyang Huarui, Mianyang Huaxiang and Shenyang Brilliance Power for each of the three years ending December 31, 2015 in aggregate will not exceed RMB774.1 million, RMB868.6 million and RMB1,044.3 million, respectively. The annual caps for the three years ending December 31, 2015 are determined with reference to (i) the estimated number of vehicles to be produced for each vehicle model, new vehicle models to be launched by Huachen Group and vehicle models that will cease production in 2013 based on discussions with Huachen Group regarding its plans for 2013 and Huachen Group’s plans for 2013 furnished to us; (ii) the historical trend of our sales to Huachen Group in the recent years, which shows that there had been an overall increase in our sales to Huachen Group in 2011 as compared to that in 2010; and (iii) the expected increase in Huachen Group’s demand for our engines in light of the forecast increase in the PV and LCV engine sales in the PRC at a CAGR of 17.5% from 2012 to 2016 (please refer to “Industry Overview — Overview of the PRC PV and LCV Engine Market” of this document).

Framework Agreement

On [●], 2013, we entered into a sale framework agreement with Huachen (the “Huachen Sale Agreement”), pursuant to which we agreed to sell engines and engine components to Huachen Group for an initial period commencing from the [●] until December 31, 2015. Unless such agreement is terminated prior to its expiry date, the Huachen Sale Agreement is renewable for additional terms of three years.

[●] Implications

As each of the applicable percentage ratios (other than the profits ratio) under Rule 14.07 of the [●] for the above transactions set out in this sub-section 9 (including the expected transaction amounts for the three years ending December 31, 2015) in aggregate on an annual basis exceeded, and is expected to exceed, 5%, such transactions constitute non-exempt continuing connected transactions for our

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Company which are subject to reporting, annual review, announcement and independent Shareholders’ approval requirements under Chapter 14A of the [●].

CONFIRMATIONS

Directors’ Confirmation

Our Directors (including the independent non-executive Directors) confirmed that the above continuing connected transactions 5, 6, 7, 8 and 9 have been entered into in the ordinary and usual course of our Group’s business, on normal commercial terms or on terms no less favorable to our Company than those available to or from (as appropriate) independent third parties, and are fair and reasonable and in the interests of our Company and our Shareholders as a whole. Our Directors (including the independent non-executive Directors) further confirmed that the proposed annual caps in respect of the above continuing connected transactions 5, 6, 7, 8 and 9 are fair and reasonable and in the interests of our Company and our Shareholders as a whole.

Anticipated Future Continuing Connected Transactions

Pursuant to the engine assembly license agreement dated December 12, 2012 entered into among PVM, BMW Brilliance Automotive and us, and related agreements, we will procure related engine parts and components from BMW Brilliance Automotive and BMW Brilliance Automotive will provide technical consulting and advisory services to us. The engine assembled from such parts and components will then be supplied by us to Shenyang Jinbei for installation into a Jinbei MPV model.

Shenyang Jinbei is a connected person of our Company as set out in sub-section 7 above. BMW Brilliance Automotive is a connected person of our Company since it is an associate of Brilliance China, a substantial Shareholder of our Company. The above transactions between us and each of Shenyang Jinbei and BMW Brilliance Automotive will constitute continuing connected transactions for our Company when each of them commences. Since the entire arrangement is very preliminary at this stage, further details of each of the above transactions are yet to be finalized. As this is a tentative project we have undertaken with PVM, we are currently not able to assess the expected transaction values. We will however undertake to comply with all the relevant requirements under Chapter 14A of the [●] as and when appropriate, including disclosure and obtain prior independent Shareholders’ approval if the relevant percentage threshold has been exceeded.

SHARE CAPITAL

GENERAL MANDATE TO ISSUE NEW SHARES

Subject to the [●] becoming unconditional, the Directors have been granted a general and unconditional mandate to allot or issue and deal with Shares with an aggregate nominal value of not more than:

- (i) 20% of the total nominal amount of Shares in issue immediately following completion of the [●] but before the exercise of the [●]; and
- (ii) the total nominal amount of Shares repurchased by our Company pursuant to the mandate referred to in the paragraph “General mandate to repurchase Shares” below.

This general mandate will expire:

- (i) at the conclusion of the next general meeting of our Company;
- (ii) at the expiration of the period within which our Company is required by the Articles or any applicable laws of the Cayman Islands to hold its next annual general meeting; or
- (iii) when varied or revoked by an ordinary resolution of the Shareholders in general meeting,

whichever is the earliest.

Particulars of this general mandate are set out in “Statutory and General Information — Further Information about our Company and our Subsidiaries — 3. Written resolutions of our Shareholders” in Appendix V to this document.

GENERAL MANDATE TO REPURCHASE SHARES

Subject to the [●] becoming unconditional, the Directors have been granted a general mandate to exercise all the powers of our Company to repurchase Shares with a total nominal value of not more than 10% of the total nominal amount of the Shares in issue immediately following completion of the [●] but before the exercise of the [●].

This general mandate only relates to repurchases made on the [●] or on any other stock exchange on which the Shares are [●] (and which are recognized by the [●] and the [●] for this purpose), and which are in accordance with the [●]. A summary of the relevant [●] is set out in “Statutory and General Information — Further Information about our Company and our subsidiaries” in Appendix V to this documents.

This mandate will expire:

- (i) at the conclusion of the next general meeting of our Company;
- (ii) at the expiration of the period within which our Company is required by the Articles or any applicable laws of the Cayman Islands to hold its next annual general meeting; or
- (iii) when varied or revoked by an ordinary resolution of the Shareholders in general meeting,

whichever is the earliest.

Particulars of this general mandate are set out in “Statutory and General Information — Further Information about our Company and our Subsidiaries — 3. Written resolutions of our Shareholders” in Appendix V to this document.

SHARE CAPITAL

SHARE OPTION SCHEME

On April 25, 2012, we conditionally adopted the Share Option Scheme. Summaries of each of the principal terms of the Share Option Scheme are set out in “Statutory and General Information — Other Information — Share Option Scheme” in Appendix V to this document.

INSPECTION OF BOOKS AND RECORDS

The Shareholders will have no general right under the Companies Law to inspect or obtain copies of our register of members or corporate records. They will, however, have the rights set out in our Articles.

TRANSFER OF SHARES

There is no provision in the Companies Law and the Articles which prohibits the transfer of Shares by the Shareholders.

FINANCIAL INFORMATION

The following discussion and analysis of our business, financial condition and results of operations is based on and should be read in conjunction with our audited consolidated financial statements as of and for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012, including the notes thereto, as set forth in “Appendix I — Accountants’ Report” and other financial information appearing elsewhere in this document. Our financial statements have been prepared in accordance with HKFRS, which may differ in material respects from generally accepted accounting principles in other jurisdictions, including the United States. Historical results are not indicative of future performance and results for interim periods are not indicative of results for the full year. You should read the accountants’ report included as Appendix I to this document and not rely merely on the information contained in this section.

This discussion contains forward-looking statements that involve risks and uncertainties. We caution you that our business and financial performance are subject to substantial risks and uncertainties including, but not limited to, those factors included under the sections “Risk Factors” and “Business” in this document. Our future results could differ materially from those projected in forward-looking statements. See “Forward-looking Statements” in this document.

For the purposes of this section, unless the context otherwise requires, references to 2009, 2010 and 2011 refer to our financial year ended December 31 of such year. Unless indicated otherwise, financial information described in this section is described on a consolidated basis.

OVERVIEW

We are one of the leading automotive engine manufacturers in the independent branded segment of the PRC passenger vehicle, or PV, and light commercial vehicle, or LCV, engine market in terms of sales volume in 2011. We were the largest independent branded engine manufacturer of small bus engines in China in 2011 in terms of sales volume according to the Frost & Sullivan Report. According to the Frost & Sullivan Report, in terms of sales volume in 2011, we accounted for 9.4% of the independent branded segment of the PV and LCV engine market in China, and independent brands accounted for approximately 13.8% of the PV and LCV engine market in China. Our target PV and LCV engine market in China has experienced rapid growth in recent years. According to the Frost & Sullivan Report, the total sales volume of PV and LCV engines in China had grown from 7.9 million units in 2007 to 17.2 million units in 2011.

Our light-duty gasoline and diesel engines have displacements ranging from 1.0L to 2.7L and engine power ranging from 38.5kW to 120.0kW. As of the Latest Practicable Date, we currently manufacture and sell 36 models of automotive engines, including 28 models of light-duty gasoline engines, which include 15 models under 1.6L, three models between 1.6L to 2.0L, eight models between 2.0L to 2.5L and two models between 2.5L to 3.0L; and eight models of light-duty diesel engines between 2.0L to 2.5L. All 36 models have obtained regulatory clearance, including 30 models in mass production, and six models pending the launch of the compatible vehicles. Our engines are installed in a wide range of passenger and light-duty commercial vehicles, including light-duty vehicles, small buses and minibuses, and small and light-duty trucks. All vehicles installed with our engines meet the National Emission Limits (National III and IV) and Phase II of the Fuel Consumption Limits, or the equivalent overseas standards, and some of vehicles installed with our engines meet Phase III of the PV Fuel Consumption Limits.

Our customers include local and foreign-invested automotive manufacturers and automotive components companies in China. We have established stable and long-term relationships with our

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major customers through joint product development and by providing high quality products and services. We provide before and after-sales services to our customers through a wide sales network covering all major regions of China. Our independent branding strategy allows us to sell our engines to multiple automotive manufacturers in the fast-growing PV and LCV engine segment of the automotive industry in China, such as SUVs, minibuses, small trucks, sedans and MPVs.

The following consolidated statements of comprehensive income for the three years ended December 31, 2011 and the nine months ended September 30, 2011 and 2012, and the consolidated statements of financial position as of December 31, 2009, 2010 and 2011 and September 30, 2012 are derived from, and should be read in conjunction with, our Financial Information, including the notes thereto, included in the Accountants’ Report set forth in Appendix I to this document.

Consolidated Statements of Comprehensive Income

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Revenue	1,285,167	1,945,114	2,307,748	1,499,996	1,946,268
Cost of sales	(1,114,759)	(1,643,824)	(1,831,140)	(1,197,205)	(1,556,276)
Gross profit	170,408	301,290	476,608	302,791	389,992
Other income	10,197	11,144	10,012	6,643	6,361
Selling and distribution expenses ...	(52,018)	(65,845)	(48,611)	(29,737)	(40,214)
Administrative expenses	(44,378)	(55,419)	(62,638)	(46,772)	(49,891)
Finance costs	(11,130)	(17,753)	(37,520)	(22,872)	(21,555)
Other expenses	(13,568)	(23,595)	(33,212)	(16,962)	(24,577)
Share of result of a jointly controlled entity	—	—	—	—	281
Profit before tax	59,511	149,822	304,639	193,091	260,397
Income tax expense	(1,234)	(365)	(44,250)	(28,524)	(36,628)
Profit and total comprehensive income for the year/period	<u>58,277</u>	<u>149,457</u>	<u>260,389</u>	<u>164,567</u>	<u>223,769</u>
Earnings per share — Basic (RMB)	<u>0.073</u>	<u>0.187</u>	<u>0.316</u>	<u>0.206</u>	<u>0.238</u>

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Consolidated Statements of Financial Position

	As of December 31,			As of September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Non-current assets				
Property, plant and equipment	220,915	231,802	278,262	323,650
Prepaid lease payments	14,736	63,724	62,323	61,243
Intangible assets	23,768	11,597	43,695	72,978
Investment in a jointly controlled entity	—	—	—	49,633
Deferred tax assets	1,174	809	1,030	1,162
Deposits for acquisition of property, plant and equipment and prepaid lease payments	26,928	10,120	13,009	5,468
	<u>287,521</u>	<u>318,052</u>	<u>398,319</u>	<u>514,134</u>
Current assets				
Inventories	208,635	251,368	221,202	238,332
Prepaid lease payments	422	1,434	1,434	1,434
Trade and other receivables	99,804	170,506	497,706	660,975
Amounts due from related companies	532,205	826,400	1,061,910	954,309
Loan to a related company	77,625	78,029	—	—
Loan to a Shareholder	—	—	32,771	32,595
Pledged bank deposits	268,811	207,161	223,059	76,022
Bank balances and cash	37,117	66,776	327,747	551,996
	<u>1,224,619</u>	<u>1,601,674</u>	<u>2,365,829</u>	<u>2,515,663</u>
Current liabilities				
Trade and other payables	787,318	923,893	1,312,341	1,325,111
Amounts due to related companies	47,512	75,971	116,698	101,056
Loans from related companies	40,000	40,000	—	—
Loans from Shareholders	—	—	32,771	32,595
Bank borrowings due within one year	93,000	176,950	163,950	194,950
Other loan	—	—	—	4,000
Other tax payables	6,030	19,260	43,300	53,271
Income tax payables	—	—	30,686	35,910
	<u>973,860</u>	<u>1,236,074</u>	<u>1,699,746</u>	<u>1,746,893</u>
Net current assets	<u>250,759</u>	<u>365,600</u>	<u>666,083</u>	<u>768,770</u>
Total assets less current liabilities	<u>538,280</u>	<u>683,652</u>	<u>1,064,402</u>	<u>1,282,904</u>
Non-current liabilities				
Bank borrowings due after one year	32,000	—	—	—
Other loan	—	4,000	4,000	—
Deferred income	3,768	31,179	28,010	26,743
	<u>35,768</u>	<u>35,179</u>	<u>32,010</u>	<u>26,743</u>
Net assets	<u>502,512</u>	<u>648,473</u>	<u>1,032,392</u>	<u>1,256,161</u>
Capital and reserves				
Paid-in capital/share capital	200,008	200,008	7,693	7,693
Reserves	302,504	448,465	1,024,699	1,248,468
Total equity	<u>502,512</u>	<u>648,473</u>	<u>1,032,392</u>	<u>1,256,161</u>

FINANCIAL INFORMATION

BASIS OF PRESENTATION

Our PRC operating entity Mianyang Xincheng was jointly established as a Sino-foreign equity joint venture in the PRC in 1998 by two shareholders, Southern State, a then wholly-owned subsidiary of Brilliance China, and Xinhua Combustion Engine, which held their interests in equal proportions.

Our Company was incorporated in the Cayman Islands on March 10, 2011 as part of the Reorganization in preparation of the [●]. Pursuant to the Reorganization, our Company became the holding company of the entities comprising our Group on August 29, 2011. For more details of the Reorganization, see “History and Reorganization” in this document. The consolidated financial information of our Group for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012 (the “Financial Information”) has been prepared on the basis as if our Company had always been the holding company of the companies now comprising our Group throughout the Track Record Period. All intra-group transactions, balances, income and expenses have been eliminated on consolidation.

For more information on the basis of presentation of our Financial Information included herein, see Note 2 of the Accountants’ Report included as Appendix I to this document

KEY FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Our results of operations and financial condition as well as the comparability of results of operations between periods are affected by a number of internal and external factors, some of which are beyond our control, including those set out below.

Macro-Economic Conditions in the PRC

The demand for our products is generally affected by the macro-economic conditions in the PRC, including consumer spending and the sales volume of automobiles. Growth in urban population and disposable income, which has risen in line with the growth of the PRC economy, has resulted in increased demand for automobiles and indirectly, increased demand for our products. The PRC economy has experienced sustained and rapid growth over the last two decades. In 2009, due to the PRC Government’s incentive fiscal policies and moderate monetary policies, including a stimulus package to reduce the negative impact from the global financial crisis, China’s real GDP grew 9.2% from 2008. As a result, our engine sales were not materially affected by the global financial crisis and increased as the domestic demand for automobiles increased. However, since 2010, the PRC Government has tightened its credit policy to control rising inflation through raising the RMB benchmark deposit and loan interest rates. This macro-economic policy change increased the financing costs of our customers and placed pressure on their cash flows. As a result, in 2010 and 2011, our trade and other receivables and amounts due from related companies increased significantly partially due to customers prolonging their payment cycle or increasingly using bank promissory notes for payment which carry a longer credit period than cash payments. According to our knowledge, the abilities of our customers to obtain bank promissory notes, supported by actual transactions and secured by deposits with the issuing banks, have not been significantly affected by the tightened credit policy in the PRC. Furthermore, according to a speech delivered by China’s Premier Wen Jiaobao at the annual meeting of the National People’s Congress in Beijing on March 5, 2012, China’s GDP growth is targeted at 7.5% for the year 2012. Going forward, according to the 12th Five-Year Plan, the PRC Government expects to achieve an average of 7.0% annual GDP growth during the period from 2011 to 2015. This expected slowed growth of the PRC economy may have an impact on our business and results of operations in the future.

Demand for Light-duty Automotive Engines

Our results of operations are affected by the level of demand for our engines in the automotive engine industry in the PRC, particularly in the OEM market. Demand for our engines is primarily driven by

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the general demand for LCVs and PVs in the PRC, which, in recent years, has been driven by a number of factors, including growth of the PRC economy, industrialization and improved highway networks in the PRC, macro-economic policies of the PRC Government and PRC automotive industry regulations. The PRC Government may impose restrictions or provide stimuli that affect the demands for and sales of the LCVs and PVs in the PRC, which could, in turn, affect the demand for our engines. Demand for our engines is also directly driven by government policies encouraging the research and development of low emission and fuel-efficient engines. Such policies include, for example, the Notice of Promotion and Implementation Rules on “Energy-saving Products and People-benefiting Projects” regarding Fuel-efficient Vehicles (Passenger Vehicles with Displacement of 1.6L or below). These and other factors will continue to affect the market demand for our engines. Fluctuations in the demand for LCVs and PVs in the PRC market and changes in the government policies in the PRC will affect our results of operations and financial condition. See “Risk Factors — Risks Relating to Our Industry — Changes in automotive industry policies and regulations may adversely affect our business, financial condition and results of operations” in this document.

Ability to Develop and Launch Technologically Advanced Automotive Engines

Our results of operations and future growth depend on our ability to continue to develop and launch technologically advanced engines. As of the Latest Practicable Date, we are in the process of upgrading 11 existing engine models and developing four new engine models, which are in various stages of product development by our in-house research and development team. We currently aim to bring five engine models to the market between 2012 and 2014. We also seek to continue to optimize the performance of our existing engines through our research and development efforts. As our customers’ needs evolve, the engine specifications they require change as well. Our ability to design and develop new engines that meet these changing requirements has been and will continue to be critical to our ability to maintain and increase our total sales volume and profitability. As a result, we expect to continue to make significant investments in research and development, particularly with respect to designing and developing more technologically advanced and cost-competitive engines.

Customer Concentration

Substantially all of our products are sold directly to a limited number of automotive manufacturers in the PRC. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, sales to our top five customers, two of which are our connected parties, accounted for 82.9%, 77.8%, 76.0% and 75.3% of our revenue, respectively, and sales to our top five customers on a group basis accounted for 86.8%, 86.1%, 84.9% and 81.7% of our revenue, respectively. For the same periods, sales to Brilliance China Group on a group basis accounted for 48.8%, 41.4%, 18.0% and 19.6% of our revenue, respectively, and sales to Huachen Group on a group basis accounted for 2.8%, 13.9%, 28.7% and 25.0%, respectively. We enter into supply agreements with our connected parties on an arm’s length basis. For details of these connected transactions, see “Connected Transactions” in this document. Although sales to our connected parties have reduced proportionally during the Track Record Period, our Directors believe that sales to Brilliance China Group will continue to contribute a significant portion of our revenue in the near future and our results of operations are closely related to the performance of Brilliance China Group and our other connected parties. We plan to strengthen the relationships with our existing customers and develop new customer relationships to gain more market share, increase our revenue and reduce our reliance on sales to Brilliance China Group and other connected parties.

Cost of Materials

The cost of materials, consisting of cost of aluminum ingots and engine components, represents the largest component of our cost of sales. For the three years ended December 31, 2011 and the nine

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months ended September 30, 2012, cost of materials accounted for 91.4%, 92.0%, 93.4% and 94.0% of our total cost of sales, respectively. We purchase aluminum ingots as a main raw material in manufacturing our engine cylinder heads. Our suppliers purchase other metals such as iron as raw materials in manufacturing our engine components and parts. Therefore, we are subject to the risks of fluctuations in the price of aluminum ingots, and indirectly the prices of iron and other metals. The cost of engine components accounted for 88.6%, 89.1%, 90.5% and 91.6% of our total cost of sales for the three years ended December 31, 2011 and the nine months ended September 30, 2012 and the cost of aluminum ingots accounted for 2.8%, 2.9%, 2.9% and 2.4% of our total cost of sales for the same periods, respectively. Changes in the availability and price of aluminum ingots or any of our major engine components could have a significant impact on our operating costs and results of operations, although during the Track Record Period, the changes of prices of aluminum ingots and engine components did not have any significant adverse effect on our operating costs and results of operations. For major engine components that are subject to volatile price changes, we have a general understanding with some of our suppliers based on industry practice that if the prices of raw materials used in manufacturing the engine components change significantly, we may adjust our procurement prices based on good faith negotiation. We generally set the prices of our products based on our production costs and estimated profit margin at the beginning of the year, and we generally need to negotiate any price adjustments with our customers before we are able to pass on our increased material costs to them. Therefore, we may not be able to pass on significant increases in our material costs to our customers to reflect material cost changes in the market on a timely manner. As we increase our production in accordance with our capacity expansion plans, we expect that our demand for aluminum ingots and engine components will increase. Although we believe that we benefit from economies of scale in our procurement efforts and can obtain favorable pricing terms from our suppliers, fluctuations in the prices of aluminum ingots and engine components will continue to have an impact on our results of operations. See “Risk Factors — Risks relating to our business — We may face increases in the prices of raw material and engine components” in this document.

Production Capacity

Our results of operations have been and are expected to continue to be affected by our production capacity. In 2008, our production capacity and production activities were affected by the Wenchuan Earthquake as our production facilities were damaged and production was halted temporarily. By the end of 2009, our production capacity had substantially recovered to the pre-earthquake level. Our current production capacity has reached 255,000 units per annum. The market demand for our products in the PRC has increased significantly in recent years. As a result, we intend to increase our production capacity in order to meet and take advantage of the increased market demand for our products. Our expansion plans include the construction of and relocation to a new production base located in Mianyang High-Tech Development Zone, Sichuan Province, which is expected to commence full commercial operation by September 30, 2013, the establishment of the Dongfeng JV with Dongfeng and the management of an engine production line for FAW Jilin. We believe that increasing our production capacity will help us to gain market share and increase our revenue. However, if we over-expand our production capacity beyond the demand for our products, our results of operations may be adversely affected as the production facilities are not fully utilized. For details of our production capacity expansion plan, see “Business — Production” in this document.

Tax

Our results of operations are affected by changes in tax rates, particularly the applicable tax rates in the PRC, where we carry out our operations and derive all our revenue and profits. The enterprise income tax generally applicable in the PRC has been 25% since January 1, 2008. We enjoyed certain preferential enterprise income tax rates during the Track Record Period as a result of several government policies, including a 15% enterprise income tax rate under the Western China

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Development Plan, an exemption from the enterprise income tax for the two years ended December 31, 2010 as a result of Wenchuan Earthquake relief and a 15% enterprise income tax rate as a High and New Technology Enterprise from 2009 to 2011. The High and New Technology Enterprise qualification was renewed in 2011, which entitled us to enjoy such reduced tax rate for another three years until December 31, 2014. See “Description of key income statement items — Income tax expense” in this section. We may not be able to continue to enjoy such preferential enterprise income tax rates if we cannot renew our High and New Technology Enterprise qualification upon expiration in the future.

Competition

We face competition in the PRC light-duty automotive engine market primarily from other independent branded competitors. We believe the factors that are critical to our competitiveness in this market include production capacity, marketing and distribution channels, breadth and quality of product offerings, competitive pricing, brand recognition, after-sales services and research and development capabilities. We believe that we have enjoyed certain competitive advantages as a result of our strong research and development capabilities, breadth and quality of our product offerings at competitive prices, strong relationships with our customers, extensive sales, marketing and services network and a high level of brand recognition, among other factors. See “Business — Our Competitive Strengths” in this document for additional details. However, increased competition or our inability to sustain our competitive advantage could adversely affect our results of operations. For example, we experienced downward pressure on our product prices during the Track Record Period due to a combination of factors, including competition. In the event that we have to reduce our product prices to remain competitive but fail to offset such reductions by increasing our sales volume, reducing our costs and expenses or by introducing new competitive products, our profitability may be materially and adversely affected. See “Business — Competition,” “Risk Factors — Risks relating to our business — Our profitability could be negatively affected by downward pricing trends of our products” and “Risk Factors — Risks Relating to Our Industry — We operate in a competitive industry and face intense competition from our competitors.” in this document.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies and estimates are those accounting policies and estimates that involve significant judgments and uncertainties and potentially yield materially different results under different assumptions and conditions. Our consolidated financial statements have been prepared in accordance with HKFRS, which requires that we adopt accounting policies and make estimates that, we believe, are the most appropriate in the circumstances for the purposes of giving a true and fair view of our results of operations and financial condition. Estimates and judgments are based on historical experience, prevailing market conditions and rules and regulations, and are reviewed on a continual basis taking into account the changing environment and circumstances. For more details, see Note 4 and Note 5 to the Accountants’ Report set forth in Appendix I to this document.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold and services provided in the normal course of our business, net of discounts and sales related taxes. We recognize revenue from the sale of products when products are delivered to and accepted by the customers. We generally issue invoices upon the receipt of customers’ acceptance of the products and the corresponding invoices are recorded on or before the respective month end. At the end of each month, we will reconcile the amounts of sales with major customers to ensure the revenue and the corresponding account receivables are properly recorded in that month. In certain circumstances, we may require our customers to make a deposit with us before we deliver our

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products. Advances received from our customers prior to meeting the criteria for revenue recognition are included in the consolidated statement of financial position under current liabilities. We recognize service income when services are provided. Our product return policy only allows products to be returned due to product defects as assessed and agreed by our quality control team. We recognize interest income from a financial asset when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably. Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Taxes

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable by us is based on taxable profit for the year/period. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. Our liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

We recognize deferred tax on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries, except where we are able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realized, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which we expect, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Current and deferred tax is recognized in profit or loss, except when it relates to items that are recognized in other comprehensive income or directly in equity, in which case the current and deferred tax is also recognized in other comprehensive income or directly in equity respectively.

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Land use rights

Payments for obtaining land use rights are accounted for as prepaid lease payments and are charged to profit or loss on a straight-line basis over the lease terms as stated in the relevant land use rights certificates granted to us in the PRC and the remaining terms of the business license of the PRC entity, whichever is the shorter. Prepaid lease payments which are to be charged to profit or loss in the next twelve months are classified as current assets.

Property, plant and equipment

Property, plant and equipment, including land and buildings held for use in our production or supply of goods, or for administrative purposes (other than construction in progress as described below), are stated at cost less subsequent accumulated depreciation and accumulated impairment losses, if any. We recognize depreciation so as to write off the cost of items of property, plant and equipment other than properties under construction less their residual values over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Properties in the course of construction for production, supply or administrative purposes are carried at cost, less any recognized impairment loss. Costs include professional fees and, for qualifying assets, borrowing costs capitalized in accordance with our accounting policy. Such properties are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Government grants

We do not recognize government grants until there is reasonable assurance that we will comply with the conditions attaching to them and that the grants will be received.

We recognize government grants in profit or loss on a systematic basis over the periods in which we recognize as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that we should purchase, construct or otherwise acquire non-current assets are recognized as deferred income in the consolidated statement of financial position and transferred to profit or loss over the useful lives of the related assets. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to our Group with no future related costs are recognized in profit or loss in the period in which they become receivable.

The benefit of a government loan received at a below-market rate of interest is treated as a government grant, measured as the difference between proceeds received and the fair value of the loan on initial recognition based on prevailing market interest rates.

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Depreciation and impairment of property, plant and equipment

Our management determines the estimated useful lives, residual value and related depreciation charges for its property, plant and equipment. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment of similar nature and functions. Our management will

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increase the depreciation charge where useful lives are expected to be shorter than previously estimated, or it will write-off or write-down obsolete or non-strategic assets that have been abandoned or sold. Change in these estimations may have a material impact on our results.

We test whether property, plant and equipment has suffered any impairment in accordance with its accounting policy whenever there is any indication that the assets may have been impaired. The recoverable amounts of property, plant and equipment have been determined based on the discounted cash flow method. Our directors consider that the recoverable amount exceeded the carrying amount of the property, plant and equipment and, therefore, no impairment was recognized during the Track Record Period.

As of December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of property, plant and equipment were approximately RMB220.9 million, RMB231.8 million, RMB278.3 million and RMB323.7 million, respectively.

Amortization and impairment of intangible assets

Our management determines the estimated useful lives and related amortization charges for its intangible assets. This estimate is based on the historical experience of the actual useful lives of intangible assets of similar nature and functions. Our management will increase the amortization charge where useful lives are expected to be shorter than previously estimated, or it will write-off or write-down obsolete or non-strategic assets that have been abandoned or sold.

We test whether intangible assets have suffered any impairment in accordance with its accounting policy whenever there is any indication that the assets may have been impaired. The recoverable amounts of intangible assets have been determined based on the discounted cash flow method. Our directors consider that the recoverable amount exceeded the carrying amount of the intangible assets and, therefore, no impairment was recognized during the Track Record Period.

As of December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of intangible assets were approximately RMB23.8 million, RMB11.6 million, RMB43.7 million and RMB73.0 million, respectively.

Estimated impairment of trade receivables and amounts due from related companies and loan to a related company

When there is objective evidence of impairment loss, we take into consideration the estimation of future cash flows. The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). Where the actual future cash flows are less than expected, a material impairment loss may arise. As of December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of our trade receivables were RMB51.9 million, RMB33.1 million, RMB245.4 million and RMB380.4 million, respectively (net of allowance for doubtful debts of RMB322,000, RMB50,000, RMB43,000 and RMB98,000 as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively). As of December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of amounts due from related companies, which are trade receivables, were RMB458.1 million, RMB701.4 million, RMB892.8 million and RMB942.5 million, respectively. As of December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amount of loan to a related company was RMB77.6 million, RMB78.0 million, nil and nil, respectively.

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Provision of inventories

We record inventories at the lower of cost and net realizable value. Net realizable value is the estimated selling price for inventories, less all the estimated costs of completion and costs necessary to make the sales. We have operational procedures in place to monitor this risk as a significant proportion of our working capital is devoted to inventories. Our management reviews the inventory aging listing on a periodical basis for those aged inventories. This involves comparison of carrying value of the aged inventory items with the respective net realizable value. The purpose is to ascertain whether allowance is required to be made in the financial statements for any obsolete and slow-moving items. Although we carry out periodic review of the net realizable value of inventory, the actual realizable value of inventory is not known until the sale is concluded.

Provision for warranty claims

We make provision for warranty based on the possible claims on our products by customers with reference to the warranty coverage period and the percentage of warranty expenses incurred over total sales amounts during the Track Record Period. In case where the actual claims are greater than expected, a material increase in warranty expenses may arise, which would be recognized in profit or loss for the period in which such a claim takes place. As of December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amount of our provision for warranty claims was approximately RMB0.05 million, RMB7.4 million, RMB5.3 million and RMB5.1 million, respectively.

Description of Key Income Statement Items

Revenue

We derive our revenue primarily from sales of automotive engines and we generate a small portion of our revenue from sales of engine components and providing testing services to external customers. The following table sets forth a breakdown of our revenue and percentage of revenue contribution for the periods indicated:

	Year ended December 31,						Nine months ended September 30,			
	2009		2010		2011		2011		2012	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000 (unaudited)	%	RMB'000	%
Revenue										
Light-duty gasoline engines	983,650	76.5	1,557,768	80.1	1,803,574	78.2	1,145,302	76.3	1,559,926	80.2
Light-duty diesel engines	275,220	21.4	352,208	18.1	463,365	20.0	319,292	21.3	358,602	18.4
	1,258,870	97.9	1,909,976	98.2	2,266,939	98.2	1,464,594	97.6	1,918,528	98.6
Engine components and service income	26,297	2.1	35,138	1.8	40,809	1.8	35,402	2.4	27,740	1.4
Total	1,285,167	100	1,945,114	100	2,307,748	100	1,499,996	100	1,946,268	100

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In particular, our sales of automotive engines include sales of light-duty gasoline engines and light-duty diesel engines. Our other income includes income from sales of engine components and providing testing services as our laboratory is one of the government-accredited engine testing centers. The following tables set forth the revenue, sales volume and average unit price of our automotive engines by fuel type and displacement range for the periods indicated:

	Year ended December 31,						Nine months ended September 30,					
	2009		2010		2011		2011		2012			
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000 (unaudited)	%	RMB'000	%		
Revenue												
Light-duty												
Gasoline												
Engines												
≤1.6L	265,820	21.1	589,872	30.9	622,333	27.5	380,928	26.0	650,549	33.9		
1.6L – 2.0L	261,668	20.8	321,716	16.8	290,550	12.8	187,101	12.8	236,749	12.3		
>2.0L – 2.5L . . .	446,292	35.4	635,450	33.3	856,929	37.8	547,776	37.4	646,286	33.7		
>2.5L – 3.0L . . .	9,870	0.8	10,730	0.6	33,762	1.5	29,497	2.0	26,342	1.4		
Sub-total	983,650	78.1	1,557,768	81.6	1,803,574	79.6	1,145,302	78.2	1,559,926	81.3		
Light-duty												
Diesel												
Engines												
>2.0L – 2.5L . . .	275,220	21.9	352,208	18.4	463,365	20.4	319,292	21.8	358,602	18.7		
Total	1,258,870	100	1,909,976	100	2,266,939	100	1,464,595	100	1,918,528	100		

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	Sales Volume (Unit)	Sales Volume (Unit)	Sales Volume (Unit)	Sales Volume (Unit)	Sales Volume (Unit)
Light-duty Gasoline Engines					
≤1.6L	32,292	74,182 ⁽¹⁾	80,326	47,902	86,564 ⁽⁴⁾
1.6L — 2.0L	37,227	46,534	40,320 ⁽²⁾	26,005	34,011
>2.0L — 2.5L	49,983	69,890	88,238	55,124	65,127
>2.5L — 3.0L	438	478	1,676 ⁽³⁾	1,402	1,402
Subtotal	119,940	191,084	210,560	130,433	187,104
Light-duty Diesel Engines					
>2.0L — 2.5L	10,768	14,817	19,694	13,313	16,543
Total	<u>130,708</u>	<u>205,901</u>	<u>230,254</u>	<u>143,746</u>	<u>203,647</u>

- (1) The increase of 41,890 units, or 129.7%, from 2009 to 2010 was primarily due to launch of new products in the second half of 2009 whose production and sales volume further increased in 2010.
- (2) The decrease of 6,214 units, or 13.4%, from 2010 to 2011 was primarily due to reduced sales of National III Emission Limits compatible engines as a result of the adoption of higher National IV Emission Limits in several major cities in 2011.
- (3) The increase of 1,198 units, or 250.6% from 2010 to 2011 was primarily due to increased demands from our customers.
- (4) The increase of 38,662 units, or 80.7%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012 was primarily due to increased demand from existing customers and sales to new customers.

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	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	Average Unit Price (RMB)	Average Unit Price (RMB)	Average Unit Price (RMB)	Average Unit Price (RMB)	Average Unit Price (RMB)
				(unaudited)	
Light-duty Gasoline Engines					
≤1.6L	8,232	7,952	7,748	7,952	7,515 ⁽⁴⁾
1.6L — 2.0L	7,029	6,914	7,206	7,195	6,961
>2.0L — 2.5L	8,929	9,093	9,712 ⁽¹⁾	9,937	9,924
>2.5L — 3.0L	22,603	22,447	20,145 ⁽²⁾	21,039	18,789 ⁽⁵⁾
Light-duty Diesel Engines					
>2.0L — 2.5L	25,559	23,771 ⁽³⁾	23,528	23,984	21,677 ⁽⁶⁾

- (1) The increase of RMB619 per unit, or 6.8%, from 2010 to 2011 was primarily due to change in product mix of this displacement range where the portion of higher margin engines increased in 2011.
- (2) The decrease of RMB2,302 per unit, or 10.3%, from 2010 to 2011 was primarily due to lowered product prices as a result of price adjustment to expand our market and attract new customers in 2011.
- (3) The decrease of RMB1,797 per unit, or 7.5%, from 2009 to 2010 was primarily due to lowered product prices as a result of price adjustment to expand our market and attract new customers in 2010.
- (4) The decrease of RMB437 per unit, or 5.5%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012 was primarily due to lower product prices and certain customers choosing to have less spare parts sold with the engines to reduce their production costs.
- (5) The decrease of RMB2,250, or 10.7%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012 was primarily due to lower product prices as a result of price adjustments at the demand of a customer who increased the number of engines purchased in the period.
- (6) The decrease of RMB2,307, or 9.6%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012 was primarily due to a change in product mix within this displacement range where we introduced a new lower priced engine model.

The increases in our revenue during the Track Record Period were mainly due to increases in the sales volumes of our engines. The average unit prices of our engines during the Track Record Period may not accurately reflect the actual prices of our engines. Each displacement range of each fuel type includes multiple engine models. The product mix within each displacement range changed from year to year during the Track Record Period due to the retirement of old engine models, launching of new engine models and changes in engine specifications at the request of our customers. Prices of different engines, even within the same displacement range, may vary significantly in the same year, because of different costs of materials and manufacturing, supply and demand and other factors. As such, we consider a 5% year-on-year fluctuation in the average unit price as normal. We may price our products at a premium for our reputation and product quality when competing with other local engine manufacturers. For products facing intense competition, we price our products competitive against comparable products in the market to obtain new market share. During the Track Record Period, we have experienced downward pressure on our product prices as our competitors lower their product prices and at the request of our customers as part of their cost control efforts. As a result, overall, some of our engines may have displaced a slight decreasing pricing trend.

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Cost of sales

Our cost of sales consists primarily of costs of raw material and engine components, direct labor, energy and fuel and overhead. Costs of raw material and engine components mainly include costs for aluminum ingots, structural parts, generators and electric control systems and other engine components and parts. Labor costs include wages and salaries for our workers directly involved in our production processes and in the provision of sales and after-sales services. Energy and fuel costs include costs for energy and fuel consumed in our production processes. Overhead includes maintenance of production equipment and utility costs. The following table sets forth a breakdown of our cost of sales and percentage of cost of sales contribution for the periods indicated:

	Year ended December 31,						Nine months ended September 30,			
	2009		2010		2011		2011		2012	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000 (unaudited)	%	RMB'000	%
Cost of Sales										
Raw material and engine components	1,018,415	91.4	1,512,520	92.0	1,710,960	93.4	1,103,841	92.2	1,463,537	94.0
Labor cost	19,604	1.8	31,572	1.9	27,538	1.5	10,238	0.9	22,848	1.5
Depreciation expense . . .	29,799	2.7	31,566	1.9	23,706	1.3	19,854	1.7	19,221	1.2
Amortization of development costs . . .	11,411	1.0	12,171	0.7	10,037	0.5	6,957	0.6	1,561	0.1
Other overhead expenses	35,530	3.1	55,995	3.5	58,899	3.3	56,315	4.6	49,109	3.2
Total	1,114,759	100	1,643,824	100	1,831,140	100	1,197,205	100	1,556,276	100

During the Track Record Period, the purchase prices of our engine components generally decreased gradually as we were able to reduce the purchase prices of some engine components through negotiations with our suppliers as a result of our improved economies of scale. However, in the past, we have experienced some level of price fluctuations of aluminum ingots and certain engine components. Our aluminum ingot unit purchase prices increased by 5.4% from 2009 to 2010 and increased by 6.0% from 2010 to 2011, but decreased by 2.3% for the nine months ended September 30, 2012. Cost of aluminum ingots accounted for 2.8%, 2.9%, 2.9% and 2.4% of our total cost of sales for the three years ended December 31, 2011 and the nine months ended September 30, 2012. As such, our cost of sales was not materially affected by the fluctuations of the aluminum ingots purchase prices during the Track Record Period. The cost of engine components accounted for 88.6%, 89.1%, 90.5% and 91.6% of our total cost of sales for the three years ended December 31, 2011 and the nine months ended September 30, 2012. Out of over 200 kinds of engine components we procure and use in our production, we do not have a single engine component that accounted for more than 10% of our total costs of raw material and engine components during the Track Record Period, and we did not experience significant purchase price fluctuation of any engine component during the Track Record Period. Furthermore, some of our sales contracts provide that in case our raw material and engine components costs increase significantly beyond normal market standard, we may adjust our product prices through good faith negotiations with our customers. As such, the changes in the purchase prices of aluminum ingots and engine components during the Track Record Period did not significantly affect our gross profit margin.

Gross profit and gross profit margin

Our gross profit is derived primarily from the manufacture and sale of our light-duty engines. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our overall gross profit margin for the sale of light-duty engines was 13.0%, 15.4%, 20.4% and 19.9%, respectively. Our overall gross profit margins were primarily affected by product mix as the gross profit margins of

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different products by fuel type and displacement range may vary significantly in a given period. The gross profit margin of each product category was affected by a combination of factors, including sales volume, product prices, cost of sales, product mix and labor efficiency. The following tables set forth the gross profit and gross profit margin of our automotive engines by fuel type and displacement range for the periods indicated:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB million	RMB million	RMB million	RMB million (unaudited)	RMB million
Gross Profit					
Light-duty Gasoline Engines					
≤1.6L	15.1	56.1	80.0	54.6	90.0
1.6L – 2.0L	32.3	38.8	65.3	39.5	49.9
>2.0L – 2.5L	74.9	123.7	182.6	113.7	141.7
>2.5L – 3.0L	2.3	5.1	14.3	13.6	10.5
Sub-total	124.6	223.7	342.2	221.4	292.1
Light-duty Diesel Engines					
>2.0L – 2.5L	39.0	70.1	118.4	82.0	89.7
Total	<u>163.6</u>	<u>293.8</u>	<u>460.6</u>	<u>303.4</u>	<u>381.8</u>

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	%	%	%	% (unaudited)	%
Gross Profit Margin					
Light-duty Gasoline Engines					
≤1.6L	5.7	9.5	12.9	14.3	13.8
1.6L – 2.0L	12.3	12.0	22.5	21.1	21.1
>2.0L – 2.5L	16.8	19.5	21.3	20.8	21.9
>2.5L – 3.0L	23.2	47.7	42.5	46.3	40.0
Sub-total	12.7	14.4	19.1	19.3	18.7
Light-duty Diesel Engines					
>2.0L – 2.5L	14.2	19.9	25.5	25.7	25.0
Total	13.0	15.4	20.4	20.7	19.9

The gross profit margin of our less than 1.6L gasoline engines increased from 5.7% for 2009 to 9.5% for 2010, primarily due to lower product development costs and decreased engine component costs compared with 2009. It increased to 12.9% for 2011, primarily due to changes in the product mix of this displacement range where the portion of higher margin engines increased. It increased slightly to 13.8% for the nine months ended September 30, 2012, primarily due to decreased engine component costs.

The gross profit margin of our 1.6L to 2.0L gasoline engines decreased slightly from 12.3% for 2009 to 12.0% for 2010, primarily due to decreasing product prices to maintain our competitiveness and to increase the market share of our products, which was offset by slightly decreased engine component costs. It increased to 22.5% for 2011, primarily due to decreased cost of production and increasing use of advanced VVT technology to satisfy high emission standards at the request of our customers, which

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commanded higher sale prices of our engines. It decreased slightly to 21.1% for the nine months ended September 30, 2012, primarily due to decreased product prices partially offset by decreased cost of production.

The gross profit margin of our 2.0L to 2.5L gasoline engines increased from 16.8% for 2009 to 19.5% for 2010, primarily due to increasing product prices and decreased engine component costs. It increased to 21.3% for 2011, primarily due to changes in the product mix of this displacement range where the portion of higher margin engines increased. It increased slightly to 21.9% for the nine months ended September 30, 2012, primarily due to decreases in certain engine component prices and decreased cost of production.

The gross profit margin of our 2.5L to 3.0L gasoline engines increased significantly from 23.2% for 2009 to 47.7% for 2010, primarily due to the full localization of our parts procurement for this displacement range, which significantly reduced our cost of materials in 2010. It decreased to 42.5% for 2011, primarily due to lower engine sales prices as a result of price adjustments to expand our market and attract new customers. It decreased to 40.0% for the nine months ended September 30, 2012, primarily due to decreased product prices as a result of our effort to increase our market share in this displacement range.

The gross profit margin of our 2.0L to 2.5L diesel engines increased from 14.2% for 2009 to 19.9% for 2010, primarily due to decreased parts procurement costs in 2010 as the sales volume increased and economics of scale in procurement were realized. It increased to 25.5% for 2011, primarily due to further decreased engine component procurement prices as the sales volume increased. It decreased to 25.0% for the nine months ended September 30, 2012, primarily due to adjustments of the engine functionality requested by certain customers which increased the cost of production.

Other income

Our other income consists primarily of bank interest income, government grants and imputed interest on loan to related company and others.

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
				(unaudited)	
Other income					
Bank interest income	3,619	4,330	2,257	1,691	2,838
Government grants	1,962	2,607	5,062	2,920	3,117
Imputed interest on loan to a related company	3,895	3,900	1,971	1,971	—
Gain on disposal of property, plant and equipment	—	—	—	—	261
Others	721	307	722	61	145
	<u>10,197</u>	<u>11,144</u>	<u>10,012</u>	<u>6,643</u>	<u>6,361</u>

During the Track Record Period, we received subsidies from various authorities within the PRC Government to enhance our research and development capabilities and improve our new products. During the Track Record Period, from time to time, we also received other incentive subsidies for improvement of working capital and immediate financial assistance to our operating activities from local and state government authorities. There are no unfulfilled conditions and other contingencies

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attached to the grants. The subsidies were granted on a discretionary basis to us and non-recurring in nature.

Selling and distribution expenses

Our selling and distribution expenses consist primarily of the costs associated with selling and distributing our products such as sales staff salaries and welfare, advertising and promotion, transportation and others. The following table sets forth our selling and distribution expenses for the periods indicated:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Selling and distribution expenses					
Salaries	8,958	7,722	6,183	3,926	4,336
Travel expenses	2,047	2,453	2,686	1,890	2,406
Marketing expenses	5,461	7,586	6,010	4,681	6,411
Transportation expenses	19,927	33,344	19,038	11,739	20,544
Packaging expenses	11,855	10,027	10,167	4,549	3,086
Others	3,770	4,713	4,527	2,952	3,431
Total	<u>52,018</u>	<u>65,845</u>	<u>48,611</u>	<u>29,737</u>	<u>40,214</u>

Administrative expenses

Administrative expenses consist primarily of expenses for salaries and welfare for administrative staff, depreciation, entertainment, miscellaneous tax expenses, traveling and communication, office expenses, insurance and other miscellaneous expenses. The following table sets forth our administrative expenses for the periods indicated:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Administrative expenses					
Salaries	20,620	23,863	23,351	15,719	16,805
Depreciation	5,899	8,961	6,612	5,225	5,035
Entertainment	4,188	6,093	4,165	3,080	2,847
Taxes	1,173	4,030	14,735	8,043	11,900
Others	12,498	12,472	13,775	14,705	13,304
Total	<u>44,378</u>	<u>55,419</u>	<u>62,638</u>	<u>46,772</u>	<u>49,891</u>

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Other expenses

Other expenses consist primarily of research expenses, loss resulting from scrapped fixed assets, loss resulting from scrapped assets caused by the Wenchuan Earthquake, factory relocation costs and [●] expenses. The following table sets forth our other expenses for the periods indicated:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Other expenses					
Loss resulting from disposal of property, plant and equipment	314	64	232	204	—
Research expenses	13,254	19,355	19,783	9,467	12,415
Factory relocation expense	—	4,176	2,276	1,810	—
[●] expenses	—	—	10,879	5,439	12,162
Others	—	—	42	42	—
Total	<u>13,568</u>	<u>23,595</u>	<u>33,212</u>	<u>16,962</u>	<u>24,577</u>

Finance costs

Finance costs consist primarily of interest expenses on our bank and other borrowings, and discounted bills, net of capitalized interest expenses.

During the Track Record Period, we discounted certain bills receivable to banks for cash in connection with our increased cash flow needs as our business expanded. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, the finance costs related to discounted bills were RMB3.6 million, RMB7.6 million, RMB35.0 million and RMB14.0 million, respectively. The average discount rate for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012 (calculated by using the finance costs related to discounted bills for the year/period divided by the aggregate amount of discounted bills for the year/period) was 0.7%, 1.4%, 4.1% and 3.0%, respectively. The increases in the average discount rate from 2009 to 2011 were primarily due to the increasing portion of bills discounted bearing a higher interest rate and the overall increase in interest rate caused by the tightened credit policy of the PRC Government in 2010 and 2011. The decrease in the average discount rate in the nine months ended September 30, 2012 was primarily due to the decrease in interest rate as a result of the relaxed credit policy by the PRC Government in late 2012.

Income tax expense

According to the provisions promulgated by the SAT and the Sichuan Administration of Taxation in 2001 and 2002 in relation to the implementation of the development of the China Western Region, Mianyang Xinchun enjoyed a preferential enterprise income tax rate of 15% from 2001 to 2010. Pursuant to Cai Shui No.104 [2008] Notice in relation to Taxation Policies in support of Recovery and Reconstruction after the Wenchuan Earthquake (《關於支持汶川地震災後恢復重建有關稅收政策問題的通知》) promulgated by the MOF the General Administration of Customs and the SAT, Mianyang Xinchun is an affected entity located in the Wenchuan Earthquake affected area and was exempted from the enterprise income tax for the year ended December 31, 2008. Further, pursuant to Cai Shui No.131 [2009] Notice in Relation to Extension of Taxation Favorable Treatment Period (《關於延長部份稅收優惠政策執行期限的通知》) promulgated by the MOF and the SAT, Mianyang

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Xinchen was approved to extend the tax exemption from the enterprise income tax for the years ended December 31, 2009 and 2010. Mianyang Xinchen was accredited as a “High and New Technology Enterprise” by the Sichuan Province branch of MST and other authorities in December 2008 for a term of three years, and was therefore further registered with the local tax authority to be eligible for the reduced 15% enterprise income tax rate from 2009 to 2011. Accordingly, Mianyang Xinchen was subject to a 15% enterprise income tax rate for the year ended December 31, 2011. Our qualification as a High and New Technology Enterprise was renewed in 2011 for another three years, which entitles us to enjoy such reduced tax rate for another three years until December 31, 2014.

We recorded income tax expense in the amount of RMB1.2 million, RMB0.4 million, RMB44.3 million and RMB36.6 million for the three years ended December 31, 2011 and the nine months ended September 30, 2012, respectively. Our effective income tax rates for the three years ended December 31, 2011 and the nine months ended September 30, 2012 were 2.1%, 0.2%, 14.5% and 14.1%, respectively. The changes in our effective income tax rate were a result of the above-mentioned changes in applicable tax rates and tax benefits and our generally increased revenue for the relevant period. The low effective income tax rates in 2009 and 2010 were mainly a result of the enterprise income tax exemption related to the Wenchuan Earthquake, and the increase to 14.5% for 2011 was a result of the termination of such enterprise income tax exemption in 2011 and the application of the reduced 15% enterprise income tax rate based on our renewed High and New Technology Enterprise status. The discontinuation of any of the above-mentioned preferential tax treatments available to us will cause our effective tax rate to increase. See “Risk Factors — We are subject to potential changes or discontinuation of the preferential tax treatments and government subsidies in the PRC currently available to us.”

No Hong Kong profits tax has been paid as our income neither arises in, nor is derived from Hong Kong.

Our subsidiary that is a tax resident in the PRC is subject to PRC dividend withholding tax of 10% when and if undistributed earnings are declared to be paid to its non-PRC resident immediate holding company registered in the BVI as dividends out of profits that arose on or after January 1, 2008.

We plan to set aside the undistributed profits of Mianyang Xinchen for reinvestment purpose. If such amounts exceed the reinvestment plan, deferred tax liabilities will be recognized in respect of the withholding tax on the then undistributed profits.

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RESULTS OF OPERATIONS

The following table sets forth our consolidated results of operations for the periods indicated:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Revenue	1,285,167	1,945,114	2,307,748	1,499,996	1,946,268
Cost of sales	(1,114,759)	(1,643,824)	(1,831,140)	(1,197,205)	(1,556,276)
Gross profit	170,408	301,290	476,608	302,791	389,992
Other income	10,197	11,144	10,012	6,643	6,361
Selling and distribution expenses ...	(52,018)	(65,845)	(48,611)	(29,737)	(40,214)
Administrative expenses	(44,378)	(55,419)	(62,638)	(46,772)	(49,891)
Finance costs	(11,130)	(17,753)	(37,520)	(22,872)	(21,555)
Other expenses	(13,568)	(23,595)	(33,212)	(16,962)	(24,577)
Share of result of a jointly controlled entity	—	—	—	—	281
Profit before tax	59,511	149,822	304,639	193,091	260,397
Income tax expense	(1,234)	(365)	(44,250)	(28,524)	(36,628)
Profit and total comprehensive income for the year/period	<u>58,277</u>	<u>149,457</u>	<u>260,389</u>	<u>164,567</u>	<u>223,769</u>

Nine months ended September 30, 2012 compared to nine months ended September 30, 2011

Revenue

Our revenue was RMB1,946.3 million for the nine months ended September 30, 2012, representing an increase of RMB446.3 million, or 29.8%, from RMB1,500.0 million for the nine months ended September 30, 2011. In particular, revenue from our gasoline engines sales increased from RMB1,145.3 million for the nine months ended September 30, 2011, or by 36.2%, to RMB1,559.9 million for the nine months ended September 30, 2012. Revenue from our diesel engines sales increased from RMB319.3 million for the nine months ended September 30, 2011, or by 12.3%, to RMB358.6 million for the nine months ended September 30, 2012. The overall increases were primarily due to increased demand for our products mainly as a result of the growth of the automotive industry in the PRC, in particular the increase in sales of our less than 1.6L gasoline engines due to increased demand from existing customers and the addition of new customers, and an increase in market recognition of our products.

Revenue from sales of gasoline engines with displacement of less than 1.6L was RMB650.5 million for the nine months ended September 30, 2012, representing an increase of 70.8% from RMB380.9 million for the nine months ended September 30, 2011, primarily due to an increase of units sold from 47,902 units for the nine months ended September 30, 2011 to 86,564 units for the nine months ended September 30, 2012, offset by a 5.8% decrease of average unit price.

Revenue from sales of gasoline engines with displacement of between 1.6L and 2.0L (incl.) was RMB236.7 million for the nine months ended September 30, 2012, representing an increase of 26.5% from RMB187.1 million for the nine months ended September 30, 2011, primarily due to an increase of units sold from 26,005 units for the nine months ended September 30, 2011 to 34,011 units for the nine months ended September 30, 2012, offset by a 3.3% decrease of average unit price.

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Revenue from sales of gasoline engines with displacement of between 2.0L and 2.5L (incl.) was RMB646.3 million for the nine months ended September 30, 2012, representing an increase of 18.0% from RMB547.8 million for the nine months ended September 30, 2011, primarily due to an increase of units sold from 55,124 units for the nine months ended September 30, 2011 to 65,127 units for the nine months ended September 30, 2012.

Revenue from sales of gasoline engines with displacement of between 2.5L and 3.0L (incl.) was RMB26.4 million for the nine months ended September 30, 2012, representing a decrease of 10.5% from RMB29.5 million for the nine months ended September 30, 2011, primarily due to 10.6% decrease of average unit price.

Revenue from sales of diesel engines with displacement of between 2.0L and 2.5L (incl.) was RMB358.6 million for the nine months ended September 30, 2012, representing an increase of 12.3% from RMB319.3 million for the nine months ended September 30, 2011, primarily due to an increase of units sold from 13,313 units for the nine months ended September 30, 2011 to 16,543 units for the nine months ended September 30, 2012, offset by a 10.6% decrease of average unit price.

Cost of sales

Our cost of sales were RMB1,556.3 million for the nine months ended September 30, 2012, representing an increase of 30.0%, from RMB1,197 million for the nine months ended September 30, 2011. In particular, cost of sales for our gasoline engines sales increased from RMB919.9 million for the nine months ended September 30, 2011, or by 37.8%, to RMB1,267.9 million for the nine months ended September 30, 2012. Cost of sales for our diesel engines sales increased from RMB236.2 million for the nine months ended September 30, 2011, or by 13.8%, to RMB268.9 million for the nine months ended September 30, 2012. Such increases were in line with the corresponding increases in revenue from these products during this period.

Gross profit

As a result of the foregoing, our gross profit was RMB390.0 million for the nine months ended September 30, 2012, representing an increase of 26.7% from RMB302.8 million for the nine months ended September 30, 2011. Our gross profit margin was 20.0% for the nine months ended September 30, 2012 as compared with 20.2% for the nine months ended September 30, 2011, primarily due to decreased average unit prices of less than 1.6L and 2.5L-3.0L gasoline engines and 2.0L-2.5L diesel engines to increase our competitiveness, offset by decreased cost of overall engine components and change of product mix in general where the portion of less than 1.6L gasoline engines with higher margin increased. In particular, gross profit from our gasoline engine sales increased from RMB255.4 million for the nine months ended September 30, 2011, or by 14.3%, to RMB292.0 million for the nine months ended September 30, 2012. Gross profit from our diesel engine sales increased from RMB83.1 million for the nine months ended September 30, 2011, or by 7.9%, to RMB89.7 million for the nine months ended September 30, 2012. The gross profit margin for our gasoline engines was 18.7% for the nine months ended September 30, 2012 compared to 19.7% for the nine months ended September 30, 2011. The gross profit margin for our diesel engines was 25.0% for the nine months ended September 30, 2012 compared to 26.0% for the nine months ended September 30, 2011.

Other income

We had other income of RMB6.4 million for the nine months ended September 30, 2012, representing a decrease of RMB0.2 million, or 3.0%, from RMB6.6 million for the nine months ended September 30, 2011. The decrease was primarily due to a RMB2.0 million decrease in imputed interest on a loan to a related company, partially offset by (i) a RMB0.2 million increase in government grants in relation to our research activities and (ii) a RMB1.1 million increase in bank interest income.

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Selling and distribution expenses

Our selling and distribution expenses were RMB40.2 million for the nine months ended September 30, 2012, representing an increase of RMB10.5 million, or 35.4%, from RMB29.7 million for the nine months ended September 30, 2011. The increase was primarily due to (i) a RMB8.8 million increase in transportation expenses related to increased engine sales, (ii) a RMB0.4 million increase in salaries and welfare of our sales staff, and (iii) a RMB1.7 million increase in marketing expenses due to scaled-up marketing activities, offset by a RMB1.5 million decrease in packaging expenses primarily due to our usage of recycled packaging materials in 2012.

Administrative expenses

Our administrative expenses were RMB49.9 million for the nine months ended September 30, 2012, representing an increase of RMB3.1 million, or 6.6%, from RMB46.8 million for the nine months ended September 30, 2011. The increase was primarily due to (i) a RMB1.3 million increase in salaries and welfare of our administrative staff and (ii) a RMB3.9 million increase in miscellaneous tax payments, partially offset by decreases in other administrative expenses.

Other expenses

Our other expenses were RMB24.6 million for the nine months ended September 30, 2012, representing an increase of RMB7.6 million, or 44.7%, from RMB17.0 million for the nine months ended September 30, 2011. The increase was primarily due to (i) RMB6.7 million in [●] expenses related to this [●] and (ii) a RMB2.9 million increase in research expenses.

Finance costs

Our finance costs were RMB21.6 million for the nine months ended September 30, 2012, representing a decrease of RMB1.3 million, or 5.8%, from RMB22.9 million for the nine months ended September 30, 2011. The decrease was primarily due to (i) a RMB1.5 million decrease in interest expenses related to loans from related companies and (ii) a RMB1.7 million decrease in our interest expenses related to our use of discounted bills, offset by a RMB1.9 million increase in our interest expenses in connection with our increased interest rates on bank borrowings.

Income tax expense

Our income tax expense was RMB36.6 million for the nine months ended September 30, 2012, representing an increase of RMB8.1 million, from RMB28.5 million for the nine months ended September 30, 2011. The increase was primarily due to the increase in our taxable income. Our effective income tax rate for the nine months ended September 30, 2011 and 2012 was 14.8% and 14.1%, respectively.

Profit for the period

As a result of the foregoing, our profit for the period was RMB223.8 million for the nine months ended September 30, 2012, representing an increase of RMB59.2 million, or 36.0%, from RMB164.6 million for the nine months ended September 30, 2011. Our earnings per share for the period was RMB0.238 for the nine months ended September 30, 2012, representing an increase of RMB0.032, or 15.5%, from RMB0.206 for the nine months ended September 30, 2011.

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Year ended December 31, 2011 compared to year ended December 31, 2010

Revenue

Our revenue was RMB2,307.7 million in 2011, representing an increase of RMB362.6 million, or 18.6%, from RMB1,945.1 million in 2010. In particular, revenue from our gasoline engines sales increased from RMB1,557.8 million in 2010, or 15.8%, to RMB1,803.6 million in 2011. Revenue from our diesel engines sales increased from RMB352.2 million in 2010, or 31.6%, to RMB463.4 million in 2011. The overall increase was primarily due to (i) increased demand for our products mainly as a result of the growth of the automotive industry in the PRC, in particular the increase in purchases of our less than 1.6L and 2.0L-2.5L gasoline engines and 2.0L-2.5L diesel engines by our major customer Zhengzhou Nissan. Purchase by Zhengzhou Nissan accounted for 19.2% and 27.9% of our revenue for the year ended December 31, 2010 and 2011, respectively, and (ii) increased market recognition of our products.

Revenue from sales of gasoline engines with displacement of not greater than 1.6L was RMB622.3 million in 2011, representing an increase of 5.5% from RMB589.9 million in 2010, primarily due to an increase of units sold from 74,182 units in 2010 to 80,326 units in 2011, offset by a 2.6% decrease of average unit price.

Revenue from sales of gasoline engines with displacement of between 1.6L and 2.0L (incl.) was RMB290.6 million in 2011, representing a decrease of 9.7% from RMB321.7 million in 2010, primarily due to a decrease of units sold from 46,534 units in 2010 to 40,320 units in 2011, offset by a 4.2% increase of average unit price.

Revenue from sales of gasoline engines with displacement of between 2.0L and 2.5L (incl.) was RMB856.9 million in 2011, representing a significant increase of 34.8% from RMB635.5 million in 2010, primarily due to a significant increase of units sold from 69,890 units in 2010 to 88,238 units in 2011 and a 6.8% increase of average unit price.

Revenue from sales of gasoline engines with displacement of between 2.5L and 3.0L (incl.) was RMB33.8 million in 2011, representing a significant increase of 214.7% from RMB10.7 million in 2010, primarily due to an increase of units sold from 478 units in 2010 to 1,676 units in 2011, offset by a 10.3% decrease of average unit price.

Revenue from sales of diesel engines with displacement of between 2.0L and 2.5L (incl.) was RMB463.4 million in 2011, representing a significant increase of 31.6% from RMB352.2 million in 2010, primarily due to a significant increase of units sold from 14,817 units in 2010 to 19,694 units in 2011, offset by a 1.0% decrease of average unit price.

Cost of sales

Our cost of sales were RMB1,831.1 million in 2011, representing an increase of RMB187.3 million, or 11.4%, from RMB1,643.8 million in 2010. In particular, cost of sales for our gasoline engines sales increased from RMB1,334.0 million in 2010, or 9.4%, to RMB1,459.3 million in 2011. Cost of sales for our diesel engines sales increased from RMB282.1 million in 2010, or 22.1%, to RMB344.4 million in 2011. Such increases were in line with the corresponding increases in revenue from these products during this period and were affected by the increased unit purchase price of aluminum ingots, and were partially offset by the decreases in the purchase prices of some of our engine components mainly through negotiation with our suppliers as a result of our improved economies of scale.

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Gross profit

As a result of the foregoing, our gross profit was RMB476.6 million in 2011, representing an increase of 58.2% from RMB301.3 million in 2010. Our gross profit margin was 20.7% in 2011 as compared with 15.5% in 2010, primarily due to increased average unit prices of 2.0L-2.5L gasoline engines, decreased cost of engine components for 2.0L-2.5L gasoline engines due to increased purchase volume and change of product mix in general where the portion of 2.0L-2.5L gasoline engines and 2.0L-2.5L diesel engines with higher margin increased due to increased sales to Zhengzhou Nissan. In particular, gross profit from our gasoline engine sales increased from RMB223.7 million in 2010, or 53.9%, to RMB344.3 million in 2011. Gross profit from our diesel engine sales increased 69.6% from RMB70.1 million in 2010 to RMB118.9 million in 2011. The gross profit margin for our gasoline engines was 19.1% in 2011 compared to 14.4% in 2010. The gross profit margin for our diesel engines was 25.7% in 2011 compared to 19.9% in 2010.

Other income

We had other income of RMB10.0 million in 2011, representing a decrease of RMB1.1 million, or 9.9%, from RMB11.1 million in 2010. The decrease was primarily due to (i) a RMB1.9 million decrease in imputed interest on loan to a related company and (ii) a RMB2.1 million decrease in bank interest income, partially offset by a RMB0.4 million increase in other income, and a RMB2.5 million increase in government grant.

Selling and distribution expenses

Our selling and distribution expenses were RMB48.6 million in 2011, representing a decrease of RMB17.2 million, or 26.2%, from RMB65.8 million in 2010. The decrease was primarily due to (i) a RMB14.3 million decrease in transportation expenses due to our customer Zhengzhou Nissan chose to bear the transportation expenses for engines sold to them as a result of commercial negotiation with us in exchange for us agreeing not to raise product price to reflect the increased manufacturing cost in 2011, (ii) a RMB1.5 million decrease in salaries and welfare of our sales staff due to reduced numbers of regional sales staff to improve their efficiency, and (iii) a RMB1.6 million decrease in marketing expenses due to scale-back of advertising activities in the light of demands for our products exceeded our production capacity in 2011.

Administrative expenses

Our administrative expenses were RMB62.6 million in 2011, representing an increase of RMB7.2 million, or 13%, from RMB55.4 million in 2010. The increase was primarily due to (i) a RMB10.7 million increase in tax payment due to the new city maintenance and construction tax and surcharge for education that became applicable to us in 2011, and (ii) a RMB1.1 million increase in social welfare expenses as our business grew, partially offset by a RMB2.3 million decrease in depreciation, a RMB1.9 million decrease in entertainment expenses, a RMB0.2 million decrease in bank commissions and a RMB0.6 million decrease in board meeting expenses.

Other expenses

Our other expenses were RMB33.2 million in 2011, representing an increase of RMB9.6 million, or 40.7%, from RMB23.6 million in 2010. The increase was primarily due to (i) a RMB10.9 million [●] expenses related to this [●] and (ii) a RMB0.4 million increase in research expenses, partially offset by a decrease of RMB1.9 million in factory relocation expense.

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Finance costs

Our finance costs were RMB37.5 million in 2011, representing an increase of RMB19.7 million, or 110.7%, from RMB17.8 million in 2010. The increase was primarily due to (i) a RMB1.9 million increase in our interest expenses in connection with our increased interest rates on bank borrowings and (ii) a RMB27.4 million increase in our interest expenses related to our increased use of discounted bills in connection with our increased cash flow needs as our business expanded, offset by a RMB0.1 million decrease in interest expenses related to loans from related companies and a RMB9.4 million increase in capitalized interest.

Income tax expense

Our income tax expense was RMB44.3 million in 2011, representing an increase of RMB43.9 million, from RMB0.4 million in 2010. The significant increase was due to the expiration of the tax exemption for 2009 and 2010 in support of recovery and reconstruction after the Wenchuan Earthquake and the application of 15% enterprise income tax rate from 2011 as Mianyang Xinchun was accredited as a High and New Technology Enterprise. Our effective income tax rate for 2010 and 2011 were 0.2% and 14.5%, respectively.

Profit for the year

As a result of the foregoing, our profit for the year was RMB260.4 million in 2011, representing an increase of RMB110.9 million, or 74.2%, from RMB149.5 million in 2010. Our earnings per share for the year was RMB0.316 in 2011, representing an increase of RMB0.129, or 69.0%, from RMB0.187 in 2010.

Year ended December 31, 2010 compared to year ended December 31, 2009

Revenue

Our revenue was RMB1,945.1 million in 2010, representing an increase of RMB659.9 million, or 51.3%, from RMB1,285.2 million in 2009. In particular, revenue from our gasoline engines sales increased from RMB983.7 million in 2009, or 58.4%, to RMB1,557.8 million in 2010. Revenue from our diesel engines sales increased from RMB275.2 million in 2009, or 28.0%, to RMB352.2 million in 2010. The overall increase was primarily due to (i) increased demand for our products mainly as a result of the growth of the automotive industry in the PRC, in particular the significant increase in sales of our less than 1.6L gasoline engines and 2.0L to 2.5L gasoline engines as a result of favorable government policies for low emission engines and increased market recognition of our products and (ii) a RMB8.8 million increase in sales of engine components and service income incidental to the increased engine sales.

Revenue from sales of gasoline engines with displacement of not greater than 1.6L was RMB589.9 million in 2010, representing a significant increase of 121.9% from RMB265.8 million in 2009, primarily due to a significant increase of units sold from 32,292 units in 2009 to 74,182 units in 2010, offset by a 3.4% decrease of average unit price.

Revenue from sales of gasoline engines with displacement of between 1.6L and 2.0L (incl.) was RMB321.7 million in 2010, representing a 23% increase from RMB261.7 million in 2009, primarily due to a 25% increase of units sold from 37,227 units in 2009 to 46,534 units in 2010, offset by a 1.7% decrease of average unit price.

Revenue from sales of gasoline engines with displacement of between 2.0L and 2.5L (incl.) was RMB635.5 million in 2010, representing a 42.4% increase from RMB446.3 million in 2009, primarily due to a 39.8% increase of units sold from 49,983 units in 2009 to 69,890 units in 2010 and a 1.8% increase of average unit price.

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Revenue from sales of gasoline engines with displacement of between 2.5L and 3.0L (incl.) was RMB10.7 million in 2010, representing a 8.1% increase from RMB9.9 million in 2009, primarily due to an increase of units sold from 438 units in 2009 to 478 units in 2010, offset by a 0.7% decrease of average unit price.

Revenue from sales of diesel engines with displacement of between 2.0L and 2.5L (incl.) was RMB352.2 million in 2010, representing a 28.0% increase from RMB275.2 million in 2009, primarily due to a 37.6% increase of units sold from 10,768 units in 2009 to 14,817 units in 2010, offset by a 7.0% decrease of average unit price.

Cost of sales

Our cost of sales were RMB1,643.8 million in 2010, representing an increase of RMB529.0 million, or 47.5%, from RMB1,114.8 million in 2009. In particular, cost of sales for our gasoline engines sales increased from RMB859.0 million in 2009, or 55.3%, to RMB1,334.0 million in 2010. Cost of sales for our diesel engines sales increased from RMB236.2 million in 2009, or 19.4%, to RMB282.1 million in 2010. Such increases were in line with the corresponding increases in revenue from these products during this period and were affected by the increased unit purchase price of aluminum ingots, and were partially offset by decreases in the purchase prices of some of our engine components mainly through negotiation with our suppliers as a result of our improved economies of scale.

Gross profit

As a result of the foregoing, our gross profit was RMB301.3 million in 2010, representing an increase of RMB130.9 million, or 76.8%, from RMB170.4 million in 2009. Our gross profit margin was 15.5% in 2010 as compared with 13.3% in 2009, primarily due to decreased cost of overall engine components due to increased purchase volume, offset by decreased average unit prices of less than 1.6L gasoline engines due to increased sales volume and change in product mix in general where the portion of one new model of less than 1.6L gasoline engines with lower margin increased. In particular, gross profit from our gasoline engines sales increased from RMB124.6 million in 2009, or 79.5%, to RMB223.7 million in 2010. Gross profit from our diesel engines sales increased from RMB39.0 million in 2009, or 79.7%, to RMB70.1 million in 2010. The gross profit margin for our gasoline engines was 14.4% in 2010 compared to 12.7% in 2009. The gross profit margin for our diesel engines was 19.9% in 2010 compared to 14.2% in 2009.

Other income

Our other income was RMB11.1 million in 2010, representing an increase of RMB0.9 million, or 8.8%, from RMB10.2 million in 2009. The increase was primarily due to (i) a RMB0.71 million increase in bank interest income and (ii) a RMB0.65 million increase in government subsidies for research and development activities to enhance our research and development capabilities.

Selling and distribution expenses

Our selling and distribution expenses were RMB65.8 million in 2010, representing an increase of RMB13.8 million, or 26.5%, from RMB52.0 million in 2009. The increase was primarily due to (i) a RMB13.4 million increase in transportation expenses related to our increased product sales and (ii) a RMB2.1 million increase in marketing expenses related to the marketing and promotion of our engines, partially offset by a decrease in the compensation paid to our sales staff as a result of the one-time bonus paid in 2009 and a decrease in packaging expenses as we began using new, less expensive packaging materials in 2010.

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Administrative expenses

Our administrative expenses were RMB55.4 million in 2010, representing an increase of RMB11.0 million, or 24.8%, from RMB44.4 million in 2009. The increase was primarily due to (i) a RMB3.2 million increase in salaries for our administrative and management staff as our business grew, (ii) a RMB3.1 million increase in depreciation costs and (iii) a RMB2.9 million increase in stamp duty and land use tax mainly due to the acquisition of the land use rights for the new production facilities in Mianyang.

Other expenses

Our other expenses were RMB23.6 million in 2010, representing an increase of RMB10.0 million, or 73.5%, from RMB13.6 million in 2009. The increase was primarily due to (i) a RMB6.1 million increase in research expenses and (ii) RMB4.2 million increase in expenses incurred as a result of the relocation of our production equipment to the new production site located in the Mianyang High-Tech Development Zone in 2010.

Finance costs

Our finance costs were RMB17.8 million in 2010, representing an increase of RMB6.7 million, or 60.4%, from RMB11.1 million in 2009. The increase was primarily due to (i) a RMB2.6 million increase in our interest expenses in connection with our increased bank borrowings and (ii) a RMB4.0 million increase in discounted bills in connection with our increased cash flow needs as our business expanded.

Income tax expense

Our income tax expense was RMB0.4 million in 2010, representing a decrease of RMB0.8 million, or 66.7%, from RMB1.2 million in 2009. Our effective income tax rates for 2009 and 2010 were 2.1% and 0.2%, respectively.

Profit for the year

As a result of the foregoing, our profit for the year was RMB149.5 million in 2010, representing an increase of RMB91.2 million, or 156.4%, from RMB58.3 million in 2009. Our earnings per share for the year was RMB0.187 in 2010, representing an increase of RMB0.114, or 156.2%, from RMB0.073 in 2009.

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Description of Certain Items from Our Consolidated Statements of Financial Position

The following table sets forth selected data from our consolidated statements of financial position as of the dates presented, which have been derived from, and should be read in conjunction with, our Financial Information, including the notes thereto, included in the Accountants’ Report set forth in Appendix I to this document.

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
				RMB'000
Non-current assets				
Property, plant and equipment	220,915	231,802	278,262	323,650
Prepaid lease payments	14,736	63,724	62,323	61,243
Intangible assets	23,768	11,597	43,695	72,978
Investment in a jointly controlled entity	—	—	—	49,633
Deferred tax assets	1,174	809	1,030	1,162
Deposits for acquisition of property, plant and equipment and prepaid lease payments	26,928	10,120	13,009	5,468
	<u>287,521</u>	<u>318,052</u>	<u>398,319</u>	<u>514,134</u>
Current assets				
Inventories	208,635	251,368	221,202	238,332
Prepaid lease payments	422	1,434	1,434	1,434
Trade and other receivables	99,804	170,506	497,706	659,795
Amounts due from related companies	532,205	826,400	1,061,910	955,489
Loans to a related company	77,625	78,029	—	—
Loan to a Shareholder	—	—	32,771	32,595
Pledged bank deposits	268,811	207,161	223,059	76,022
Bank balances and cash	37,117	66,776	327,747	551,996
	<u>1,224,619</u>	<u>1,601,674</u>	<u>2,365,829</u>	<u>2,515,663</u>
Current liabilities				
Trade and other payables	787,318	923,893	1,312,341	1,325,111
Amounts due to related companies	47,512	75,971	116,698	101,056
Loan from related companies	40,000	40,000	—	—
Loans from Shareholders	—	—	32,771	32,595
Bank borrowings due within one year	93,000	176,950	163,950	194,950
Other loan	—	—	—	4,000
Other tax payables	6,030	19,260	43,300	53,271
Income tax payables	—	—	30,686	35,910
	<u>973,860</u>	<u>1,236,074</u>	<u>1,699,746</u>	<u>1,746,893</u>
Net current assets	<u>250,759</u>	<u>365,600</u>	<u>666,083</u>	<u>768,770</u>
Total assets less current liabilities	<u>538,280</u>	<u>683,652</u>	<u>1,064,402</u>	<u>1,282,904</u>
Non-current liabilities				
Bank borrowings due after one year	32,000	—	—	—
Other loan	—	4,000	4,000	—
Deferred income	3,768	31,179	28,010	26,743
	<u>35,768</u>	<u>35,179</u>	<u>32,010</u>	<u>26,743</u>
Net assets	<u>502,512</u>	<u>648,473</u>	<u>1,032,392</u>	<u>1,256,161</u>
Capital and reserves				
Paid-in capital/share capital	200,008	200,008	7,693	7,693
Reserves	302,504	448,465	1,024,699	1,248,468
Total equity	<u>502,512</u>	<u>648,473</u>	<u>1,032,392</u>	<u>1,256,161</u>

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Property, Plant and Equipment

Our property, plant and equipment consist of buildings, plants and machinery, office equipment and other facilities, motor vehicles and properties under development. As of December 31, 2009, 2010 and 2011 and September 30, 2012, property, plant and equipment amounted to RMB220.9 million, RMB231.8 million, RMB278.3 million and RMB323.7 million, respectively. The increases were primarily due to the acquisition of equipment and machinery in line with the growth in our product sales, the construction of new production facilities and office buildings and the relocation of our production facilities to the new production site. For details, see “Business — Properties” in this document.

Intangible assets

Our intangible assets consist of capitalized development costs of new engines. Our intangible assets decreased from RMB23.8 million as of December 31, 2009 to RMB11.6 million as of December 31, 2010, primarily due to the amortization of the development costs. Our intangible assets increased from RMB11.6 million as of December 31, 2010 to RMB43.7 million as of December 31, 2011, primarily due to the increased development costs for our new products and models such as D22, V22, 3TZ and 4A15T, which were partially offset by the amortization. Due to the same reason, it further increased to RMB73.0 million as of September 30, 2012.

Inventories

Our inventories consist of raw material and engine components, work-in-progress and finished goods. The following table sets forth a summary of our inventory balances at the end of each period indicated:

	As of December 31,			As of
	2009	2010	2011	September 30, 2012
	RMB'000	RMB'000	RMB'000	RMB'000
Raw material and engine components	52,330	50,150	93,159	136,652
Work-in-progress	18,640	26,676	20,648	20,869
Finished goods	137,665	174,542	107,395	80,811
Total	<u>208,635</u>	<u>251,368</u>	<u>221,202</u>	<u>238,332</u>

Our raw material and engine components decreased from RMB52.3 million as of December 31, 2009 to RMB50.1 million as of December 31, 2010, primarily due to increased production activities in 2010. Our raw material and engine components increased from RMB50.1 million as of December 31, 2010 to RMB93.2 million as of December 31, 2011, primarily due to increased raw material and engine components reserved in preparation of the relocation of our production facilities to the new location in the Mianyang High-Tech Development Zone to reduce the risk of insufficient supplies during the transition period. It increased to RMB136.7 million as of September 30, 2012, primarily due to increased purchase of certain engine components at lower prices by us.

Our work-in-progress primarily consists of products in the process of being manufactured. Our work-in-progress increased from RMB18.6 million as of December 31, 2009 to RMB26.7 million as of December 31, 2010, primarily due to increased production to meet the growth in demand for our products. Our work-in-progress decreased from RMB26.7 million as of December 31, 2010 to RMB20.6 million as of December 31, 2011, primarily due to increased efficiency of our production lines driven by increasing demands for our products. It remained relatively stable for the nine months ended September 30, 2012.

Our finished goods primarily consist of products that are stored in our warehouses pending delivery. Our finished goods increased from RMB137.7 million as of December 31, 2009 to RMB174.5 million

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as of December 31, 2010, primarily due to increased production and sales of our products. Our finished goods decreased from RMB174.5 million as of December 31, 2010 to RMB107.4 million as of December 31, 2011, primarily due to increased sales volume that surpassed our production volume. Due to the same reason, it further decreased to RMB80.8 million as of September 30, 2012.

Our inventories are net of provision of RMB6.1 million, RMB5.9 million, RMB0.9 million and RMB1.0 million, as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, which is determined with reference to the net realizable value of the inventories items.

The following table sets forth the turnover days of our inventory for the periods indicated:

	Year ended December 31,			Nine months ended September 30,
	2009	2010	2011	2012
Inventory turnover days⁽¹⁾	61	51	47	40

(1) Inventory turnover days equal average inventory divided by cost of sales and multiplied by 365 for each of the three years ended December 31, 2011 and by 274 for the nine months ended September 30, 2012.

Our inventory turnover days decreased from 61 days in 2009 to 51 days in 2010 and to 47 days in 2011, primarily due to our improved inventory management and increased sales. It decreased to 40 days for the nine months ended September 30, 2012, primarily due to further increased sales. Our inventory turnover days are relatively low, mainly because we strive to maintain lean and efficient production processes and adopt effective internal inventory management practices to reduce our inventory risks. See “Business — Inventory Management” and “Business — Logistics” of this document for a discussion of our inventory management and logistics practices.

Trade and other receivables

Our trade and other receivables primarily consist of trade receivables, bills receivable, prepayments for purchase of raw material and engine components and other receivables. Our trade receivables primarily consist of account receivables with our non-related customers in connection with the sale of our products. Our bills receivable primarily consist of bank promissory notes delivered by our non-related customers in lieu of cash payment for purchases. Our prepayments primarily consist of deposit payments made to suppliers for the procurement of raw material and engine components, which we believe is consistent with general industry practice in the PRC. Other receivables mostly consist of advances to employees and to-be-received government subsidies.

For a description of our trade and other receivables with our related customers, which are accounted for on our consolidated statements of financial position as “Amounts due from related companies,” please see “— Description of Certain Items from Our Consolidated Statements of Financial Position — Amounts due from related companies.”

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The following table sets forth a breakdown of our trade and other receivables as of the dates indicated:

	As of December 31,			As of September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Trade receivables	52,245	33,186	245,480	380,419
Less: Allowance for doubtful debts	(322)	(50)	(43)	(98)
Trade receivables, net	51,923	33,136	245,437	380,321
Bills receivable	40,853	134,332	241,542	265,649
Total trade and bills receivables	92,776	167,468	486,979	645,970
Prepayments for purchase of raw material and engine components	5,076	1,337	3,059	4,727
Other receivables	1,952	1,701	7,668	10,278
	<u>99,804</u>	<u>170,506</u>	<u>497,706</u>	<u>660,975</u>

Our trade and bills receivables increased from RMB92.8 million as of December 31, 2009 to RMB167.5 million as of December 31, 2010, to RMB487.0 million as of December 31, 2011, and to RMB646.0 million as of September 30, 2012, primarily due to the increase in our sales. In particular, our trade receivables decreased from RMB52.2 million as of December 31, 2009 to RMB33.2 million as of December 31, 2010, primarily due to timely payments by our customers in 2010, and increased significantly from RMB33.2 million as of December 31, 2010 to RMB245.5 million as of December 31, 2011 and further to RMB380.4 million as of September 30, 2012, due to, in addition to increased sales, the PRC Government tightening credit policy starting in 2010 and continuing in 2011 and 2012 to control inflation which increased pressure on our customers' cash flows who subsequently prolonged their payment cycle. For the same reason, our bills receivable also increased substantially during the Track Record Period, as customers increasingly used bank promissory notes in lieu of cash for payment.

We generally extend our non-related customers a credit period of 30 to 60 days from the date of issuance of invoice and further extend the credit period by 3 to 6 months if at any point during the credit period the customer chooses to pay by bank promissory notes, although such terms may vary based on our historical relationships with, and assessment of creditworthiness of, each customer, and our financial position and working capital needs. Accordingly, it is possible for non-related customers to be extended a credit period of up to 240 days. We believe that settlement by bank promissory notes is generally a customary practice in our industry. The bank promissory notes we receive are issued by reputable PRC banks, so we generally consider the risk of default is relatively low. We receive cash payment from the issuing banks when the bank promissory notes mature, unless we endorse or discount them.

Before accepting any new customer, we assess its credit quality and define its credit limit based on its reputation in the industry. We review the limits granted to our customers regularly. As our key customers are generally creditworthy and have demonstrated a good track record of timely payments, we generally consider the credit risks relating to our trade and bills receivables to be relatively low. To the extent necessary in light of the prolonged credit periods we may extend to our non-related customers, we supplement our working capital needs through bank borrowings, discounting bills receivable for cash and endorsing bank promissory notes to purchase raw materials and engine component parts from our suppliers in addition to cash generated from our operations. When we discount bills receivable to banks in exchange for cash, we incur finance costs as a result of the discount. There is no additional cost (for example, discounts or additional charges) of endorsing bills receivable to settle trade payables.

As of December 31, 2009, 2010 and 2011 and September 30, 2012, our allowance for doubtful debts was RMB0.3 million, RMB0.05 million, RMB0.04 million and RMB0.1 million, respectively, which

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our management considered was sufficient. On the same dates, trade receivables of RMB6.7 million, RMB2.6 million, RMB43.5 million and RMB202.2 million were past due but not impaired. As of September 30, 2012, these receivables past due were mainly attributable to FAW Jilin, which accounted for RMB48.3 million, Chongqing Xinyuan Automotive Company Limited ("Chongqing Xinyuan"), which accounted for RMB22.9 million, and Zhengzhou Nissan, which accounted for RMB95.5 million. We still maintain normal business contacts and transaction records with these customers. As of December 31, 2012, RMB129.7 million of our trade receivables that were past due as of September 30, 2012 have been settled by bank promissory notes, which we believe have relatively low default risk. Among the remaining balance of RMB72.5 million, RMB48.3 million was attributable to FAW Jilin, RMB7.7 million was attributable to Chongqing Xinyuan, and nil was attributable to Zhengzhou Nissan, respectively.

Although we face increased pressure on our cash flow and risks related to non-payment of these past due receivables, we believe, considering the high credibility of these customers, their good track record with us and the subsequent settlement by cash or bank promissory notes issued by reputable PRC banks, no impairment allowance is necessary in respect of the remaining unsettled balances and our overall risks are controllable. We do not hold any collateral over these balances because we expect to be able to collect all these receivables in the future.

Substantially all of our trade and bills receivables at the end of the relevant report periods were due within six months.

The following is an aged analysis of our trade receivables, net of allowance for doubtful debts, presented based on the invoice date at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Within 1 month	28,408	27,688	178,905	92,378
1 to 2 months	15,739	1,764	39,838	142,006
2 to 3 months	6,669	1,987	21,809	86,325
3 to 6 months	1,107	586	4,726	59,432
6 months to 1 year	—	1,044	2	160
Over 1 year	—	67	157	20
	<u>51,923</u>	<u>33,136</u>	<u>245,437</u>	<u>380,321</u>

The following is an aged analysis of our bills receivable presented based on the issue date of the bills at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Within 3 months	40,073	77,247	172,836	154,329
3 to 6 months	780	57,085	68,706	110,140
	<u>40,853</u>	<u>134,332</u>	<u>241,542</u>	<u>264,469</u>

Up to December 31, 2012, we have subsequently settled a portion of the outstanding trade and bills receivables at September 30, 2012, amounting to RMB265.4 million by cash and RMB203.7 million by bank promissory notes.

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The following table sets forth the turnover days of our trade and bills receivables for the periods indicated:

	Year ended December 31,			Nine months ended
	2009	2010	2011	September 30, 2012
Trade and bills receivables turnover days⁽¹⁾	53	55	97	150

(1) Trade and bills receivables turnover days equal average trade and bills receivables, divided by revenue from third parties and multiplied by 365 for each of the three years ended December 31, 2011 and by 274 days for the nine months ended September 30, 2012.

Our trade and bills receivables turnover days increased from 53 days in 2009 to 55 days in 2010, primarily because we offered extended payment period to new customers to expand our sales in 2010. Our trade and bills receivables turnover days increased from 55 days in 2010 to 97 days in 2011 primarily because some of our customers delayed their payments to us or increasingly chose to pay by bank promissory notes due to the tightened credit policy by the PRC Government in 2011, which increased pressure on their cash flows. It further increased to 150 days in the nine months ended September 30, 2012, primarily due to a combination of increased sales, customers prolonging their payments and/or continuing to pay by bank promissory notes. These customers include Zhengzhou Nissan and GAC Changfeng, who contributed to 27.9% and 5.4% of our revenue in 2011. We believe our trade and bills receivables turnover days are comparable to the industry average, and we strive to maintain effective internal management and reduce our trade and bills receivables related risks by performing periodic evaluations of the overdue balances and customer visits to ensure our exposure to bad debts is not significant and adequate impairment losses are made for irrecoverable amounts. We have also included receivables collection rates as one of the standards to evaluate the performance of our sales personnel to encourage them to collect amounts due from our customers.

Our prepayments to our suppliers decreased from RMB5.1 million as of December 31, 2009 to RMB1.3 million as of December 31, 2010, primarily due to better credit terms granted to us by our suppliers as our procurement amounts increased with our business growth. Our prepayments to our suppliers increased from RMB1.3 million as of December 31, 2010 to RMB3.1 million as of December 31, 2011, primarily due to our ramped up production to meet increasing demands for our products which led to increased prepayments to secure supplies. It further increased to RMB4.7 million as of September 30, 2012, primarily due to the same reason.

Amounts due from related companies

During the Track Record Period, we had trade balances with related companies generated from engines and engine parts sold to our related companies, including Huachen Group, Brilliance China Group and Wuliangye Group. Our trade receivables from related companies primarily consist of account receivables with our related customers in connection with the sale of our products. Our bills receivable from related companies primarily consist of bank promissory notes delivered by our related customers in lieu of cash payment for purchases. For details of our transactions with related companies, see “Relationship with our Controlling Shareholders and Huachen”, “Connected Transactions” and Note 23 of the Accountants’ Report as set forth in Appendix I to this document. The increases in the amounts due from related companies primarily reflect the increased sales of our products to our related companies during the Track Record Period.

For the Track Record Period, all the amounts due from our related companies are trade-related.

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The following table sets forth the analysis of the amounts due from related companies as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>2012</u>
Amounts due from related companies				<u>RMB'000</u>
Trade receivables	458,105	701,400	892,816	942,549
Bills receivable	<u>74,100</u>	<u>125,000</u>	<u>169,094</u>	<u>11,760</u>
Total	<u>532,205</u>	<u>826,400</u>	<u>1,061,910</u>	<u>954,309</u>

As of September 30, 2012, the amounts due from Huachen Group and Brilliance China Group accounted for 34.5% and 21.7% of our total trade and bills receivables from our related and non-related companies, respectively. The following table sets forth the amounts due from Huachen Group and Brilliance China Group as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>2012</u>
Amounts due from				<u>RMB'000</u>
Huachen Group	61,323	312,058	780,645	552,721
Brilliance China Group	<u>470,882</u>	<u>514,256</u>	<u>281,359</u>	<u>346,849</u>

Amounts due from our related companies are unsecured, interest free and with credit periods of three months from the invoice dates and a further three to six months for bills receivable. The following is an aging analysis of our amounts due from related companies presented based on the invoice dates at the end of the reporting period:

	As of December 31,			As of
	2009	2010	2011	September 30,
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>2012</u>
Within 3 months	312,445	435,269	473,345	470,999
3 to 6 months	99,432	144,231	182,851	347,800
6 months to 1 year	17,653	105,435	232,406 ⁽¹⁾	122,816 ⁽²⁾
Over 1 year	<u>28,575</u>	<u>16,465</u>	<u>4,214</u>	<u>934</u>
	<u>458,105</u>	<u>701,400</u>	<u>892,816</u>	<u>942,549</u>

- (1) The increase in 2011 was primarily due to the delayed payment by some of our related customers, mainly Shenyang Brilliance Power, caused by the tightened credit policy by the PRC Government in 2011, which increased pressure on their cash flows.
- (2) The decrease for the nine months ended September 30, 2012 was primarily due to our collection of a significant portion of the amounts due from our related companies.

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The following is an aged analysis of our bills receivable presented based on the issue dates of the bills at the end of the reporting period:

	As of December 31,			As of
	2009	2010	2011	September 30, 2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 3 months	74,100	100,000	159,962	10,710
3 to 6 months	—	25,000	9,132	2,230
	<u>74,100</u>	<u>125,000</u>	<u>169,094</u>	<u>12,940⁽¹⁾</u>

- (1) The decrease for the nine months ended September 30, 2012 was primarily because a significant amount of bills matured and were paid in cash by the issuing banks, and we increasingly endorsed and discounted bills receivable from our related companies for cash or payment to our suppliers.

The following table sets forth the turnover days of our trade and bills receivables due from our related companies for the periods indicated:

	Year ended December 31,			Nine months ended
	2009	2010	2011	September 30, 2012
Amounts due from related companies turnover days⁽¹⁾	186	231	320	302

- (1) Amounts due from related companies turnover days equal average amounts due from related companies divided by sales to related companies and multiplied by 365 for each of the three years ended December 31, 2011 and by 274 days for the nine months ended September 30, 2012.

The turnover days of our amounts due from related companies increased from 186 days in 2009 to 231 days in 2010 and to 320 days in 2011, primarily because they delayed their payments to us and, to a lesser extent, increasingly chose to pay by bank promissory notes due to the tightened credit policy by the PRC Government in 2010 and 2011, which increased pressure on their cash flows. It decreased to 302 days for the nine months ended September 30, 2012, primarily because we settled a portion of the trade and bills receivables due from our related companies.

Our credit policy is that credit is offered to our related companies following a financial assessment of their business and an established payment record. In determining the recoverability of amounts due from related companies, we consider that if our related companies are financially sound, no impairment should be necessary. Our customer credit policy sets out certain criteria which a customer, either related or non-related, needs to fulfill before we grant a longer credit period. These criteria include history of business relationship with us, payment history, prospects and market shares of the customers and competitiveness of their new products. Moreover, we consider that the risk of non-payment by related customers are relatively lower than non-related customers given their long business relationship with us. Having made reference to the credit period offered by other automotive engine suppliers in the PRC and having consulted with our customers with regard to the credit terms offered to these customers by other automotive engine suppliers in the PRC, we believe that the credit period offered to our related customers is in line with industry practice.

Included in the amounts due from our related companies are aggregate carrying amounts of RMB145.7 million, RMB266.1 million, RMB419.5 million and RMB471.6 million as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, which were past due and for which we had not provided for impairment loss. The amounts past due were mainly caused by delayed payment by our related companies, in particular, Brilliance China Group and Huachen Group, when their cash flows were affected by the launching of their new automotive models and tightened credit policy by the PRC

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Government to control inflation in 2010 and 2011. As of September 30, 2012, out of the RMB471.6 million that were past due, RMB266.2 million and RMB192.9 million were due from Huachen Group and Brilliance China Group.

We allowed a significant portion of the related companies balance to become overdue and without holding any collateral over these balances because our management assessed these related companies to be credible customers who have long-term relationships with us and who our management believe to be financially sound, and we believe that these balances will ultimately be settled. We perform periodic evaluations of the overdue balances and customer visits to ensure our exposure to bad debts is not significant and adequate impairment losses are made for irrecoverable amounts. Taking into consideration the gradual and frequent repayments from these related companies, we did not consider impairment allowance to be necessary in respect of these balances. Although in reality we allowed a significant portion of the balance to be overdue, which deviated from our credit policy, we do not plan to change our currently allowed credit periods. We intend to continue to enforce our credit policy by rigorously requesting the relevant customers to pay, including calling and visiting them in person, once any receivables are past due according to such allowed credit period.

Up to December 31, 2012, we had subsequently settled a portion of the outstanding amounts due from related companies at September 30, 2012, amounting to RMB11.8 million by cash and RMB580.2 million by bank promissory notes. As of December 31, 2012, RMB378.1 million of the amounts due from our related companies that were past due as of September 30, 2012 have been settled by bank promissory notes, which we believe are of relatively low default risk. Among the RMB378.1 million that has been settled as of December 31, 2012, RMB265.0 million was by Huachen Group and RMB100.6 million was by Brilliance China Group.

After [●], we expect to continue to have amounts due from our related companies generated from the ongoing engine sales to our related companies. We intend to strive to reduce the level of past due balances from our related companies through frequent negotiations and communications with them and by more strictly enforcing our credit policy. For further details, please see “Relationship with our Controlling Shareholders and Huachen” and “Connected Transactions” in this document.

Trade and other receivables analysis by top five customers

The following table sets forth the trade and bills receivables due from our top five customers, including our related and non-related companies, for the periods indicated:

	As of December 31,			As of	Subsequently
	2009	2010	2011	September 30,	settled
	RMB'000	RMB'000	RMB'000	2012	amount up to
					December 31,
					2012
					RMB'000
Trade receivables	415,203	637,145	973,138	1,059,371	654,245
Bills receivables	102,998	201,350	305,570	253,188	253,188
Total trade and bills receivables	<u>518,201</u>	<u>838,495</u>	<u>1,278,708</u>	<u>1,312,559</u>	<u>907,433</u>

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The following table sets forth the turnover days of our trade receivables, bills receivables and total trade and bills receivables due from our top five customers for the periods indicated:

	<u>Year ended December 31,</u>			<u>Nine months ended</u>
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>September 30, 2012</u>
Trade receivables turnover days⁽¹⁾	80	127	144	104
Bills receivables turnover days⁽¹⁾	30	37	48	26
Total trade and bills receivables turnover days⁽¹⁾	110	164	192	130

(1) The turnover days equal average amounts due from top five customers divided by total sales to top five customers and multiplied by 365 for each of the three years ended December 31, 2011 and by 274 days for the nine months ended September 30, 2012.

Up to December 31, 2012, we have subsequently settled a portion of outstanding trade and bills receivables from our top five customers, amounting to RMB253.2 million by cash and RMB654.2 million by bank promissory notes, which together accounted for 69% of our trade and bills receivables from our top five customers as at September 30, 2012.

Trade and other payables

Our trade and other payables primarily consist of trade and bills payables for purchases of raw material and engine components from various suppliers, accrued purchase of raw material and engine components, amounts payable for construction of our production facilities, payroll and welfare payables and provision for warranty. Our suppliers typically grant us a credit period of three months.

For a description of our trade and other payables with our related customers, which are accounted for on our consolidated statements of financial position as “Amounts due to related companies,” please see “— Description of Certain Items from Our Consolidated Statements of Financial Position — Amounts due to related companies.”

Our trade and other payables increased from RMB787.3 million as of December 31, 2009 to RMB923.9 million as of December 31, 2010, primarily due to increases in the procurement of raw material and engine components for our production activities in line with the overall growth of our operations. Our trade and other payables increased from RMB923.9 million as of December 31, 2010 to RMB1,312.3 million as of December 31, 2011, primarily due to increases in the procurement of raw material and engine components in line with our business growth and longer credit periods extended by our suppliers to us as we increased our purchase volumes from them. It increased to RMB1,325.1 million as of September 30, 2012, primarily due to increases in the procurement of raw material and engine component in line with our business growth.

In particular, our accrued purchase of raw material and engine components, which are raw material and engine components that have already been consumed in our production but for which we have not been invoiced yet, decreased slightly from RMB167.3 million as of December 31, 2009 to RMB165.4 million as of December 31, 2010, primarily due to changes in the composition of our raw material and engine components consumption. Our accrued purchase of raw material and engine components increased from RMB165.4 million as of December 31, 2010 to RMB255.5 million as of December 31, 2011, primarily due to our increased sales volume and changes in the composition of our raw material and engine components consumption. It further increased to RMB372.5 million as of September 30, 2012, primarily due to the same reason. We generally receive invoices for the raw material and engine components from our suppliers one month after their consumption in our production. We believe this practice is line with the engine manufacturing industry practice in the PRC.

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Furthermore, our provisions for warranty increased from RMB0.05 million as of December 31, 2009 to RMB7.4 million as of December 31, 2010, primarily due to provisions made for two new product models for which our customers reported minor quality issues in 2010. The provisions were made based on our prudent financial policy and before the cause of the issues was determined. It was later determined, in 2011, that one minor quality issue involves emission of black smoke, which was caused by improper use and the other minor quality issue was related to the wear and tear of combustion chamber, which caused by use of wrong type of fuel. Our provisions for warranty decreased from RMB7.4 million as of December 31, 2010 to RMB5.3 million as of December 31, 2011, primarily due to the decrease in warranty provisions for the two new product models after the cause of the issues was determined in 2011 and due to our further improved product quality. It decreased to RMB5.1 million as of September 30, 2012, primarily due to our further improved product quality.

The credit period of our trade payables and bills payable is normally within three months and three to six months, respectively. Substantially all of our trade and other payables at the end of the relevant report periods were due within six months.

The following table sets forth the aging analysis of our trade payables presented based on the invoice date and bills payables presented based on the bills issue date, as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
Within 3 months	363,572	481,297	515,744	593,011
3 to 6 months	192,620	195,976	437,268	229,491
6 months to 1 year	1,269	6,096	19,593	37,239
Over 1 year	3,298	4,858	—	—
	<u>560,759</u>	<u>688,227</u>	<u>972,605</u>	<u>859,741</u>

The following table sets forth the turnover days of our trade and bills payables for the periods indicated:

	Year ended December 31,			Nine months
	2009	2010	2011	ended
				September 30,
				2012
Trade and bills payables turnover days⁽¹⁾	169	174	207	217

(1) Trade and bills payables turnover days equal average trade and bills payables and accrued purchase of raw materials divided by cost of sales from third parties and multiplied by 365 for each of the three years ended December 31, 2011 and by 274 days for the nine months ended September 30, 2012.

Our trade and bills payables turnover days increased from 169 days in 2009 to 174 days in 2010, to 207 days in 2011 and to 217 days for the nine months ended September 30, 2012, primarily due to (i) longer credit periods extended by our suppliers to us as we increased our purchase volumes from them and (ii) our increased use of bank promissory notes as payment method to reduce pressure on our cash flow, which have a longer credit period. Our trade and bills payables turnover days are relatively high mainly because our payment terms usually allow us to make payment within three to six months with reasonable extensions.

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Amounts due to related companies

During the Track Record Period, we had trade balances with related companies generated from engine components sourced from our related companies, including Brilliance China Group and Wuliangye Group, and non-trade related balances generated from property maintenance and construction and tax rebate to shareholders. For details of our transactions with related companies, see “Connected Transactions” and Note 26 of the Accountants’ Report as set forth in Appendix I to this document. The increases in our amounts due to related companies primarily reflect the increased procurement of engine components from our related companies during the Track Record Period.

The following table sets forth our trade and non-trade related amounts due to our related companies as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
Amounts due to related companies				RMB'000
Trade related	39,308	68,849	114,343	100,310
Non-trade related	8,204	7,122	2,355	746
	<u>47,512</u>	<u>75,971</u>	<u>116,698</u>	<u>101,056</u>

The trade related amounts are interest free, unsecured and with a credit period of three to six months. The non-trade related amounts are interest free, unsecured and repayable on demand.

The trade related amounts consist of both trade payables and bills payables. The following table sets forth an aging analysis of trade payables (trade related) presented based on the invoice date as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
Within 3 months	25,561	36,848	69,857	50,413
3 to 6 months	917	7,391	7,754	14,593
6 months to 1 year	20	345	5,061	4,026
Over 1 year	—	—	117	—
	<u>26,498</u>	<u>44,584</u>	<u>82,789</u>	<u>69,032</u>

Our bills payable (trade related) are guaranteed by banks in the PRC and have maturities of 3 to 6 months. The following table sets forth an aging analysis of bills payable (trade related) presented based on the bills issuance date as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
Within 3 months	5,426	3,243	120	7,480
3 to 6 months	7,384	21,022	31,434	23,798
	<u>12,810</u>	<u>24,265</u>	<u>31,554</u>	<u>31,278</u>

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The following table sets forth the turnover days of our amounts due to our related companies for the periods indicated:

	Year ended December 31,			Nine months ended September 30,
	2009	2010	2011	2012
Amounts due to related companies turnover days⁽¹⁾	81	99	172	206

(1) Amounts due to related companies turnover days equal average amounts due to related companies (trade related) divided by purchase from related companies and multiplied by 365 for each of the three years ended December 31, 2011 and by 274 day for the nine months ended September 30, 2012.

The turnover days of our amounts due to related companies increased from 81 days in 2009 to 99 days in 2010, to 172 days in 2011 and to 206 days for the nine months ended September 30, 2012, primarily due to (i) longer credit periods extended by our suppliers to us as we increased our purchase volumes from them and (ii) our increased use of bank promissory notes as payment method, which have a longer credit period.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have financed our working capital, capital expenditure and other capital requirements primarily through cash generated from our operations, short-term borrowings from banks and related companies and capital contributions from Shareholders. Our loan agreements do not contain any major or unusual restrictive covenants or cross-default provisions which may materially affect our liquidity and capital resources by limiting our potential business operations or strategies.

Our future cash requirements will depend on many factors, including our operating income, terms of trade, costs to build additional production capacities and other changing business conditions and future developments. Generally, we extend a credit period of three months to our related customers and 30 to 60 days to our non-related customers with a further three to six months extension for payment by bank promissory notes and our suppliers grant us a credit period of three months with a further three to six months extension if we pay by bank promissory notes. As such, we strive to match the credit terms extended by our suppliers to us with those extended by us to our customers to maintain balanced cash flows. However, during the Track Record Period, we occasionally extended longer credit period to our customers who were behind on their payments. We gave extended credit period only to customers who we deem have good track record with us, high credibility and low operational risks. We expect to improve our credit management by allowing less extended credit period to our customers. During the Track Record Period, we experienced negative cash flows from our operating activities in 2010, primarily due to increased trade receivables caused by delayed payments by our related customers, when their cash flows were affected by the launching of their new automobile models and tightened credit policy by the PRC Government. Occasionally, we also extended longer credit period in favor of new customers who we expect to have growth potential. We started to enhance our liquidity management in late 2011, in particular with regard to related companies, by extending less credit period beyond our normal credit policy and improving collection of amounts past due from our related companies. We have also included receivables collection rate as one of the standards to evaluate the performance of our sales personnel to encourage them to collect amounts due from our customers. [As a result, as of the Latest Practicable Date, all amounts due from our related companies that are past due had been settled.] For risks related to the PRC Government tightened credit policy, see “Risk Factors — The global financial crisis, economic downturn and uncertainty may have a material and adverse effect on our business, financial condition and results of operations”.

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In the future, if industry practice shifts away from our current practice and our trade terms with customers and suppliers change accordingly, we may need to fund our working capital needs with increasing bank or other borrowings, which will increase our finance costs. We may require additional cash to repay existing debt obligations or to re-finance our existing debts or due to changing business conditions or other future developments. We may seek to sell additional equity or debt securities or borrow from lending institutions. We cannot assure you that financing will be available in the amounts we need or on terms acceptable to us, if at all. The sale of additional equity securities, including convertible debt securities, would dilute our existing Shareholders. If we are unable to obtain additional equity or debt financing as required, our business operations and prospects may suffer.

We expect to fund our future capital expenditure, working capital and other cash requirements from cash generated from our operations, the [●] from the [●] and, when necessary, bank and other borrowings.

Cash Flows

The following table sets forth selected cash flow data from our consolidated statements of cash flows for the periods indicated:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Net cash from (used in) operating activities . . .	150,280	(9,622)	267,663	(38,072)	196,412
Net cash (used in) from investing activities . . .	(196,011)	2,166	(25,499)	51,696	21,826
Net cash from (used in) financing activities . . .	64,182	37,115	18,807	(77,711)	6,012
Net increase (decrease) in cash and cash equivalents	18,451	29,659	260,971	(58,649)	224,249
Cash and cash equivalents at beginning of the year/period	18,666	37,117	66,776	66,776	327,747
Cash and cash equivalents at end of the year/period	37,117	66,776	327,747	8,127	551,996

Cash flows from (used in) operating activities

We derive our cash flows from operating activities primarily from the receipt of payment for sales of products. Our cash used in operating activities primarily consists of payment for purchases of raw material and engine components.

For the nine months ended September 30, 2012, we had net cash from operating activities of RMB196.4 million. The amount primarily reflected our profit before tax of RMB260.4 million, as adjusted by income statement items with non-operating cash effect and the following factors: (i) a decrease in amounts due from related companies of RMB107.6 million as a result of collection, (ii) a increase in trade and other payables and other tax payables of RMB2.0 million, offset by (iii) an decrease in amounts due to related companies of RMB14.0 million as our procurement of engine components increased, (iv) an increase in inventories of RMB17.3 million, (v) an increase in trade and other receivables of RMB161.8 million due to increased sales, and (vi) an income tax paid of RMB31.5 million.

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For the year ended December 31, 2011, we had net cash from operating activities of RMB267.7 million. The amount primarily reflected our profit before tax of RMB304.6 million, as adjusted by income statement items with non-operating cash effect and the following factors: (i) an increase in trade and other payables and other tax payables of RMB383.7 million as our procurement of raw material and engine components increased, (ii) an increase in amounts due to related companies of RMB46.3 million as our procurement of engine components increased, (iii) a decrease in inventories of RMB35.2 million, offset by (iv) an increase in trade and other receivables and other tax recoverables of RMB327.2 million due to increased sales as well as the tightened credit policy by the PRC Government in 2011 which increased pressure on our customers' cash flows who prolonged their payment cycle and increased use of bank promissory notes for payment, (v) an increase in amounts due from related companies of RMB236.3 million, mainly caused by delayed payments by our related companies, whose own cash flows were also affected by the tightened credit policy of the PRC Government in 2011, and (vi) an income tax paid of RMB13.8 million in 2011.

For the year ended December 31, 2010, we had net cash used in operating activities of RMB9.6 million. The amount primarily reflected our profit before tax of RMB149.8 million, as adjusted by income statement items with non-operating cash effect and the following factors: (i) an increase in amounts due from related companies of RMB294.2 million mainly caused by delayed payments by our related companies, in particular, Brilliance China Group and Huachen Group, when their own cash flows were affected by launching of their new products and tightened credit policy by the PRC Government, (ii) an increase in trade and other receivables of RMB70.4 million as our sales increased, (iii) increase in inventories of RMB42.6 million, offset by (iv) an increase in trade and other payables and other tax payables of RMB143.7 million as our procurement of raw material and engine components increased, and (v) an increase in amounts due to related companies of RMB29.5 million.

For the year ended December 31, 2009, we had net cash from operating activities of RMB150.3 million. The amount primarily reflected our profit before tax of RMB59.5 million, as adjusted by income statement items with non-operating cash effect and the following factors: (i) an increase in trade and other payables and other tax payables of RMB441.0 million as our procurement of raw material and engine components increased in line with the overall growth of our operations, (ii) an increase in amounts due to related companies of RMB19.2 million, (iii) a decrease in trade and other receivables and other tax recoverables of RMB8.3 million, offset by (iv) an increase in amounts due from related companies of RMB386.7 million, and (v) an increase in inventories of RMB46.6 million.

Cash flows (used in) from investing activities

For the nine months ended September 30, 2012, we had net cash from investing activities of RMB21.8 million, primarily reflecting (i) a net decrease in pledged bank deposits of RMB147.0 million, (ii) an interest received of RMB2.8 million from our bank deposits, and (iii) receipt from government grants of RMB1.6 million related to purchase of production facilities and equipment, offset by (iv) investment in Dongfeng JV of RMB50.0 million, (v) development costs related to development of new products of RMB47.1 million, and (vi) payment of RMB32.0 million for purchase of property, plant and equipment.

For the year ended December 31, 2011, we had net cash used in investing activities of RMB25.5 million, primarily reflecting (i) repayment from a related company of RMB80.0 million related to business operations, (ii) payment of RMB58.6 million for purchase of property, plant and equipment, (iii) development costs related to development of new products of RMB26.8 million, (iv) a net increase in pledged bank deposits of RMB15.9 million, (v) deposits paid for acquisition of property, plant and equipment and prepaid lease payments of RMB6.9 million, (vi) an interest received of RMB2.3 million from our bank deposits, and (vii) receipt from government grants of RMB0.4 million related to purchase of production facilities and equipment.

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For the year ended December 31, 2010, we had net cash from investing activities of RMB2.2 million, primarily reflecting (i) a net decrease in pledged bank deposits of RMB61.7 million, (ii) payment of RMB31.9 million for purchase of property, plant and equipment, (iii) payment of RMB28.2 million for purchase of prepaid lease payments, (iv) deposits paid for acquisition of property, plant and equipment and prepaid lease payments of RMB9.6 million, (v) receipt from government grants of RMB5.7 million related to purchase of production facilities and equipment, and (vi) interest received of RMB4.3 million from our bank deposits.

For the year ended December 31, 2009, we had net cash used in investing activities of RMB196.0 million, primarily reflecting (i) a net increase in pledged bank deposits of RMB164.4 million, (ii) deposits paid for acquisition of property, plant and equipment and prepaid lease payments of RMB24.2 million, (iii) payment of RMB10.8 million for purchase of property, plant and equipment, (iv) development costs related to development of new products of RMB2.1 million, (v) interest received of RMB3.6 million from our bank deposits, and (vi) receipt from government grants of RMB1.1 million related to purchase of production facilities and equipment.

Cash flows from (used in) financing activities

For the nine months ended September 30, 2012, we had net cash from financing activities of RMB6.0 million, primarily reflecting (i) new bank borrowings of RMB135.0 million, (ii) repayment of bank borrowings of RMB104.0 million, (iii) interest paid of RMB23.4 million, and (iv) repayment to a related party of RMB1.6 million.

For the year ended December 31, 2011, we had net cash from financing activities of RMB18.8 million, primarily reflecting (i) new bank borrowings of RMB214.0 million, (ii) proceeds from issuance of shares of RMB123.5 million related to Reorganization, (iii) repayment of bank borrowings of RMB227.0 million, (iv) interest paid of RMB47.0 million, and (v) repayment to a related company of RMB46.3 million.

For the year ended December 31, 2010, we had net cash from financing activities of RMB37.1 million, primarily reflecting (i) new bank borrowings of RMB145.0 million, (ii) repayment of bank borrowing of RMB93.0 million, and (iii) interest paid of RMB17.8 million.

For the year ended December 31, 2009, we had net cash from financing activities of RMB64.2 million, primarily reflecting (i) new bank borrowings of RMB100.0 million, (ii) repayment of bank borrowing of RMB25.0 million, and (iii) interest paid of RMB11.1 million.

FINANCIAL INFORMATION

Working Capital

The following table sets forth the details of our current assets and liabilities as of the dates indicated:

	As of December 31,			As of	As of [●],
	2009	2010	2011	September 30,	2013
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Current Assets					
Inventories	208,635	251,368	221,202	238,332	[●]
Prepaid lease payments	422	1,434	1,434	1,434	[●]
Trade and other receivables	99,804	170,506	497,706	660,975	[●]
Amounts due from related companies . . .	532,205	826,400	1,061,910	954,309	[●]
Loan to a related company	77,625	78,029	—	—	[●]
Loan to a Shareholder	—	—	32,771	32,595	[●]
Pledged bank deposits	268,811	207,161	223,059	76,022	[●]
Bank balances and cash	37,117	66,776	327,747	551,996	[●]
Total current assets	1,224,619	1,601,674	2,365,829	2,515,663	[●]
Current Liabilities					
Trade and other payables	787,318	923,893	1,312,341	1,325,111	[●]
Amounts due to related companies	47,512	75,971	116,698	101,056	[●]
Loans from related companies	40,000	40,000	—	—	[●]
Loans from Shareholders	—	—	32,771	32,595	[●]
Bank borrowings due within one year . .	93,000	176,950	163,950	194,950	[●]
Other loan	—	—	—	4,000	[●]
Other tax payables	6,030	19,260	43,300	53,271	[●]
Income tax payables	—	—	30,686	35,910	[●]
Total current liabilities	973,860	1,236,074	1,699,746	1,746,893	[●]
Net Current Assets	250,759	365,600	666,083	768,770	[●]

During the Track Record Period, our working capital position improved over time. We recorded net current assets of RMB250.8 million, RMB365.6 million, RMB666.1 million and RMB768.8 million as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively. The increase was primarily attributable to the continuous improvement in business performance and cash inflow of our Group as reflected in the continuous increases in the trade and other receivables, amounts due from related companies and cash and bank balances. We did not have any material defaults in payment of trade and non-trade payables and bank borrowings, or breaches of the finance covenants during the Track Record Period.

As of September 30, 2012, we had RMB552.0 million of cash and bank balances and RMB135.1 million of available and unutilized borrowing capacity under our loan agreements. The recent global financial market volatility and credit tightening in the PRC did not, and we do not foresee in the near future that will, affect our ability to obtain external financing when necessary. We maintain a relatively high level of cash balance mainly for expected capital expenditure related to our production capacity expansion and new product development, and repayment of our bank loans if our liquidity allows. For the nine months ended September 30, 2012, we had net cash from operating activities of RMB196.4 million. Our total estimated capital expenditure for the year ending December 31, 2013 is approximately RMB393.6 million. We estimate that we will receive net proceeds from the [●] of approximately HK\$[720] million, or RMB[●] million, assuming the [●] is not exercised. Taking into account the above, our Directors believe that we have sufficient working capital for our present planned business operations, capital commitments and other contractual obligations and for at least the next 12 months following the date of this document.

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CAPITAL EXPENDITURES

During the Track Record Period, our capital expenditures were primarily related to the acquisition of land use rights and property, plant and equipment relating to the construction, expansion and upgrade of our production facilities and expanding our production capacity. For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our capital expenditure amounted to RMB48.7 million, RMB102.8 million, RMB119.6 million and RMB101.2 million, respectively.

Indebtedness

As of [●], 2013, we had RMB[●] million of outstanding bank borrowings and RMB[●] million of unutilized borrowing capacity under our loan agreements. The following table sets forth our bank borrowings as of the dates indicated:

	As of December 31,			As of	As of
	2009	2010	2011	September 30,	[●], 2013
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Bank borrowings repayable within one year	93,000	176,950	163,950	194,950	[●]
Bank borrowings repayable more than one year, but not exceeding two years	32,000	—	—	—	[●]
	125,000	176,950	163,950	194,950	[●]
Less: Amounts due for settlement within 12 months shown under current liabilities ...	(93,000)	(176,950)	(163,950)	(194,950)	[●]
Amounts due for settlement after 12 months	32,000	—	—	—	[●]

Our short-term bank borrowings increased during the Track Record Period, as the increased production and sales of our products required additional working capital.

As of December 31, 2009 and 2010, we also had loans from related companies in the amount of RMB40 million, which were used for funding the development of our new products and technical know-how. These loans were unsecured, bore interest at 5% per annum and had 2-year term repayable in 2010. These loans have been repaid in full. Our PRC legal adviser, Jingtian & Gongcheng, has advised us that according to the PRC Lending General Provisions (《貸款通則》), inter-company loans are not permitted and a penalty of an amount equal to one to five times the interest income generated from such lending may be imposed on the lender and that we, as the borrower, would not be subject to any penalties or claims for such loans borrowed from related companies.

We received an interest-free loan of RMB4 million from a state-owned entity related to the Sichuan Province government in 2010 as a form of government support to finance the relocation of our production facilities. The loan has a term of three years, is repayable in July 2013. The loan is a one-time discretionary loan and is not recurrent in nature. There is no unfulfilled condition for us to use the loan.

We received an interest-free loan of RMB32.8 million (HK\$40 million) in 2011 payable by the end of 2012 from our Shareholders, namely, Brilliance Investment and Xinhua Investment, to fund a loan provided by us to Lead In for the Lead In Subscribed Shares in relation to the Reorganization. In October 2012, the loans were further extended to October 2013. For further details of the loan, see “History and Reorganization — Reorganization — Acquisition of 50% equity interest in Mianyang Xinchun from Xinhua Combustion Engine by Southern State” in this document.

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As of September 30, 2012, RMB153.0 million of our bank loans were secured by property, plant and equipment and land use rights. The bank loans carried weighted average interest rates of 5.5%, 5.4%, 6.3% and 6.49% as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively.

Capital Commitments

The following table summarizes our capital commitments as of the dates indicated:

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
				RMB'000
Capital expenditure in respect of the acquisition of property, plant and equipment, prepaid lease payments and intangible assets				
— contracted for but not provided in financial information	5,999	57,098	52,357	16,671
— authorized but not contracted for	178,795	194,550	95,542	326,615
	<u>184,794</u>	<u>251,648</u>	<u>147,899</u>	<u>343,286</u>
Capital expenditure in respect of investment in a jointly controlled entity				
— contracted for but not provided in financial information	—	—	125,000	75,000

OPERATING LEASE ARRANGEMENT

Operating lease payments represent rental payable by us for warehouses. Leases are negotiated and rentals are fixed for an average of one year. We had no commitments for future minimum lease payments under non-cancellable operating leases as the lease agreements are entered into for a one-year period. The following table sets out our operating lease commitments as of the dates indicated:

	As of December 31,			Nine months ended	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
				(unaudited)	
Warehouse	<u>120</u>	<u>100</u>	<u>100</u>	<u>75</u>	<u>75</u>

CONTINGENT LIABILITIES

During the Track Record Period, we received certain bank promissory notes with payment terms of six months from a related party for the settlement of a loan receivable from that related party. As a result, for recording purpose, we recognized note receivable from the bank and derecognized the loan receivable from that related party. For cash flow management, we settled accounts payable to certain suppliers by endorsing the above-mentioned bank promissory notes with recourse to those suppliers in lieu of cash payment. As a result, for recording purpose, we derecognized accounts payable to the suppliers and the note receivable from the bank. The overall effect of these transactions resulted in the settlement of a loan receivable from a related party and the derecognition of certain accounts payable to certain suppliers.

During the Track Record Period, there has been no default in the payment of the endorsed and discounted bills.

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Despite the fact that the bank promissory notes endorsed to the suppliers are with recourse in nature, in the opinion of our Directors, the obligations to the corresponding suppliers were discharged in accordance with the commercial practice in the PRC as we have transferred substantially all the risks and rewards of ownership of the bank promissory notes to the suppliers and the risk of the default in payment of the endorsed and discounted bills receivable is low, because all endorsed and discounted bills receivable are guaranteed by reputable PRC banks. Nevertheless, we chose to disclose the above-mentioned transactions as a contingent liability to our Group so as to quantify the maximum exposure to our Group that may result from the default of those bank promissory notes. The maximum possible exposure of our Group from the default of these endorsed and discounted bills receivable at the end of each of reporting period was as follows:

	As of December 31,			As of
	2009	2010	2011	September 30,
	RMB'000	RMB'000	RMB'000	2012
				RMB'000
<i>Outstanding endorsed and discounted bills receivable with recourse</i>	353,039	627,225	678,857	583,521

As of September 30, 2012, being the latest practicable date for the purpose of this statement, we had material contingent liabilities in the amount of RMB583.5 million. Except as disclosed above, we did not have any other material contingent liabilities outstanding as of September 30, 2012.

All the acceptance of bank promissory notes for the settlement of our loan receivables and the endorsement of our bills receivable for the settlement of trade and other payables to our suppliers were backed by underlying transactions or creditor-debtor relationship between relevant parties, and all these bank promissory notes are examined and issued by commercial banks in accordance with the PRC Negotiable Instruments Law. Our PRC legal adviser, Jingtian & Gongcheng, has advised us that, this practice is in compliance with applicable PRC laws, rules and regulations, in particular, the PRC Negotiable Instruments Law (《中華人民共和國票據法》). We expect to continue this practice of endorsing bills receivable for the settlement of other balances after [●].

Save as disclosed in this document, we did not have material outstanding mortgages, charges, debentures, loan capital, bank overdrafts, loans, debt securities or other similar indebtedness, finance leases or hire purchase commitments, liabilities under acceptances or acceptance credits or any guarantees or other material contingent liabilities outstanding as of the Latest Practicable Date.

OFF-BALANCE SHEET ARRANGEMENTS

As of the Latest Practicable Date, we did not have any off-balance sheet arrangements.

FINANCIAL RATIOS

The following table sets forth certain financial ratios of our Group as at the dates and for the periods indicated:

	Year ended December 31,			Nine months ended
	2009	2010	2011	September 30, 2012
Return on equity ⁽¹⁾	11.6%	23.0%	25.2%	23.8%
Return on assets ⁽²⁾	3.9%	7.8%	9.4%	9.8%
Interest coverage ⁽³⁾	6.3	9.4	9.1	13.1

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	As at December 31,			As at
	2009	2010	2011	September 30, 2012
Current ratio ⁽⁴⁾	1.3	1.3	1.4	1.4
Quick ratio ⁽⁵⁾	1.0	1.1	1.3	1.3
Gearing ratio ⁽⁶⁾	32.8%	33.5%	15.9%	15.5%
Net debt to equity ratio ⁽⁷⁾	25.4%	23.2%	Net cash	Net cash

- (1) Return on equity represents net profit or annualized profit for the period divided by total equity as at the end of the period.
- (2) Return on assets represents net profit or annualized profit for the period divided by total assets as at the end of the period.
- (3) Interest coverage represents profit before tax and finance costs divided by finance costs for the period.
- (4) Current ratio represents total current assets divided by total current liabilities as at the end of the period.
- (5) Quick ratio represents total current assets less inventories divided by total current liabilities as at the end of the period.
- (6) Gearing ratio represents total bank borrowings and loans from related companies divided by total equity as at the end of the period.
- (7) Net debt to equity ratio represents total bank borrowings and loans from related companies less cash and cash equivalents divided by total equity as at the end of the period.

Return on equity

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our return on equity was 11.6%, 23.0%, 25.2% and 23.8%, respectively. Return on equity increased substantially from 11.6% for 2009 to 23.0% for 2010, mainly due to the increase in net profit. The ratio remained relatively stable from 2010 to 2011 and to the nine months ended September 30, 2012.

Return on assets

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our return on assets was 3.9%, 7.8%, 9.4% and 9.8%, respectively. Return on assets increased substantially from 3.9% for 2009 to 7.8% for 2010 and to 9.4% for 2011, mainly due to the increase in net profit. The ratio remained relatively stable from 2011 to the nine months ended September 30, 2012.

Interest coverage

For the three years ended December 31, 2011 and the nine months ended September 30, 2012, our interest coverage was 6.3, 9.4, 9.1 and 13.1, respectively. The interest coverage generally increased during the Track Record Period, mainly as a result of growth of our profit before finance costs and tax during the Track Record Period. It decreased from 9.4 as at December 31, 2010 to 9.1 as at December 31, 2011, mainly due to higher finance costs primarily resulting from increased use of discounted bills.

Current ratio

As at December 31, 2009, 2010 and 2011 and September 30, 2012, our current ratio was 1.3, 1.3, 1.4 and 1.4, respectively. Our current ratio during the Track Record Period remained relatively stable.

Quick ratio

As at December 31, 2009, 2010 and 2011 and September 30, 2012, our quick ratio was 1.0, 1.1, 1.3 and 1.3, respectively. Our quick ratio increased from 1.1 as at December 31, 2010 to 1.3 as at December 31, 2011, mainly because inventories decreased from RMB251.4 million as at December 31, 2010 to RMB221.2 million as at December 31, 2011, primarily as a result of a decrease in finished good inventory due to increased sales volume that surpassed our production volume.

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Gearing ratio

As at December 31, 2009, 2010 and 2011 and September 30, 2012, our gearing ratio was 32.8%, 33.5%, 15.9% and 15.5%, respectively. Our gearing ratio decreased from 33.5% as at December 31, 2010 to 15.9% as at December 31, 2011, mainly because bank borrowings decreased from RMB177.0 million as at December 31, 2010 to 164.0 million as at December 31, 2011 and loans from related companies decreased from RMB40.0 million as at December 31, 2010 to RMB32.8 million as at December 31, 2011, and total equity increased from RMB648.5 million as at December 31, 2010 to RMB1,032.4 million as at December 31, 2011, primarily as a result of an increase in retained profits in 2011, an increase in equity arising from the Reorganization and the issuance of new equity to Dongfeng Motors Engineering and Lead In.

Net debt to equity ratio

Our net debt to equity ratio was 25.4% and 23.2% as at December 31, 2009 and 2010, respectively. We were in a net cash position as at December 31, 2011 and September 30, 2012, mainly because of larger amount of cash and cash equivalents as at December 31, 2011 and September 30, 2012 as our cash flow from operating activities improved.

MARKET RISKS

We are exposed to various types of market risks, including commodities risk, interest rate risk, credit risk and liquidity risk in the normal course of our business. As our Group’s functional currency is RMB and substantially all of our transactions are made and settled in RMB, we do not believe we are exposed to any significant exchange rate risk.

Commodities Risk

We are exposed to fluctuations in the prices of raw material and engine components, as well as the price of energy used in the manufacturing process, which are influenced by local as well as national supply and demand conditions. We currently do not hedge against commodity risk, which we believe is in line with the PRC automotive industry practice. We purchase most of our raw material, engine components and energy at market prices and such purchase costs are generally accounted for as part of the cost of sale. Accordingly, rising prices for raw material, engine components and energy, to the extent that we cannot pass on such increases to our customers, could adversely affect our results of operations. For further details, please refer to “Risk Factors — Risks Relating to Our Business — We may face increases in the prices of raw material and engine components” in this document.

Interest Rate Risk

Our income and operating cash flows are substantially independent of fluctuations in market interest rates as we do not have significant interest-bearing assets. We are exposed to cash flow interest rate risk on the variable rate of interest earned on the pledged bank deposits and bank balances and variable rate of interest incurred on bank borrowings. Our exposure to market risks for changes in interest rates with respect to our borrowings is also limited because our borrowings have fixed interest rates. However, borrowings issued at fixed rates expose us to fair value interest rate risk. Please see Note 35 to the Accountants’ Report included in Appendix I to this document for further details, including a sensitivity analysis with respect to our interest rate risks.

Credit Risk

Our exposure to credit risk is primarily related to our trade receivables. In order to minimize the credit risk, our management reviews the recoverable amount of each individual debt at the end of the

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reporting period to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, our management considers that our credit risk is significantly reduced.

Our exposure to credit risk on liquid funds is limited because our counterparties are banks with high credit ratings.

We have concentration of credit risk, as 83%, 88%, 87% and 80% of our total trade receivables and amounts due from related companies (trade related) as of December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, were due from our top five customers. These top five customers have demonstrated creditworthiness based on their track record of timely payments. In order to minimize the concentration of credit risk, our management has delegated staff responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure follow-up action is taken to recover overdue debts. Our management also performs periodic evaluations and customer visits to ensure our exposure to bad debts is not significant and adequate impairment losses are made for irrecoverable amounts.

Liquidity Risk

In the management of the liquidity risk, we closely monitor our cash position resulting from our operations and maintain a level of cash and cash equivalents deemed adequate by our management to meet in full our financial obligations as they fall due for the foreseeable future. Our management also monitors the utilization of our bank borrowings. For details of our remaining contractual maturity for our financial liabilities based on the agreed repayment terms as of December 31, 2009, 2010 and 2011 and September 30, 2012, please see Note 35 to the Accountants' Report included in Appendix I to this document.

Foreign Exchange Fluctuations

Our functional currency is RMB as substantially all of our transactions are settled in RMB. In addition, conversion of RMB to foreign currencies is subject to rules and regulations of foreign exchange control promulgated by the PRC Government. On July 21, 2005, the PRC Government changed its policy of pegging the value of the RMB to the U.S. dollar. Under this policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. The PRC Government may take further actions that could cause future exchange rates to vary significantly from current or historical exchange rates.

A depreciation in the RMB would adversely affect the value of any dividends we pay to our Shareholders outside the PRC. An appreciation in the RMB, however, would adversely affect the value of the proceeds we will receive from the [●] or any capital contribution in foreign currency if they are not converted to RMB in a timely manner. Historically we have not used any financial instruments to hedge against foreign exchange risks.

DISTRIBUTABLE RESERVES

As of September 30, 2012, the distributable reserves of our Company was RMB nil.

DIVIDENDS AND DIVIDEND POLICY

We currently do not have a fixed dividend policy. The declaration, payment and amount of dividends in the future will be subject to the discretion of the Board and will depend on our results of operations, cash flows, financial condition, statutory and regulatory restrictions on the payment of dividends by us, future prospects and other factors that our Directors may consider relevant. Holders of our Shares will

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be entitled to receive such dividends pro rata according to the amounts paid up or credited as paid up on the Shares. The declaration, payment, and amount of dividends will be subject to the discretion of the Directors.

Dividends may be paid only out of our distributable profits as permitted under the relevant laws. To the extent profits are distributed as dividends, such portion of profits will not be available to be reinvested in our operations. There can be no assurance that we will be able to declare or distribute any dividend in the amount set out in any plan of the Board or at all. The dividend distribution record in the past may not be used as a reference or basis to determine the level of dividends that may be declared or paid by us in the future.

NO MATERIAL ADVERSE CHANGE

Our Directors confirm that there has been no material adverse change in the financial or trading position, indebtedness, mortgage, contingent liabilities, guarantees or prospects of our Group since September 30, 2012, the date of the latest audited consolidated financial statements of our Group.

FUTURE PLANS

FUTURE PLANS

Please see the section headed “Business — Our Strategies” in this document for detailed description of our future plans.

APPENDIX I

ACCOUNTANTS’ REPORT

The following is the text of a report, prepared for inclusion in this document, received from the reporting accountants of the Company, Deloitte Touche Tohmatsu, Certified Public Accountants, Hong Kong.



[Date]

The Directors

Xinchen China Power Holdings Limited

[●]

Dear Sirs,

We set out below our report on the financial information relating to Xinchen China Power Holdings Limited 新晨中國動力控股有限公司 (the “Company”, formerly known as Xinchen China Power Holdings Ltd.) and its subsidiaries (hereinafter collectively referred to as the “Group”) for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012 (the “Track Record Period”) (the “Financial Information”) for inclusion in the document of the Company dated [] (the “Document”) in connection with the [●] of the shares of the Company (the “[●]”) on the [●] (the “[●]”).

The Company was incorporated in the Cayman Islands as an exempted company with limited liability under the Companies Law (2010 Revision) of the Cayman Islands on March 10, 2011. Pursuant to a group reorganization, as more fully explained in the section headed “History and Reorganization” in the document (the “Group Reorganization”), the Company became the holding company of the entities comprising the Group which are principally engaged in the development, manufacture and sale of automotive engines for passenger vehicles and light duty commercial vehicles in the People’s Republic of China (the “PRC”) on August 29, 2011.

As at the date of this report, the Company has equity interests in the following subsidiaries:

<u>Name of subsidiary</u>	<u>Place and date of incorporation/ establishment</u>	<u>Issued and fully paid share/ registered capital</u>	<u>Equity interest attributable to the Group</u>	<u>Principal activities</u>
Southern State Investment Limited 南邦投資有限公司 (“Southern State”) (Note a)	British Virgin Islands (“BVI”) September 30, 1997	US\$1	100%	Investment holding
Mianyang Xinchen Engine Co., Ltd.* 綿陽新晨動力機械有限公司 (“Mianyang Xinchen”) (Note b)	PRC March 23, 1998	US\$24,120,000	100%	Development, manufacture and sale of automotive engines for passenger vehicles and light duty commercial vehicles

* English name for reference only.

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ACCOUNTANTS’ REPORT

Notes:

- (a) Southern State was a 50% shareholder of Mianyang Xincheng prior to the Group Reorganization. On August 29, 2011, Mianyang Xincheng became a wholly owned subsidiary of Southern State, which is 100% owned by the Company upon the completion of the Group Reorganization. Details of the Group Reorganization are set out in Note 2.
- (b) Mianyang Xincheng is the major operating subsidiary of the Group and a Sino-foreign equity joint venture enterprise.

The financial year-end date of all the entities now comprising the Group is December 31.

The statutory financial statements of Mianyang Xincheng for each of the three years ended December 31, 2011 were prepared in accordance with relevant accounting principles and financial regulations applicable to enterprises established in the PRC (the “PRC GAAP”) and were audited by Sichuan Huaxin (Group) CPA Firm (四川華信(集團)會計師事務所), certified public accountants registered in the PRC in accordance with the China Standards on Auditing.

No audited statutory financial statements have been prepared for the Company and Southern State since their dates of incorporation, as they were incorporated in jurisdictions where there is no statutory audit requirement. For the purpose of this report, we have, however, reviewed all the relevant transactions of the Company for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012, or since the date of incorporation to the date of this report and carried out such procedures as we considered necessary for inclusion of the Financial Information relating to the Company and the Group.

For the purpose of this report, the directors of the Company have prepared consolidated financial statements of the Group for the Track Record Period (collectively referred to as the “Underlying Financial Statements”) in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”). We have carried out an independent audit on the Underlying Financial Statements in accordance with Hong Kong Standards on Auditing issued by HKICPA.

We have examined the Underlying Financial Statements in accordance with the Auditing Guideline 3.340 “[●] and the Reporting Accountant” as recommended by the HKICPA.

The Financial Information of the Group for the Track Record Period as set out in this report has been prepared from the Underlying Financial Statements, on the basis set out in Note 2 to the Financial Information. No adjustments are considered necessary to the Underlying Financial Statements in the preparation of this report for inclusion in the Document.

The Underlying Financial Statements are the responsibility of the directors of the Company. The directors of the Company are also responsible for the contents of the Document in which this report is included. It is our responsibility to compile the Financial Information set out in this report from the Underlying Financial Statements, to form an independent opinion on the Financial Information and to report our opinion to you.

In our opinion, on the basis of presentation set out in Note 2 to the Financial Information, the Financial Information gives, for the purpose of this report, a true and fair view of the state of affairs of the Group as at December 31, 2009, 2010 and 2011 and September 30, 2012 and of the Company as at December 31, 2011 and September 30, 2012 and of the results and cash flows of the Group for the Track Record Period.

The comparative consolidated statement of comprehensive income, consolidated statement of cash flows and consolidated statement of changes in equity of the Group for the nine months ended September 30, 2011 together with the notes thereon have been extracted from the Group’s unaudited consolidated financial information for the same period (the “September 2011 Financial Information”)

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ACCOUNTANTS’ REPORT

which were prepared by the directors of the Company solely for the purpose of this report. We conducted our review on the September 2011 Financial Information in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the HKICPA. Our review of the September 2011 Financial Information consists of making enquiries, primarily of persons responsible for the financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly we do not express an audit opinion on the September 2011 Financial Information. Based on our review, nothing has come to our attention that causes us to believe that the September 2011 Financial Information is not prepared, in all material respects, in accordance with the accounting policies consistent with those used in the preparation of the Financial Information which conform with HKFRSs.

APPENDIX I

ACCOUNTANTS’ REPORT

A. FINANCIAL INFORMATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	NOTES	Year ended December 31,			Nine months ended September 30,	
		2009	2010	2011	2011	2012
		<i>RMB’000</i>	<i>RMB’000</i>	<i>RMB’000</i>	<i>RMB’000</i> (unaudited)	<i>RMB’000</i>
Revenue	6	1,285,167	1,945,114	2,307,748	1,499,996	1,946,268
Cost of sales		(1,114,759)	(1,643,824)	(1,831,140)	(1,197,205)	(1,556,276)
Gross profit		170,408	301,290	476,608	302,791	389,992
Other income	7	10,197	11,144	10,012	6,643	6,361
Selling and distribution expenses		(52,018)	(65,845)	(48,611)	(29,737)	(40,214)
Administrative expenses . . .		(44,378)	(55,419)	(62,638)	(46,772)	(49,891)
Finance costs	8	(11,130)	(17,753)	(37,520)	(22,872)	(21,555)
Other expenses	10	(13,568)	(23,595)	(33,212)	(16,962)	(24,577)
Share of result of a jointly controlled entity	18	—	—	—	—	281
Profit before tax		59,511	149,822	304,639	193,091	260,397
Income tax expense	9	(1,234)	(365)	(44,250)	(28,524)	(36,628)
Profit and total comprehensive income for the year/period	10	<u>58,277</u>	<u>149,457</u>	<u>260,389</u>	<u>164,567</u>	<u>223,769</u>
Earnings per share—Basic (RMB)	13	<u>0.073</u>	<u>0.187</u>	<u>0.316</u>	<u>0.206</u>	<u>0.238</u>

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

		At December 31,			At September 30,
	NOTES	2009	2010	2011	2012
		RMB'000	RMB'000	RMB'000	RMB'000
NON-CURRENT ASSETS					
Property, plant and equipment	14	220,915	231,802	278,262	323,650
Prepaid lease payments	15	14,736	63,724	62,323	61,243
Intangible assets	16	23,768	11,597	43,695	72,978
Investment in a jointly controlled entity	18	—	—	—	49,633
Deferred tax assets	31	1,174	809	1,030	1,162
Deposits for acquisition of property, plant and equipment and prepaid lease payments		26,928	10,120	13,009	5,468
		287,521	318,052	398,319	514,134
CURRENT ASSETS					
Inventories	21	208,635	251,368	221,202	238,332
Prepaid lease payments	15	422	1,434	1,434	1,434
Trade and other receivables	22	99,804	170,506	497,706	660,975
Amounts due from related companies	23	532,205	826,400	1,061,910	954,309
Loan to a related company	19	77,625	78,029	—	—
Loan to a shareholder	20	—	—	32,771	32,595
Pledged bank deposits	24	268,811	207,161	223,059	76,022
Bank balances and cash	24	37,117	66,776	327,747	551,996
		1,224,619	1,601,674	2,365,829	2,515,663
CURRENT LIABILITIES					
Trade and other payables	25	787,318	923,893	1,312,341	1,325,111
Amounts due to related companies	26	47,512	75,971	116,698	101,056
Loans from related companies	27	40,000	40,000	—	—
Loans from shareholders	20	—	—	32,771	32,595
Bank borrowings due within one year	28	93,000	176,950	163,950	194,950
Other loan	29	—	—	—	4,000
Other tax payables		6,030	19,260	43,300	53,271
Income tax payables		—	—	30,686	35,910
		973,860	1,236,074	1,699,746	1,746,893
NET CURRENT ASSETS		250,759	365,600	666,083	768,770
TOTAL ASSETS LESS CURRENT LIABILITIES		538,280	683,652	1,064,402	1,282,904
NON-CURRENT LIABILITIES					
Bank borrowings due after one year	28	32,000	—	—	—
Other loan	29	—	4,000	4,000	—
Deferred income	30	3,768	31,179	28,010	26,743
		35,768	35,179	32,010	26,743
NET ASSETS		502,512	648,473	1,032,392	1,256,161
CAPITAL AND RESERVES					
Paid-in capital/share capital	32	200,008	200,008	7,693	7,693
Reserves		302,504	448,465	1,024,699	1,248,468
TOTAL EQUITY		502,512	648,473	1,032,392	1,256,161

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STATEMENTS OF FINANCIAL POSITION

	NOTES	At December 31, 2011 <i>RMB’000</i>	At September 30, 2012 <i>RMB’000</i>
NON-CURRENT ASSETS			
Investment in subsidiary	17	354,654	354,654
CURRENT ASSETS			
Other receivables	22	3,000	3,000
Amount due from a subsidiary	23	—	4
Loan to a shareholder	20	32,771	32,595
Bank balances and cash	24	113,390	112,150
		149,161	147,749
CURRENT LIABILITIES			
Trade and other payables	25	95	—
Amounts due to related companies	26	826	821
Loans from shareholders	20	32,771	32,595
		33,692	33,416
NET CURRENT ASSETS		115,469	114,333
NET ASSETS		470,123	468,987
CAPITAL AND RESERVES			
Share capital	32	7,693	7,693
Reserves	33	462,430	461,294
TOTAL EQUITY		470,123	468,987

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CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Paid-in capital/ Share capital	Share premium	Special reserve	Surplus reserves	Deemed distribution to a shareholder	Retained profits	Total
	RMB'000	RMB'000	RMB'000	RMB'000 (Note a)	RMB'000 (Note b)	RMB'000	RMB'000
At January 1, 2009	200,008	—	—	83,781	(3,894)	168,235	448,130
Profit and total comprehensive income for the year	—	—	—	—	—	58,277	58,277
Fair value adjustment on interest- free loan to a related company ...	—	—	—	—	(3,895)	—	(3,895)
Transfer	—	—	—	6,555	—	(6,555)	—
At December 31, 2009	200,008	—	—	90,336	(7,789)	219,957	502,512
Profit and total comprehensive income for the year	—	—	—	—	—	149,457	149,457
Fair value adjustment on interest- free loan to a related company ...	—	—	—	—	(3,496)	—	(3,496)
Transfer	—	—	—	22,980	—	(22,980)	—
At December 31, 2010	200,008	—	—	113,316	(11,285)	346,434	648,473
Profit and total comprehensive income for the year	—	—	—	—	—	260,389	260,389
Arising from group reorganization (Note c)	(200,008)	—	200,008	—	—	—	—
Capitalization issue (see Note 32)	6,551	—	(6,551)	—	—	—	—
Issuance of new shares (see Note 32)	1,142	122,388	—	—	—	—	123,530
Transfer	—	—	—	39,070	—	(39,070)	—
At December 31, 2011	7,693	122,388	193,457	152,386	(11,285)	567,753	1,032,392
Profit and total comprehensive income for the period	—	—	—	—	—	223,769	223,769
At September 30, 2012	7,693	122,388	193,457	152,386	(11,285)	791,522	1,256,161
At January 1, 2011	200,008	—	—	113,316	(11,285)	346,434	648,473
Profit and total comprehensive income for the period (unaudited)	—	—	—	—	—	164,567	164,567
Arising from group reorganization (Note c)	(200,008)	—	200,008	—	—	—	—
At September 30, 2011 (unaudited)	—	—	200,008	113,316	(11,285)	511,001	813,040

Notes:

- Surplus reserves comprise statutory surplus reserve and discretionary surplus reserve of Mianyang Xincheng, which are non-distributable and the transfer to these reserves is determined according to the relevant laws in the PRC and by the board of directors of Mianyang Xincheng in accordance with its Article of Association. Statutory surplus reserve amounting to approximately RMB61,266,000, RMB76,586,000, RMB102,632,000 and RMB102,632,000 as at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively can be used to make up for previous year's losses or convert into additional capital of Mianyang Xincheng. Discretionary surplus reserve amounting to approximately RMB29,070,000, RMB36,730,000, RMB49,754,000 and RMB49,754,000 as at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively can be used to expand the existing operations of Mianyang Xincheng.
- Deemed distribution to a shareholder represents the fair value adjustments on interest-free loan to a subsidiary of a joint controlling shareholder of Mianyang Xincheng (see Note 19).
- Amount represents the difference between paid-in capital of Mianyang Xincheng and issued share capital of the Company arising from Group Reorganization.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB’000	RMB’000	RMB’000	RMB’000	RMB’000
				(unaudited)	
OPERATING ACTIVITIES					
Profit before tax	59,511	149,822	304,639	193,091	260,397
Adjustments for:					
Interest expenses	11,130	17,753	37,520	22,872	21,555
Interest income	(7,514)	(8,230)	(4,228)	(3,662)	(2,838)
Depreciation and amortization	48,027	53,795	42,083	33,340	27,093
Amortization of government grants	(333)	(680)	(3,569)	(2,670)	(2,817)
Provision for warranty	4,497	12,272	8,149	7,855	7,760
(Reversal of provision) provision of inventories	(805)	(176)	(5,042)	219	143
Share of result of a jointly controlled entity	—	—	—	—	(281)
Unrealized profit on sale to a jointly controlled entity	—	—	—	—	648
Allowance for (reversal of) doubtful debts	322	(272)	(7)	(7)	55
Loss (gain) on disposal of property, plant and equipment	314	64	232	204	(261)
Operating cash flows before movements in working capital	115,149	224,348	379,777	251,242	311,454
(Increase) decrease in inventories	(46,600)	(42,557)	35,208	(6,396)	(17,273)
Decrease (increase) in trade and other receivables	8,276	(70,430)	(327,193)	(260,499)	(161,824)
Increase in trade and other payables and other tax payables	440,972	143,671	383,668	334,498	2,023
(Increase) decrease in amounts due from related companies	(386,681)	(294,195)	(236,310)	(333,834)	107,601
Increase (decrease) in amounts due to related companies	19,164	29,541	46,298	(3,910)	(14,033)
Cash generated from (used in) operations	150,280	(9,622)	281,448	(18,899)	227,948
Income tax paid	—	—	(13,785)	(13,735)	(31,536)
NET CASH FROM (USED IN) OPERATING ACTIVITIES	150,280	(9,622)	267,663	(32,634)	196,412
INVESTING ACTIVITIES					
Repayment from a related company	—	—	80,000	80,000	—
Interest received	3,619	4,330	2,257	1,691	2,838
Receipt from government grants	1,101	28,091	400	400	1,550
Purchase of property, plant and equipment	(10,841)	(31,866)	(58,639)	(47,038)	(32,049)
Deposits paid for acquisition of property, plant and equipment and prepaid lease payments	(24,240)	(9,590)	(6,928)	(5,295)	(1,205)
Proceeds for disposal of property, plant and equipment	841	183	81	—	791
Purchase of leasehold land	—	(50,632)	—	—	—
Investment in a jointly controlled entity	—	—	—	—	(50,000)
Development costs paid	(2,127)	—	(26,772)	—	(47,136)
Withdrawal of pledged bank deposits	284,244	455,769	617,332	445,367	443,270
Placement of pledged bank deposits	(448,608)	(394,119)	(633,230)	(423,429)	(296,233)
NET CASH (USED IN) FROM INVESTING ACTIVITIES	(196,011)	2,166	(25,499)	51,696	21,826
FINANCING ACTIVITIES					
Interest paid	(11,130)	(17,753)	(46,951)	(24,711)	(23,380)
New bank borrowings raised	100,000	144,950	213,950	153,950	134,950
Issuance of shares	—	—	123,530	—	—
Repayment of bank borrowings	(25,000)	(93,000)	(226,950)	(166,950)	(103,950)
Advances from shareholders	—	—	32,771	—	—
Advance to a shareholder	—	—	(32,771)	—	—
Advance from a related company	1,115	—	1,570	—	—
Repayment to a related company	(803)	(1,082)	(46,342)	(40,000)	(1,609)
Other loan raised	—	4,000	—	—	—
NET CASH FROM (USED IN) FINANCING ACTIVITIES	64,182	37,115	18,807	(77,711)	6,011
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	18,451	29,659	260,971	(58,649)	224,249
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR/PERIOD	18,666	37,117	66,776	66,776	327,747
CASH AND CASH EQUIVALENTS AT END OF THE YEAR/PERIOD, represented by bank balances and cash	37,117	66,776	327,747	8,127	551,996

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NOTES TO THE FINANCIAL INFORMATION**1. GENERAL**

The Company was incorporated as an exempted company with limited liability in the Cayman Islands under the Companies Law (2010 Revision) of the Cayman Islands on March 10, 2011. The addresses of the registered office and the principal place of business of the Company are set out in Corporate Information section of the Document.

The principal activities of the Company and Southern State are investment holding. The principal activity of Mianyang Xincheng is the development, manufacture and sale of automotive engines for passenger vehicles and light duty commercial vehicles in the PRC.

2. BASIS OF PRESENTATION OF FINANCIAL INFORMATION

Mianyang Xincheng was established as a Sino-foreign equity joint venture enterprise in the PRC in 1998 by two shareholders, namely Southern State, a then wholly owned subsidiary of Brilliance China Automotive Holdings Limited (“Brilliance China”, Brilliance China and its subsidiaries collectively referred to as “Brilliance China Group”), a company listed on the Stock Exchange, and Mianyang Xinhua Internal Combustion Engine Joint-Stock Company Limited* 綿陽新華內燃機股份有限公司 (“Xinhua Combustion Engine”), a state-owned company established in the PRC, which held their interests in Mianyang Xincheng in equal shares. The directors of the Company consider the ultimate holding company of Xinhua Combustion Engine to be Sichuan Province Yibin Wuliangye Group Co., Ltd.* 四川省宜賓五糧液集團有限公司 (“Wuliangye”, Wuliangye and its subsidiaries collectively referred to as “Wuliangye Group”), which is a state-owned enterprise established in the PRC. Brilliance China is an associate of Huachen Automotive Group Holdings Company Limited* 華晨汽車集團控股有限公司 (“Huachen”, Huachen and its subsidiaries collectively referred to as “Huachen Group”), which is also a state-owned enterprise established in the PRC.

The key reorganization steps that Mianyang Xincheng underwent include: (1) the incorporation of the following offshore entities: (a) Brilliance Investment Holdings Limited (“Brilliance Investment”) was incorporated in the BVI on February 28, 2011 with the sole shareholder of Brilliance Investment being Brilliance China; (b) the Company was incorporated in the Cayman Islands on March 10, 2011 with the sole shareholder of the Company being Brilliance Investment; and (c) Xinhua Investment Holdings Limited (“Xinhua Investment”) was incorporated in the BVI on May 19, 2011 with the sole shareholder of Xinhua Investment being Xinhua Combustion Engine; (2) Brilliance China and the Company entered into an instrument of transfer on July 1, 2011, pursuant to which Brilliance China transferred the entire issued share capital of Southern State to the Company at the consideration of US\$1; (3) Southern State acquired a 50% equity interest in Mianyang Xincheng from Xinhua Combustion Engine through an auction for a consideration of approximately RMB354,654,000, as determined based on a valuation report of Mianyang Xincheng prepared by Beijing Zhongqihua Asset Valuation Co., Ltd.* 北京中企華資產評估有限責任公司, an independent and recognized business valuer with its principal place of business at Room 901, FanLi Place, Chao Yang Men Wai Street, Beijing (“Mianyang Xincheng Valuation Report”), which was completed on August 29, 2011; and (4) the Company issued and allotted new shares to Xinhua Investment on August 29, 2011, which was equal to 50% of the Company’s enlarged issued share capital.

The Group Reorganization was completed on August 29, 2011. The Group Reorganization mainly involved the insertion of investment holding companies between the two shareholders of Mianyang Xincheng and Mianyang Xincheng. Mianyang Xincheng was indirectly beneficially owned by Brilliance China Group and Wuliangye Group in equal shares before and upon the completion of the Group

* English name for reference only.

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Reorganization. Accordingly, the Financial Information of the Group for the Track Record Period has been prepared as if the Company had always been the holding company of Mianyang Xincheng throughout the Track Record Period. Prior to completion of the Group Reorganization, the financial impact of the investment holding companies was insignificant. As a result, the consolidated financial statements of the Group for the period prior to the completion of the Group Reorganization mainly reflects the financial information of Mianyang Xincheng.

The Financial Information is presented in Renminbi (“RMB”), which is same as the functional currency of the Company and its subsidiaries.

3. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

For the purpose of preparing and presenting the Financial Information of the Track Record Period, the Group has consistently adopted the Hong Kong Accounting Standards (“HKASs”), HKFRSs, amendments and Interpretations (“HK(IFRIC)-Int”), which are effective for the accounting period beginning on January 1, 2012 throughout the Track Record Period.

At the date of this report, the HKICPA has issued the following new and revised standards, amendments and interpretations which are not yet effective. The Group has not early adopted these standards, amendments and interpretation in the preparation of the Financial Information for the Track Record Period.

Amendments to HKFRSs	Annual Improvements to HKFRSs 2009-2011 Cycle ¹
Amendments to HKFRS 1	Government Loans ¹
Amendments to HKFRS 7	Disclosures—Offsetting Financial Assets and Financial Liabilities ¹
Amendments to HKFRS 9 and HKFRS 7	Mandatory Effective Date of HKFRS 9 and Transition Disclosures ²
Amendments to HKFRS 10 HKFRS 11 and HKFRS 12	Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance ¹
Amendments to HKFRS 10 HKFRS 12 and HKAS 27	Investment Entities ⁴
HKFRS 9	Financial Instruments ²
HKFRS 10	Consolidated Financial Statements ¹
HKFRS 11	Joint Arrangements ¹
HKFRS 12	Disclosure of Interests in Other Entities ¹
HKFRS 13	Fair Value Measurement ¹
Amendments to HKAS 1	Presentation of Items of Other Comprehensive Income ³
HKAS 19 (Revised in 2011)	Employee Benefits ¹
HKAS 27 (Revised in 2011)	Separate Financial Statements ¹
HKAS 28 (Revised in 2011)	Investments in Associates and Joint Ventures ¹
Amendments to HKAS 32	Offsetting Financial Assets and Financial Liabilities ⁴
HK (IFRIC)-Int 20	Stripping Costs in the Production Phase of a Surface Mine ¹

¹ Effective for annual periods beginning on or after January 1, 2013.

² Effective for annual periods beginning on or after January 1, 2015.

³ Effective for annual periods beginning on or after July 1, 2012.

⁴ Effective for annual periods beginning on or after January 1, 2014.

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The directors of the Company anticipate that the application of these new and revised standards, amendments and interpretations will have no material impact on the Financial Information.

4. SIGNIFICANT ACCOUNTING POLICIES

The Financial Information has been prepared in accordance with the HKFRSs issued by the HKICPA. In addition, the Financial Information includes applicable disclosures required by the [●] and by the Hong Kong Companies Ordinance.

The Financial Information has been prepared on the historical cost basis, as explained in the accounting policies set out below. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

The principal accounting policies are set out below.

Basis of consolidation

The Financial Information incorporates the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

Jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are initially recognized in the consolidated statement of financial position at cost and adjusted thereafter to recognize the Group’s share of the profit or loss and other comprehensive income of the jointly controlled entities. When the Group’s share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group’s net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. Additional losses are recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

The requirements of HKAS 39 are applied to determine whether it is necessary to recognize any impairment loss with respect to the Group’s investment in a jointly controlled entity. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with HKAS 36 *Impairment of Assets* as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss

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recognized forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognized in accordance with HKAS 36 to the extent that the recoverable amount of the investment subsequently increases.

Upon disposal of a jointly controlled entity that results in the Group losing joint control over that jointly controlled entity, any retained investment is measured at fair value at that date and the fair value is regarded as its fair value on initial recognition as a financial asset in accordance with HKAS 39. The difference between the previous carrying amount of the jointly controlled entity attributable to the retained interest and its fair value is included in the determination of the gain or loss on disposal of the jointly controlled entity. In addition, the Group accounts for all amounts previously recognized in other comprehensive income in relation to that jointly controlled entity on the same basis as would be required if that jointly controlled entity had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognized in other comprehensive income by that jointly controlled entity would be reclassified to profit or loss on the disposal of the related assets or liabilities, the Group reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses joint control over that jointly controlled entity.

When a group entity transacts with its jointly controlled entity, profits and losses resulting from the transactions with the jointly controlled entity are recognized in the Group’s consolidated financial statements only to the extent of interests in the jointly controlled entity that are not related to the Group.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold and services provided in the normal course of business net of discounts and sales related taxes.

Revenue from the sale of goods is recognized when goods are delivered to and accepted by the customers. Advances received from customers prior to meeting the criteria for revenue recognition are included in the consolidated statement of financial position under current liabilities.

Service income is recognized when services are provided.

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Group and the amount of income can be measured reliably. Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset’s net carrying amount on initial recognition.

Property, plant and equipment

Property, plant and equipment including land and buildings held for use in the production or supply of goods or services, or for administrative purposes (other than construction in progress as described below) are stated in the consolidated statement of financial position at cost less subsequent accumulated depreciation and accumulated impairment losses, if any.

Depreciation is recognized so as to write off the cost of items of property, plant and equipment other than construction in progress less their residual values over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Properties in the course of construction for production, supply or administrative purposes are carried at cost, less any recognized impairment loss. Costs include professional fees and, for qualifying assets, borrowing costs capitalized in accordance with the Group’s accounting policy. Such properties are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

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An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

Prepaid lease payments

Payments for obtaining land use rights are accounted for as prepaid lease payments and are charged to profit or loss on a straight-line basis over the lease terms as stated in the relevant land use rights certificates granted for usage by the Group in the PRC and the remaining terms of the operating licence of the PRC entity, whichever is the shorter. Prepaid lease payments which are to be charged to profit or loss in the next twelve months are classified as current assets.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessee

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchange prevailing on the dates of the transactions. At the end of the reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are recognized in profit or loss in the period in which they arise.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

Government grants

Government grants are not recognized until there is reasonable assurance that the Group will comply with the conditions attaching to them and that the grants will be received.

Government grants are recognized in profit or loss on a systematic basis over the periods in which the Group recognizes as expenses the related costs for which the grants are intended to compensate.

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Specifically, government grants whose primary condition is that the Group should purchase, construct or otherwise acquire non-current assets are recognized as deferred income in the consolidated statement of financial position and transferred to profit or loss over the useful lives of the related assets. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Group with no future related costs are recognized in profit or loss in the period in which they become receivable.

The benefit of a government loan received at a below-market rate of interest is treated as a government grant, measured as the difference between proceeds received and the fair value of the loan based on prevailing market interest rates.

Retirement benefit costs

Payments to the state-managed retirement benefit scheme are recognized as expense when employees have rendered service entitling them to the contributions.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year/period. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and a jointly controlled entity, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the

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carrying amount of its assets and liabilities. Current and deferred tax is recognized in profit or loss, except when it relates to items that are recognized in other comprehensive income or directly in equity, in which case the current and deferred tax is also recognized in other comprehensive income or directly in equity respectively.

Intangible assets

Research and development expenditure

Expenditure on research activities is recognized as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development activities (or from the development phase of an internal project) is recognized if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognized for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognized, development expenditure is charged to profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible assets are measured at cost less accumulated amortization and accumulated impairment losses (if any).

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sales.

Financial instruments

Financial assets and financial liabilities are recognized in the consolidated statements of financial position when a group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Financial assets

The Group's financial assets are classified as loans and receivables. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

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Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest income is recognized on an effective interest basis for debt instruments.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables (including trade and other receivables, loan to a related company, amounts due from related companies, loan to a shareholder, pledged bank deposits and bank balances and cash) are carried at amortized cost using the effective interest method, less any identified impairment losses (see accounting policy on impairment loss on financial assets below).

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of the reporting period. Financial assets are considered to be impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial assets have been affected.

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as default or delinquency in interest and principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, or an observable change in local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the assets' carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

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For financial assets measured at amortized cost, if, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Financial liabilities and equity instruments

Financial liabilities and equity instruments issued by a group entity are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest expense is recognized on an effective interest basis.

Financial liabilities

Financial liabilities, including trade and other payables, loans from related companies, amounts due to related companies, bank borrowings, loans from shareholders and other loan, are subsequently measured at amortized cost using the effective interest method.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Derecognition

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group continues to recognize the asset to the extent of its continuing involvement and recognizes an associated liability. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

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Provision for warranty claims

Provision for warranty claims is recognized when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation, and a reliable estimate can be made of the amount of the obligation. Provisions for warranty claims are measured at the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision for warranty claims is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

Impairment of tangible and intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. When it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that they may be impaired.

Recoverable amount is the higher of fair values less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or a cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or a cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized as income immediately.

Share-based payment transactions***Restricted shares***

Share-based compensation expense related to restricted shares issued pursuant to the Group’s share incentive plan is generally determined based on the fair value of the shares issued on the business day immediately prior to the date of grant. Subsequent to the date of grant, compensation expense is amortized to profit or loss over the corresponding vesting period, if any.

5. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group’s accounting policies, which are described in Note 4, the management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Depreciation and impairment of property, plant and equipment

The Group's management determines the estimated useful lives, residual value and related depreciation charges for its property, plant and equipment. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment of similar nature and functions. Management will increase the depreciation charge where useful lives are expected to be shorter than previously estimated, or it will write-off or write-down obsolete or non-strategic assets that have been abandoned or sold. Change in these estimations may have a material impact on the results of the Group.

The Group tests whether property, plant and equipment has suffered any impairment in accordance with its accounting policy whenever there is any indication that the assets may have been impaired. The recoverable amounts of property, plant and equipment have been determined based on the discounted cash flow method. The directors consider that the recoverable amount exceeded the carrying amount of the property, plant and equipment and, therefore, no impairment was recognized during the Track Record Period.

At as December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of property, plant and equipment were approximately RMB220,915,000, RMB231,802,000, RMB278,262,000 and RMB323,650,000, respectively.

Amortization and impairment of intangible assets

The Group's management determines the estimated useful lives and related amortization charges for its intangible assets. This estimate is based on the historical experience of the actual useful lives of intangible assets of similar nature and functions. Management will increase the amortization charge where useful lives are expected to be shorter than previously estimated, or it will write-off or write-down obsolete or non-strategic assets that have been abandoned or sold.

The Group tests whether intangible assets have suffered any impairment in accordance with its accounting policy whenever there is any indication that the assets may have been impaired. The recoverable amounts of intangible assets have been determined based on the discounted cash flow method. The directors consider that the recoverable amount exceeded the carrying amount of the intangible assets and, therefore, no impairment was recognized during the Track Record Period.

As at December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of intangible assets were approximately RMB23,768,000, RMB11,597,000, RMB43,695,000 and RMB72,978,000, respectively.

Provision of inventories

The Group records inventories at the lower of cost and net realisable value. Net realisable value is the estimated selling price for inventories, less all the estimated costs of completion and costs necessary to make the sales. Operational procedures have been in place to monitor this risk as a significant proportion of the Group's working capital is devoted to inventories. The management reviews the inventory aging listing on a periodic basis for those aged inventories. This involves a comparison of carrying value of the aged inventory items with the respective net realisable value. The purpose is to ascertain whether allowance is required to be made in the financial statements for any obsolete and slow moving items. Although the Group carries out periodic review on the net realisable value of inventory, the actual realisable value of inventory is not known until the sale is concluded.

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As at December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of inventories were approximately RMB208,635,000, RMB251,368,000, RMB221,202,000 and RMB238,332,000, respectively.

Estimated impairment of trade receivables and amounts due from related companies and loan to a related company

When there is objective evidence of impairment loss, the Group takes into consideration the estimation of future cash flows. The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). Where the actual future cash flows are less than expected, a material impairment loss may arise. As at December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of trade receivables were approximately RMB51,923,000, RMB33,136,000, RMB245,437,000 and RMB380,321,000, respectively (net of allowance for doubtful debts of RMB322,000, RMB50,000, RMB43,000 and RMB98,000 as at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively). As at December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of amounts due from related companies which are trade receivables were approximately RMB458,105,000, RMB701,400,000, RMB892,816,000 and RMB942,549,000, respectively. As at December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of loan to a related company were approximately RMB77,625,000, RMB78,029,000, Nil and Nil, respectively.

Provision for warranty claims

Provision for warranty is made based on the possible claims on the products by customers with reference to the warranty coverage period and the percentage of warranty expenses incurred over total sales amounts during the Track Record Period. Where the actual claims are greater than expected, a material increase in warranty expenses may arise, which would be recognized in profit or loss for the period in which such a claim takes place. As at December 31, 2009, 2010 and 2011 and September 30, 2012, the carrying amounts of provision for warranty claims were approximately RMB51,000, RMB7,442,000, RMB5,280,000 and RMB5,119,000, respectively.

6. REVENUE AND SEGMENT INFORMATION

Information reported to the Board of Directors of the Company, being the chief operating decision maker, for the purpose of resource allocation and assessment of segment performance focuses on types of goods delivered or services provided.

Segment revenue and segment results

The Board of Directors of the Company review operating results and financial information on a product by product basis. Each individual engine product constitutes an operating segment. For certain operating segments that exhibit similar long-term financial performance as they have similar economic characteristics, are produced by using similar production processes and are distributed and sold to similar classes of customers, their segment information is aggregated into a single reportable operating segment. The Group has three reportable operating segments as follows:

- (1) Gasoline engines;
- (2) Diesel engines; and
- (3) Engine components and service income.

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The following is an analysis of the Group's revenue and results by reportable segment for the Track Record Period:

For the year ended December 31, 2009

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Segment revenue-external	983,650	275,220	26,297	1,285,167
Segment results	<u>124,615</u>	<u>39,013</u>	<u>6,780</u>	170,408
Unallocated income				10,197
Unallocated expenses				
Selling and distribution expenses				(52,018)
Administrative expenses				(44,378)
Finance costs				(11,130)
Other expenses				<u>(13,568)</u>
Profit before tax				<u>59,511</u>

Other segment information included in the measurement of segment results:

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Depreciation and amortization	29,694	11,516	—	41,210
(Reversal of provision) provision of inventories ..	(820)	15	—	(805)

For the year ended December 31, 2010

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Segment revenue — external	1,557,768	352,208	35,138	1,945,114
Segment results	<u>223,721</u>	<u>70,070</u>	<u>7,499</u>	301,290
Unallocated income				11,144
Unallocated expenses				
Selling and distribution expenses				(65,845)
Administrative expenses				(55,419)
Finance costs				(17,753)
Other expenses				<u>(23,595)</u>
Profit before tax				<u>149,822</u>

Other segment information included in the measurement of segment results:

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Depreciation and amortization	33,054	10,683	—	43,737
(Reversal of provision) provision of inventories ..	(249)	73	—	(176)

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For the year ended December 31, 2011

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>
Segment revenue — external	1,803,574	463,365	40,809	2,307,748
Segment results	<u>344,313</u>	<u>118,931</u>	<u>13,364</u>	476,608
Unallocated income				10,012
Unallocated expenses				
Selling and distribution expenses				(48,611)
Administrative expenses				(62,638)
Finance costs				(37,520)
Other expenses				<u>(33,212)</u>
Profit before tax				<u><u>304,639</u></u>

Other segment information included in the measurement of segment results:

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>
Depreciation and amortization	16,880	16,862	—	33,742
Reversal of provision of inventories	(4,969)	(73)	—	(5,042)

For the nine months ended September 30, 2011 (unaudited)

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>
Segment revenue — external	1,145,302	319,292	35,402	1,499,996
Segment results	<u>221,451</u>	<u>81,991</u>	<u>(651)</u>	302,791
Unallocated income				6,643
Unallocated expenses				
Selling and distribution expenses				(29,737)
Administrative expenses				(46,772)
Finance costs				(22,872)
Other expenses				<u>(16,962)</u>
Profit before tax				<u><u>193,091</u></u>

Other segment information included in the measurement of segment results:

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>
Depreciation and amortization	18,015	8,796	—	26,811
Provision of inventories	168	51	—	219

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For the nine months ended September 30, 2012

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>
Segment revenue — external	1,559,926	358,602	27,740	1,946,268
Segment results	<u>292,090</u>	<u>89,706</u>	<u>8,196</u>	389,992
Unallocated income				6,361
Unallocated expenses				
Selling and distribution expenses				(40,214)
Administrative expenses				(49,891)
Finance costs				(21,555)
Other expenses				(24,577)
Share of result of a jointly controlled entity				<u>281</u>
Profit before tax				<u><u>260,397</u></u>

Other segment information included in the measurement of segment results:

	Gasoline engines	Diesel engines	Engine components and service income	Total
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>
Depreciation and amortization	17,660	3,122	—	20,782
(Reversal of provision) provision of inventories ..	(42)	185	—	143

The accounting policies of the reportable segments are the same as the Group’s accounting policies described in Note 4. Segment results represents the profit earned by each segment without allocation of selling and distribution expenses, administrative expenses, finance costs, other expenses and share of result of a jointly controlled entity. This is the measure reported to the directors for the purposes of resource allocation and performance assessment.

Segment assets and liabilities

The assets and liabilities of the Group are regularly reviewed by the Board of Directors of the Company as a whole and no discrete financial information on segment assets and segment liabilities is available, therefore the measure of total assets and total liabilities by reportable operating segment is not presented.

Geographical information

All of the Group’s operations and non-current assets are located in the PRC; and all of the Group’s revenue from external customers is attributed to the PRC, which is the country of domicile of Mianyang Xincheng.

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Information about major customers

Revenue from customers contributing over 10% of the total sales in all reportable segments of the Group during the Track Record Period is as follows:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Brilliance China Group	627,041	805,233	416,192	290,908	381,755
Subsidiaries of Dongfeng Automobile Co., Ltd.* 東風汽車股份有限公司 (“Dongfeng”)	296,065	380,828	651,790	397,782	513,068
Huachen Group	N/A ¹	270,414	661,627	382,368	485,440

¹ The corresponding revenue did not contribute over 10% of the total sales of the Group.

7. OTHER INCOME

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Bank interest income	3,619	4,330	2,257	1,691	2,838
Government grants (see Note 30)	1,962	2,607	5,062	2,920	3,117
Imputed interest on loan to a related company	3,895	3,900	1,971	1,971	—
Gain on disposal of property, plant and equipment	—	—	—	—	261
Others	721	307	722	61	145
	<u>10,197</u>	<u>11,144</u>	<u>10,012</u>	<u>6,643</u>	<u>6,361</u>

8. FINANCE COSTS

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Interest on borrowings wholly repayable within five years:					
Bank loans	5,553	8,188	10,097	7,564	9,426
Loans from related companies	2,000	2,000	1,900	1,500	—
Discounted bills	3,577	7,565	34,954	15,647	13,954
	11,130	17,753	46,951	24,711	23,380
Less: amounts capitalized	—	—	(9,431)	(1,839)	(1,825)
	<u>11,130</u>	<u>17,753</u>	<u>37,520</u>	<u>22,872</u>	<u>21,555</u>

Borrowing costs capitalized during the year ended December 31, 2011 and each of nine months ended September 30, 2011 (unaudited) and 2012 arose on the general borrowing pool and were calculated by applying a capitalization rate of 8.9%, 8.1% (unaudited) and 6.6%, respectively per annum to expenditure on qualifying assets incurred during that year/period.

* English name for reference only.

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9. INCOME TAX EXPENSE

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
PRC Enterprise Income Tax					
Current tax	—	—	44,471	28,853	37,910
Overprovision in prior year	—	—	—	—	(1,150)
	—	—	44,471	28,853	36,760
Deferred tax expense (credit) (see Note 31)	1,234	365	(221)	(329)	(132)
	1,234	365	44,250	28,524	36,628

Mianyang Xincheng enjoyed preferential enterprise income tax rates which were lower than the standard tax rate during the Track Record Period as approved by the relevant tax authorities in the PRC.

According to the Notice of the State Administration of Taxation of the PRC (中華人民共和國國家稅務總局) (“SAT”) and Sichuan Provincial Office, SAT (四川省國家稅務局) in 2001 and 2002 in relation to the opinions on the implementation of the Relevant Tax Treatment Policies for the Western China Development Plan 《國家稅務總局關於落實西部大開發有關稅收政策具體實施意見的通知》, Mianyang Xincheng enjoyed a preferential enterprise income tax rate of 15% from 2001 to 2010.

Pursuant to Cai Shui No. 104 [2008] Notice in relation to Taxation Policies in support of Recovery and Reconstruction after the Wenchuan Earthquake (《關於支持汶川地震災後重建有關稅收政策問題的通知》) promulgated by the Ministry of Finance of the PRC (中華人民共和國財政部) (“MOF”) and the SAT, Mianyang Xincheng was the affected entity located in the Wenchuan Earthquake affected area and was exempted from enterprise income tax for the year ended December 31, 2008. Pursuant to No.131 [2009] “Notice in relation to Extension of Tax Favourable Treatment Period” 《關於延長部份稅收優惠政策執行期限的通知》 promulgated by MOF, General Administration of Customs and the SAT, Mianyang Xincheng was approved to extend the tax exemption from the enterprise income tax for each of the years ended December 31, 2009 and 2010 in support of recovery and reconstruction after the Wenchuan earthquake.

Mianyang Xincheng was accredited as a “High and New Technology Enterprise” by the Science and Technology Bureau of Sichuan Province and relevant authorities in December 2008 for a term of three years, and was registered with the local tax authority to be eligible to the reduced 15% enterprise income tax rate from 2009 to 2011. The High and New Technology Enterprise qualification has been renewed in 2011, which entitles Mianyang Xincheng to enjoy such reduced tax rate for another three years until December 31, 2014. Accordingly, Mianyang Xincheng is subject to 15% enterprise income tax rate for the year ended December 31, 2011 and the nine months ended September 30, 2012. The qualification as a High and New Technology Enterprise will be subject to annual review by the relevant government authorities in the PRC.

No Hong Kong Profits Tax has been made as the Group’s income neither arises in, nor is derived from, Hong Kong.

The Group is not subject to PRC dividend withholding tax on the dividends paid prior to the completion of the Group Reorganization. Upon the completion of the Group Reorganization, Southern State, a non-PRC resident, will become a group entity and the immediate holding company of Mianyang Xincheng, a tax resident in the PRC. As a result, the Group will be subject to the PRC dividend withholding tax of 10% when and if undistributed earnings of Mianyang Xincheng are declared to be paid as dividends out of profits that arose on or after January 1, 2008. Deferred tax has not been provided for in the consolidated financial statements in respect of the tax effect of temporary

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differences attributable to accumulated undistributed earnings of Mianyang Xincheng as at December 31, 2009, 2010 and 2011 and September 30, 2012 amounted to approximately RMB4,370,000, RMB19,695,000, RMB45,742,000 and RMB68,027,000, respectively as the Company is able to control the timing of the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future. The directors of Mianyang Xincheng plan to set aside the undistributed profits of Mianyang Xincheng for investment purpose. If such amounts exceed the investment plan, the Group will recognize the deferred tax liabilities in respect of the withholding tax on the then undistributed profits.

The tax expense during the Track Record Period can be reconciled to the profit before tax per consolidated statements of comprehensive income as follows:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Profit before tax	59,511	149,822	304,639	198,174	260,397
Tax at PRC Tax rate of 15%	8,927	22,473	45,696	29,726	39,060
Tax effect of expenses not deductible for tax purpose	579	821	1,925	857	2,594
Tax effect of deductible temporary differences not recognized	3,530	5,302	5,589	5,059	4,036
Utilization of deductible temporary differences previously not recognized	(1,603)	(3,530)	(5,302)	(5,302)	(5,589)
Overprovision in prior year	—	—	—	—	(1,150)
Tax incentives on eligible expenditures (Note)	(1,862)	(1,449)	(3,658)	(1,816)	(2,323)
Tax exemption	(8,337)	(23,252)	—	—	—
Income tax expense	1,234	365	44,250	28,524	36,628

Note: The eligible expenditures represent research and development costs charged to profit or loss for the year/period, which is subject to an additional 50% tax deduction in the calculation of income tax expense.

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10. PROFIT FOR THE YEAR/PERIOD

Profit for the year/period has been arrived at after charging (crediting):

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Directors' remuneration (see Note 11)	812	844	846	342	593
Other staff costs	49,269	63,113	56,825	30,383	44,406
Contributions to retirement benefits scheme	2,626	3,660	5,514	3,950	6,598
Total staff costs	52,707	67,617	63,185	34,675	51,597
Depreciation of property, plant and equipment	36,194	40,992	30,646	25,344	24,452
Amortization of prepaid lease payments	422	632	1,401	1,039	1,080
Amortization of intangible assets (included in cost of sales)	11,411	12,171	10,036	6,957	1,561
Total depreciation and amortization	48,027	53,795	42,083	33,340	27,093
Research expenses (included in other expenses)	13,254	19,355	19,783	9,467	12,415
Amortization of capitalized development costs (included in total depreciation and amortization)	11,411	12,171	10,036	6,957	1,561
Total research and development costs	24,665	31,526	29,819	16,424	13,976
Auditors' remuneration	80	91	227	100	100
Exchange loss (gain), net	1	(2)	(666)	18	611
Allowance for (reversal of) doubtful debts	322	(272)	(7)	(7)	55
Included in cost of sales:					
Cost of inventories recognized as expense	1,114,759	1,643,824	1,831,140	1,197,205	1,556,276
(Reversal of provision) provision of inventories (see Note 21)	(805)	(176)	(5,042)	219	143
Provision for warranty	4,497	12,272	8,149	7,855	7,760
Included in other expenses:					
Loss on disposal of property, plant and equipment	314	64	232	204	—
Factory reallocation expenses (Note a)	—	4,176	2,276	1,810	—
[●] expenses	—	—	10,879	5,439	12,162

Note: (a) Factory reallocation expenses mainly represents transportation costs for moving the plant and machineries to the new production site.

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11. DIRECTORS' EMOLUMENTS AND EMPLOYEES' REMUNERATION

Directors' emoluments

Details of the emoluments paid to the directors of the Company during the Track Record Period are as follows:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Directors' fees	—	—	—	—	—
Salaries and allowances	231	231	234	189	290
Discretionary bonus	581	613	612	153	303
Contributions to retirement benefits scheme ...	—	—	—	—	—
	<u>812</u>	<u>844</u>	<u>846</u>	<u>342</u>	<u>593</u>

The emoluments of the directors on a named basis are as follows:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
<u>Executive Directors</u>					
Wu Xiao An 吳小安	—	—	—	—	100
Wang Yunxian 王運先	812	844	846	342	493
<u>Non-executive Directors</u>					
Qi Yumin 祁玉民	—	—	—	—	—
Li Peiqi 李培奇 (Resigned on April 24, 2012 and reappointed on August 29, 2012)	—	—	—	—	—
Tang Qiao 唐橋 (Resigned on August 29, 2012)	—	—	—	—	—
Tan Chengxu (譚成旭) (Resigned on April 24, 2012)	—	—	—	—	—
Lei Xiaoyang 雷小陽 (Resigned on November 16, 2011)	—	—	—	—	—
<u>Independent non-executive Directors</u>					
Huang Haibo 黃海波	—	—	—	—	—
Wang Jun 王隼	—	—	—	—	—
Yu Yanqi 于延琦 (Resigned on November 19, 2012)	—	—	—	—	—
Wang Songlin 王松林	—	—	—	—	—
	<u>812</u>	<u>844</u>	<u>846</u>	<u>342</u>	<u>593</u>

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Employees’ remuneration

Of the five highest paid individuals of the Group, 1, 1, 1, 1 (unaudited) and 1 is director of the Company whose emoluments are included above during the years ended December 31, 2009, 2010 and 2011 and the nine months ended September 30, 2011 (unaudited) and 2012, respectively. The remunerations of the remaining 4, 4, 4, 4 (unaudited) and 4 individuals are as follows:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB’000	RMB’000	RMB’000	RMB’000 (unaudited)	RMB’000
Salaries and allowances	369	377	376	248	239
Discretionary bonus	1,277	1,499	1,501	634	692
Contributions to retirement benefits scheme . . .	—	—	—	—	—
	<u>1,646</u>	<u>1,876</u>	<u>1,877</u>	<u>882</u>	<u>931</u>

The discretionary bonus is determined by reference to the individual performance of the directors and employees and approved by shareholders annually.

The directors and certain senior management have also been employed by the Brilliance China Group and Wuliangye Group and the payment of their contributions to retirement benefits scheme was centralized and made by the Brilliance China Group and Wuliangye Group for the Track Record Period, in which the amounts are considered as insignificant. [Mr. Wang Yunxian has held various positions in Mianyang Xincheng and Xinhua Combustion Engine and has resigned from all his positions in Xinhua Combustion Engine prior to the [●].]

The remunerations of each of the 5, 5, 4, 5 (unaudited) and 5 of the five highest paid individuals during the years ended December 31, 2009, 2010 and 2011 and the nine months ended September 30, 2011 (unaudited) and 2012, respectively are within HK\$1,000,000. The remunerations of one of the five highest paid individuals during the year ended December 31, 2011 was in the range of HK\$1,000,001 to HK\$1,500,000.

During the Track Record Period, no emoluments were paid by the Group to any of the directors of the Company or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

12. DIVIDENDS

No dividend has been paid or declared by the Company or Mianyang Xincheng during the Track Record Period.

13. EARNINGS PER SHARE

The calculation of the basic earnings per share for the Track Record Period is based on the profit for the year/period and weighted average number of shares of 800,000,000, 800,000,000, 823,815,000, 800,000,000 (unaudited) and 940,199,800 for years ended December 31, 2009, 2010 and 2011 and nine months ended September 30, 2011 (unaudited) and 2012, respectively. The number of shares for the purpose of basic earnings per share for the years ended December 31, 2009 and 2010 and the nine months ended September 30, 2011 (unaudited) is calculated based on the 800,000,000 ordinary shares of the Company after retrospective adjustment and assuming the capitalization issue on October 25, 2011 pursuant to the reorganization as described in the paragraph headed “change in share capital” in Appendix V to the Document had been effective on January 1, 2009. The weighted average number of shares for the year ended December 31, 2011 has been adjusted for the capital injection for that year.

No diluted earnings per share is presented for the Track Record Period as there was no potential dilutive ordinary share in issue.

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14. PROPERTY, PLANT AND EQUIPMENT

	<u>Buildings</u>	<u>Plant and machinery</u>	<u>Office equipment and others</u>	<u>Motor vehicles</u>	<u>Construction in progress</u>	<u>Total</u>
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
COST						
At January 1, 2009	49,787	249,309	16,516	8,688	24,364	348,664
Additions	—	8,447	1,366	571	36,232	46,616
Transfer	4,464	47,071	3,762	—	(55,297)	—
Disposals	—	(10)	(104)	(2,139)	—	(2,253)
At December 31, 2009	54,251	304,817	21,540	7,120	5,299	393,027
Additions	—	—	1,105	1,338	49,683	52,126
Transfer	34	5,439	299	—	(5,772)	—
Disposals	—	(36)	(251)	(592)	—	(879)
At December 31, 2010	54,285	310,220	22,693	7,866	49,210	444,274
Additions	8,397	—	1,209	1,631	66,182	77,419
Transfer	78,951	6,201	—	—	(85,152)	—
Disposals	—	(829)	(727)	(852)	—	(2,408)
At December 31, 2011	141,633	315,592	23,175	8,645	30,240	519,285
Additions	—	522	275	1,566	68,007	70,370
Transfer	45,028	23,851	—	—	(68,879)	—
Disposals	—	(106)	(106)	(1,791)	—	(2,003)
At September 30, 2012	186,661	339,859	23,344	8,420	29,368	587,652
DEPRECIATION						
At January 1, 2009	15,808	110,260	7,386	3,562	—	137,016
Provided for the year	9,549	23,014	2,553	1,078	—	36,194
Eliminated on disposals	—	—	(93)	(1,005)	—	(1,098)
At December 31, 2009	25,357	133,274	9,846	3,635	—	172,112
Provided for the year	10,534	25,964	3,100	1,394	—	40,992
Eliminated on disposals	—	(35)	(230)	(367)	—	(632)
At December 31, 2010	35,891	159,203	12,716	4,662	—	212,472
Provided for the year	5,379	21,452	3,011	804	—	30,646
Eliminated on disposals	—	(720)	(663)	(712)	—	(2,095)
At December 31, 2011	41,270	179,935	15,064	4,754	—	241,023
Provided for the period	5,683	16,022	2,048	699	—	24,452
Eliminated on disposals	—	(95)	(95)	(1,283)	—	(1,473)
At September 30, 2012	46,953	195,862	17,017	4,170	—	264,002
CARRYING VALUES						
At December 31, 2009	<u>28,894</u>	<u>171,543</u>	<u>11,694</u>	<u>3,485</u>	<u>5,299</u>	<u>220,915</u>
At December 31, 2010	<u>18,394</u>	<u>151,017</u>	<u>9,977</u>	<u>3,204</u>	<u>49,210</u>	<u>231,802</u>
At December 31, 2011	<u>100,363</u>	<u>135,657</u>	<u>8,111</u>	<u>3,891</u>	<u>30,240</u>	<u>278,262</u>
At September 30, 2012	<u>139,708</u>	<u>143,997</u>	<u>6,327</u>	<u>4,250</u>	<u>29,368</u>	<u>323,650</u>

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The above items of property, plant and equipment (other than construction in progress) are depreciated on a straight-line basis at the following rates per annum after taking into account the residual values:

Buildings for old factory premises	3 years (reassessed to 2 years commencing January 2011)
Buildings for new factory premises	30 years
Buildings for staff quarter	50 years
Plant and machinery	10 years
Office equipment and others	5 years
Motor vehicles	6 years

The buildings are located in the PRC and the carrying amounts of the buildings amounting to RMB84,982,000 and RMB130,010,000 as at December 31, 2011 and September 30, 2012, respectively, are in the process of obtaining the property ownership certificate.

The estimated economic life of old factory premises was originally determined at 30 years. The Wenchuan earthquake on May 12, 2008 (the "Earthquake") resulted in damage to the production premise and have been properly repaired. The production lines continued to be used and with no material suspension after the Earthquake. As a result, the management did not consider there to be an impairment indicator of the existing production premise.

In late 2008, the local government of Mianyang City started a plan for reconstruction and urban redevelopment after the Earthquake. Meanwhile, the board of directors of Mianyang Xincheng approved to relocate the production site for the expansion of its production capacity, following with the implementation of the relevant policies to encourage the automobile business by the central government.

In 2009, the Group accepted an offer of parcels of land located in the National High-Tech Industry Development Zone of Mianyang, Sichuan Province to reconstruct a new production facility considering that the parcels of land offered would allow for future business expansion. The phase I of the new production facility has been completed and commenced to operate in the year ended December 31, 2010.

In 2011, the Group reassessed the completion date of the phase II of the new production facility, which was originally in 2011, to 2012. As a result, the remaining useful life of the existing buildings has been revised from 3 years commencing January 2009 to 2 years commencing January 2011. This change in useful life has decreased the depreciation charge for the year ended December 31, 2011 by approximately RMB4,153,000.

The Group's buildings are located in the PRC.

The Group has pledged property, plant and equipment having the following carrying values to secure general banking facilities granted to the Group.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Buildings	18,275	9,780	6,672	3,564
Plant and machinery	147,458	129,845	120,578	141,188
	<u>165,733</u>	<u>139,625</u>	<u>127,250</u>	<u>144,752</u>

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15. PREPAID LEASE PAYMENTS

	<i>RMB’000</i>
CARRYING VALUES	
At January 1, 2009	15,580
Released to profit or loss	(422)
At December 31, 2009	15,158
Additions	50,632
Released to profit or loss	(632)
At December 31, 2010	65,158
Released to profit or loss	(1,401)
At December 31, 2011	63,757
Released to profit or loss	(1,080)
At September 30, 2012	<u>62,677</u>

	<u>At December 31,</u>			<u>At</u>
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>September 30,</u>
	<i>RMB’000</i>	<i>RMB’000</i>	<i>RMB’000</i>	<i>2012</i>
Analysed for reporting purpose:				<i>RMB’000</i>
Current assets	422	1,434	1,434	1,434
Non-current assets	<u>14,736</u>	<u>63,724</u>	<u>62,323</u>	<u>61,243</u>
	<u>15,158</u>	<u>65,158</u>	<u>63,757</u>	<u>62,677</u>

The Group’s prepaid lease payments comprise leasehold lands in the PRC under medium-term leases. Land use rights are released to profit or loss over the lease terms ranging from 42 to 50 years.

The Group has pledged land use rights having carrying values of approximately RMB15,158,000, RMB65,158,000, RMB63,757,000 and RMB62,677,000 as at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, to secure general banking facilities granted to the Group.

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16. INTANGIBLE ASSETS

	Completed development costs <i>RMB'000</i>	Development costs in progress <i>RMB'000</i>	Total <i>RMB'000</i>
COST			
At January 1, 2009	26,226	8,033	34,259
Additions	—	2,127	2,127
Transfer	10,160	(10,160)	—
At December 31, 2009 and December 31, 2010	36,386	—	36,386
Additions	—	42,134	42,134
At December 31, 2011	36,386	42,134	78,520
Additions	—	30,844	30,844
At September 30, 2012	36,386	72,978	109,364
AMORTIZATION			
At January 1, 2009	1,207	—	1,207
Charge for the year	11,411	—	11,411
At December 31, 2009	12,618	—	12,618
Charge for the year	12,171	—	12,171
At December 31, 2010	24,789	—	24,789
Charge for the year	10,036	—	10,036
At December 31, 2011	34,825	—	34,825
Charge for the period	1,561	—	1,561
At September 30, 2012	36,386	—	36,386
CARRYING VALUES			
At December 31, 2009	23,768	—	23,768
At December 31, 2010	11,597	—	11,597
At December 31, 2011	1,561	42,134	43,695
At September 30, 2012	—	72,978	72,978

Development costs of technical know-how of new automotive engines are both internally-generated and externally-generated and have finite useful lives and are amortized based on the expected saleable units of the new automotive engines.

17. INVESTMENT IN A SUBSIDIARY

THE COMPANY

It represents investment cost in, and deemed capital contribution by way of waiver of loans to, Southern State.

18. INVESTMENT IN A JOINTLY CONTROLLED ENTITY

	At September 30, 2012 <i>RMB'000</i>
Cost of unlisted investment in a jointly controlled entity	50,000
Share of result and other comprehensive income	281
Unrealized profit	(648)
	<u>49,633</u>

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Pursuant to a joint venture agreement entered into between Mianyang Xincheng and Dongfeng in December 2011, Changzhou Dongfeng Xincheng Engine Co., Ltd 常州東風新晨動力機械有限公司 (“Dongfeng JV”) was established on January 9, 2012 with registered capital of RMB250 million, which is owned as to 50% by Mianyang Xincheng and 50% by Dongfeng. The purpose of establishing Dongfeng JV is to construct an engine production facility with a planned production capacity of 200,000 units per annum to manufacture the joint venture branded engines for Dongfeng’s light-duty vehicles. Mianyang Xincheng’s estimated portion of the capital injection in relation to the Dongfeng JV is approximately RMB125 million, of which RMB50 million has been paid during the nine months ended September 30, 2012.

Summarized financial information respect of the Group’s interests in the jointly controlled entity which are accounted for using equity method is set out below.

	As at September 30, 2012
	RMB’000
Current assets	68,355
Non-current assets	22,519
Current liabilities	(27,379)
Non-current liabilities	(13,214)
The Group’s share of net assets	50,281
Unrealized profit on sale of engines to Dongfeng JV	(648)
	<u>49,633</u>
	Nine months ended September 30, 2012
	RMB’000
Income recognized in profit or loss	19,715
Expenses recognized in profit or loss	(19,434)
Other comprehensive income	—
The Group’s share of result for the period	<u>281</u>

19. LOAN TO A RELATED COMPANY

A loan was granted to Mianyang Huarui Automotive Company Limited* 綿陽華瑞汽車有限公司 (“Mianyang Huarui”), a subsidiary of Huachen Group, and was non-trade related, unsecured, interest free and was to be settled upon the completion of the group restructuring of Mianyang Huarui. The effective interest rate on the loan is 5% per annum. In the opinion of the directors, the group restructuring of Mianyang Huarui was expected to be completed within one year from December 31, 2009 and then again within one year from December 31, 2010 and, accordingly, the loan was classified as a current asset as at December 31, 2009 and 2010. In May 2011, Huarui settled the loan to Mianyang Xincheng by certain bills receivable issued by a bank and was collected in cash in November 2011.

20. LOAN TO A SHAREHOLDER/LOANS FROM SHAREHOLDERS

THE GROUP AND THE COMPANY

As detailed in Note 41, the Company has two trust arrangements to entitle the Group’s employees to subscribe for shares of the Company through Lead In Management Limited 領進管理有限公司 (“Lead

* English name for reference only.

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In") for their services to the Group. Under loan agreements dated October 18, 2011, each of the two shareholders of the Company, namely Brilliant Investment and Xinhua Investment, advanced loans in equal amounts of HK\$20,000,000 to the Company (collectively, the "Loans from Shareholders"). In return, (i) the Company lent an aggregate amount of HK\$40,000,000, equal to the Loans from Shareholders, to Lead In (the "Loan to a shareholder") and (ii) Lead In used the funding obtained from the Company to subscribe for 36,977,960 shares of the Company under the Discretionary Trust (see Note 41).

All the loans are non-trade related, unsecured, interest free and will be repayable within one year from the date of loan agreements by the Company and Lead In and, accordingly, they are classified as current assets and current liabilities, respectively. In October 2012, the loans have been further extended to October 2013.

21. INVENTORIES

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Raw material and components	52,330	50,150	93,159	136,652
Work-in-progress	18,640	26,676	20,648	20,869
Finished goods	137,665	174,542	107,395	80,811
	<u>208,635</u>	<u>251,368</u>	<u>221,202</u>	<u>238,332</u>

The inventories are net of provision of RMB6,101,000, RMB5,925,000, RMB883,000 and RMB1,026,000 as at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, which is determined with reference to the net realisable value of the inventory items. The reversal of provision of inventories for each of the years ended December 31, 2009, 2010 and 2011 are RMB805,000, RMB176,000, RMB5,042,000 respectively. The provision of inventories for the nine months ended September 30, 2012 is RMB143,000.

22. TRADE AND OTHER RECEIVABLES

THE GROUP

Trade and other receivables comprise the following:

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Trade receivables	52,245	33,186	245,480	380,419
Less: Allowance for doubtful debts	(322)	(50)	(43)	(98)
Trade receivables, net	51,923	33,136	245,437	380,321
Bills receivable	40,853	134,332	241,542	265,649
Total trade and bills receivables	92,776	167,468	486,979	645,970
Prepayments for purchase of raw materials and engine components	5,076	1,337	3,059	4,727
Other receivables	1,952	1,701	7,668	10,278
	<u>99,804</u>	<u>170,506</u>	<u>497,706</u>	<u>660,975</u>

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The Group generally allows a credit period of 30 to 60 days from the invoice date for trade receivables and a further 3 to 6 months for bills receivable to its external customers. The following is an aged analysis of trade receivables, net of allowance for doubtful debts, presented based on the invoice date at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 1 month	28,408	27,688	178,905	92,378
1 to 2 months	15,739	1,764	39,838	142,006
2 to 3 months	6,669	1,987	21,809	86,325
3 to 6 months	1,107	586	4,726	59,432
6 months to 1 year	—	1,044	2	160
Over 1 year	—	67	157	20
	<u>51,923</u>	<u>33,136</u>	<u>245,437</u>	<u>380,321</u>

The following is an aged analysis of bills receivable presented based on the bills issue date at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 3 months	40,073	77,247	172,836	154,329
3 to 6 months	780	57,085	68,706	110,140
	<u>40,853</u>	<u>134,332</u>	<u>241,542</u>	<u>264,469</u>

Before accepting any new customers, the Group assesses the potential customer's credit quality and defines its credit limit based on the reputation of the customers in the industry. Limits attributed to customers are reviewed regularly.

In determining the recoverability of trade and bills receivables, the Group considers any change in the credit quality of the trade and bills receivables from the date credit was initially granted up to the end of the reporting period. In the opinion of directors of the Company, the trade receivables not past due nor impaired at the end of each reporting period are of good credit quality.

Included in the Group's trade receivables balances are debtors with aggregate carrying amount of approximately RMB6,723,000, RMB2,631,000, RMB43,513,000 and RMB202,200,000 at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, which are past due as at the reporting date. Considering the high credibility of these customers, good track record with the Group and subsequent settlement, the management believes that no impairment allowance is necessary in respect of the remaining unsettled balances. The Group does not hold any collateral over these balances.

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Aging of trade receivables which are past due but not impaired:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Within 1 month	—	—	—	1,208
1 to 2 months	—	—	16,820	55,056
2 to 3 months	5,616	934	21,808	86,324
3 to 6 months	1,107	586	4,726	59,432
6 months to 1 year	—	1,044	2	160
Over 1 year	—	67	157	20
	<u>6,723</u>	<u>2,631</u>	<u>43,513</u>	<u>202,200</u>

Movement in the allowance for doubtful debts:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
At beginning of year/period	—	322	50	43
Impairment losses recognized on receivables	322	14	—	55
Amounts recovered during the year/period	—	(286)	(7)	—
At end of year/period	<u>322</u>	<u>50</u>	<u>43</u>	<u>98</u>

THE COMPANY

The other receivables of the Company represents deferred expenditure in relation to professional fees for proposed issue of new shares upon the [●].

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ACCOUNTANTS’ REPORT

23. AMOUNTS DUE FROM RELATED COMPANIES

THE GROUP

The amounts due from related companies are trade related with details as follows:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Huachen Group				
Mianyang Huarui	49,769	42,496	226,120	145,684
Shenyang Brilliance Power Train Machinery Co., Ltd. 瀋陽華晨動力機械有限公司	—	242,723	474,311	375,558
Mianyang Huaxiang Machinery Manufacturing Co., Ltd.* 綿陽華祥機械製造有限公司	—	13,368	68,685	27,234
Mianyang Huaxin Automobile Co., Ltd.* 綿陽華鑫汽車有限公司	11,554	10,321	4,903	—
Huachen	—	3,150	6,446	4,245
	<u>61,323</u>	<u>312,058</u>	<u>780,465</u>	<u>552,721</u>
Brilliance China Group				
Mianyang Brilliance Ruian Automotive Components Co., Ltd.* 綿陽華晨瑞安汽車零部件有限公司 (“Mianyang Ruian”)	216,477	183,916	272,745	—
Shenyang XingYuanDong Automobile Component Co., Ltd. 瀋陽興遠東汽車零部件有限公司 (“Xing Yuan Dong”)	14,593	3,535	3,535	341,698
Shenyang ChenFa Automobile Component Co., Ltd. 瀋陽晨發汽車零部件有限公司	228,920	316,289	1,262	222
Shenyang Brilliance JinBei Automobile Co., Ltd. 瀋陽華晨金杯汽車有限公司	10,892	10,516	3,817	4,929
	<u>470,882</u>	<u>514,256</u>	<u>281,359</u>	<u>346,849</u>
Wuliangye Group				
Sichuan Yi Bin Pushen Heavy Machinery Co., Ltd.* 四川省宜賓普什重機有限公司	—	86	86	—
Jointly controlled entity	—	—	—	54,739
	<u>532,205</u>	<u>826,400</u>	<u>1,061,910</u>	<u>954,309</u>

Analysed as:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Trade receivables	458,105	701,400	892,816	942,549
Bills receivable	74,100	125,000	169,094	11,760
	<u>532,205</u>	<u>826,400</u>	<u>1,061,910</u>	<u>954,309</u>

* English name for reference only.

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Amounts due from related companies are unsecured, interest free and with a credit period of 3 months from the invoice date and a further 3 to 6 months for bills receivable. The following is an aged analysis of trade receivables presented based on the invoice date at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 3 months	312,445	435,269	473,345	470,999
3 to 6 months	99,432	144,231	182,851	347,800
6 months to 1 year	17,653	105,435	232,406	122,816
Over 1 year	28,575	16,465	4,214	934
	<u>458,105</u>	<u>701,400</u>	<u>892,816</u>	<u>942,549</u>

The following is an aged analysis of bills receivable presented based on the bills issue date at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 3 months	74,100	100,000	159,962	10,020
3 to 6 months	—	25,000	9,132	1,740
	<u>74,100</u>	<u>125,000</u>	<u>169,094</u>	<u>11,760</u>

The Group's credit policy is that the credit is offered to related companies following financial assessment and an established payment record.

Included above are trade receivables due from related companies with aggregate carrying amounts of approximately RMB145,660,000, RMB266,131,000, RMB419,471,000 and RMB471,550,000 at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, which are past due as at the reporting date. The management of the Group has assessed these related companies to be financially sound and taking into consideration of the gradual and frequent repayments from those related companies, no impairment allowance is considered necessary in respect of these balances. In the opinion of the directors of the Company, the amounts due from related companies not past due nor impaired at the end of each reporting period are of good credit quality. The Group does not hold any collateral over these balances.

The aging of amounts due from related companies that are past due but not impaired is as follows:

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
3 to 6 months	99,432	144,231	182,851	347,800
6 months to 1 year	17,653	105,435	232,406	122,816
Over 1 year	28,575	16,465	4,214	934
	<u>145,660</u>	<u>266,131</u>	<u>419,471</u>	<u>471,550</u>

THE COMPANY

The amount due from a subsidiary is unsecured, interest free and repayable on demand.

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ACCOUNTANTS' REPORT

24. PLEDGED BANK DEPOSITS/BANK BALANCES AND CASH

THE GROUP

Bank balances and pledged bank deposits carry interest at market rates as follows:

	Bank balances	Pledged bank deposits
At December 31, 2009	0.36%	1.71% - 1.98%
At December 31, 2010	0.36%	2.25% - 2.50%
At December 31, 2011	0.01% - 0.50%	3.10% - 3.30%
At September 30, 2012	0.01% - 0.35%	2.60% - 2.80%

Pledged bank deposits represent deposits pledged to banks to secure bills payable issued to suppliers of the Group for the purchase of raw materials.

THE COMPANY

Bank balances carry interest rates at 0.01% at December 31, 2011 and September 30, 2012, respectively.

25. TRADE AND OTHER PAYABLES

THE GROUP

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Trade payables	307,943	383,991	559,447	598,206
Bills payable	252,816	304,236	413,158	261,535
Total trade and bills payables	560,759	688,227	972,605	859,741
Accrued purchase of raw materials	167,294	165,356	255,479	372,459
Construction payables	12,100	5,962	11,272	39,021
Payroll and welfare payables	23,535	35,349	37,257	26,909
Advances from customers	13,897	7,822	4,732	2,939
Provision for warranty (Note)	51	7,442	5,280	5,119
Other payables	9,682	13,735	25,716	18,923
	<u>787,318</u>	<u>923,893</u>	<u>1,312,341</u>	<u>1,325,111</u>

The credit period of trade payables and bills payable is normally within 3 months and 3 to 6 months, respectively. The following is an aged analysis of trade payables presented based on the invoice date at the end of each reporting period:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Within 3 months	258,887	316,380	440,911	351,556
3 to 6 months	44,489	56,657	98,943	209,411
6 months to 1 year	1,269	6,096	19,593	37,239
Over 1 year	3,298	4,858	—	—
	<u>307,943</u>	<u>383,991</u>	<u>559,447</u>	<u>598,206</u>

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The following is an aged analysis of bills payable, presented based on bills issue date at the end of each reporting period:

	At December 31,			At September 30,
	2009	2010	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 3 months	104,685	164,917	74,833	241,455
3 to 6 months	148,131	139,319	338,325	20,080
	<u>252,816</u>	<u>304,236</u>	<u>413,158</u>	<u>261,535</u>

Note:

The balance of provision for warranty represents management's best estimate of the Group's liability under the one year warranty granted on the sale of automotive engines and automotive engines components, based on prior experience and industry averages for defective products at the end of each reporting period.

The movement of warranty provision are as follows.

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
At beginning of year/period	1,053	51	7,442	7,442	5,280
Warranty provision charged to profit or loss . . .	4,497	12,272	12,938	7,855	7,760
Reversal of warranty provision	—	—	(4,789)	—	—
Warranty claimed by customers	(5,499)	(4,881)	(10,311)	(7,644)	(7,921)
At end of year/period	<u>51</u>	<u>7,442</u>	<u>5,280</u>	<u>7,653</u>	<u>5,119</u>

Included in warranty provision for the year ended December 31, 2010 was specific provision of RMB7 million related to claims for two new engine models which were reported by customers in 2010. After the investigation, it was noted that the claims involve emission of black smoke, which was caused by improper use and the wear and tear of combustion chamber, which was caused by the use of wrong type of fuel. Accordingly, the specific provision of RMB2.2 million was utilized and the remaining RMB4.8 million was reversed to profit or loss for the year ended December 31, 2011.

THE COMPANY

The trade and other payables of the Company represents accrued service fees.

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ACCOUNTANTS' REPORT

26. AMOUNTS DUE TO RELATED COMPANIES

THE GROUP

Details of amounts due to related companies are as follows:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Trade related:				
<u>Wuliangye Group</u>				
Xinhua Combustion Engine	33,474	59,679	101,871	73,266
Mianyang Ruian	—	—	—	14,944
Sichuan Yi Bin Pushen Auto Parts Co., Ltd*				
四川省宜賓普什汽車零部件有限公司	5,834	9,170	12,472	12,100
	<u>39,308</u>	<u>68,849</u>	<u>114,343</u>	<u>100,310</u>
Non-trade related:				
<u>Brilliance China Group</u>				
Brilliance China	—	—	28	311
Xing Yuan Dong	6,365	6,365	—	—
	<u>6,365</u>	<u>6,365</u>	<u>28</u>	<u>311</u>
<u>Wuliangye Group</u>				
Mianyang Jianmen Real Estate Development and				
Construction Limited Liability Company*				
綿陽劍門房地產開發建設有限責任公司	1,839	757	2,327	435
	<u>8,204</u>	<u>7,122</u>	<u>2,355</u>	<u>746</u>
	<u>47,512</u>	<u>75,971</u>	<u>116,698</u>	<u>101,056</u>

The trade related amounts are analysed as:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Trade payables	26,498	44,584	82,789	69,032
Bills payable	12,810	24,265	31,554	31,278
	<u>39,308</u>	<u>68,849</u>	<u>114,343</u>	<u>100,310</u>

The non-trade related amounts are analysed as:

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Bills payable	876	250	1,788	—
Other payables	7,328	6,872	567	746
	<u>8,204</u>	<u>7,122</u>	<u>2,355</u>	<u>746</u>

The trade related amounts are interest free, unsecured and with credit period of 3 to 6 months.

* English name for reference only.

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The aging of trade related amounts due to related companies presented based on the invoice date at the end of the reporting period is as follows:

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Within 3 months	25,561	36,848	69,857	50,413
3 to 6 months	917	7,391	7,754	14,593
6 months to 1 year	20	345	5,061	4,026
Over 1 year	—	—	117	—
	<u>26,498</u>	<u>44,584</u>	<u>82,789</u>	<u>69,032</u>

The bills payable are guaranteed by banks in the PRC and have maturities of 3 to 6 months. The following is an aged analysis of bills payable (trade related) presented based on the bills issue date at the end of the reporting period.

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Within 3 months	5,426	3,243	120	7,480
3 to 6 months	7,384	21,022	31,434	23,798
	<u>12,810</u>	<u>24,265</u>	<u>31,554</u>	<u>31,278</u>

The non-trade related amounts are interest free, unsecured and repayable on demand.

THE COMPANY

The amounts due to related companies represent amounts due to Brilliance China and Mianyang Xinchun. Such amounts are non-trade related, interest-free, unsecured and repayable on demand.

27. LOANS FROM RELATED COMPANIES

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Sichuan Yibin Pushi Group Co., Ltd.*				
四川省宜賓普什集團有限公司, a subsidiary of				
Wuliangye	20,000	20,000	—	—
Xing Yuan Dong	20,000	20,000	—	—
	<u>40,000</u>	<u>40,000</u>	<u>—</u>	<u>—</u>

The loans were used for funding the development of new products and technical know-how and were unsecured, bore interest at 5% per annum, had a term of 2 years and were repayable in 2010. The loans were fully settled as at December 31, 2011.

* English name for reference only.

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28. BANK BORROWINGS

	At December 31,			At September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
Bank borrowings repayable within one year	93,000	176,950	163,950	194,950
Bank borrowings repayable more than one year, but not exceeding two years	32,000	—	—	—
	125,000	176,950	163,950	194,950
Less: Amounts due for settlement within 12 months shown under current liabilities	(93,000)	(176,950)	(163,950)	(194,950)
Amounts due for settlement after 12 months	32,000	—	—	—
Secured	125,000	134,950	121,950	152,950
Unsecured	—	42,000	42,000	42,000
	125,000	176,950	163,950	194,950

All bank borrowings are denominated in RMB.

The ranges of effective interest rates (which are also equal to contractual interest rates) on the Group's bank borrowings are as follows:

	At December 31,			At September 30,
	2009	2010	2011	2012
Fixed-rate borrowings	5.31% to 5.5755%	5.31% to 5.625%	5.05% to 6.56%	6.00% to 6.56%
Variable-rate borrowings	Benchmark rate# x 105%	Benchmark rate# x 101%	Benchmark rate# x 110%	Benchmark rate# x 110%

People's Bank of China one-year RMB Lending Rate

The bank borrowings are secured by property, plant and equipment and land use rights as set out in Notes 14 and 15.

At December 31, 2009, 2010 and 2011 and September 30, 2012, the Group had available unutilized bank loan facilities of approximately RMB80,000,000, RMB57,000,000, RMB90,050,000 and RMB135,050,000, respectively.

29. OTHER LOAN

The other loan is an unsecured, interest-free loan of RMB4,000,000 received from Sichuan Development Holding Co., Ltd* 四川發展(控股)有限責任公司, a state-owned entity, for a term of 3 years and repayable in July 2013. The loan is used to finance the relocation of the new production plant after the Earthquake in the PRC.

* English name for reference only.

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30. DEFERRED INCOME

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Amounts credited to profit or loss during the year/period:					
Subsidies related to research activities					
(Note a)	1,429	1,927	1,350	250	300
Subsidies related to property, plant and equipment (Note b)	333	680	3,569	2,670	2,817
Other incentive subsidies (Note c)	200	—	143	—	—
	<u>1,962</u>	<u>2,607</u>	<u>5,062</u>	<u>2,920</u>	<u>3,117</u>

The movement of deferred income is as follows.

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
At beginning of year/period	3,000	3,768	31,179	31,179	28,010
Receipt of subsidies related to property, plant and equipment	1,101	28,091	400	400	1,550
Amount credited to profit or loss during the year/period	(333)	(680)	(3,569)	(2,670)	(2,817)
At end of year/period	<u>3,768</u>	<u>31,179</u>	<u>28,010</u>	<u>28,909</u>	<u>26,743</u>

Notes:

- The Group received the relevant government subsidies for research and development activities to enhance the competitiveness in the industry and to promote new products. The subsidies related to expensed research and development activities are recognized in profit or loss as the relevant expenses were incurred.
- The Group received government subsidies for the compensation of capital expenditures incurred for the plant and machinery. The amounts are deferred and amortized over the estimated useful lives of the respective assets.
- The Group received other incentive subsidies for improvement of working capital and immediate financial assistance to the operating activities of the Group. The amount also includes grants for compensation of expenses already incurred such as interest subsidies.

There are no unfulfilled conditions or other contingencies attached to the grants. The subsidies were granted on a discretionary basis to the Group during the Track Record Period.

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31. DEFERRED TAX

The following are the major deferred tax assets (liabilities) recognized and movements thereon during the Track Record Period:

	Temporary difference on				
	Receivables	Property, plant and equipment	Development costs	Inventories	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At January 1, 2009	—	173	2,083	152	2,408
Credit (charge) to profit or loss	114	(28)	(2,083)	763	(1,234)
At December 31, 2009	114	145	—	915	1,174
Charge to profit or loss	(41)	—	—	(324)	(365)
At December 31, 2010	73	145	—	591	809
(Charge) credit to profit or loss	(1)	—	681	(459)	221
At December 31, 2011	72	145	681	132	1,030
(Charge) credit to profit or loss	(72)	(145)	327	22	132
At September 30, 2012	—	—	1,008	154	1,162

32. PAID IN CAPITAL/SHARE CAPITAL

The paid in capital amounted to RMB200,008,000 at December 31, 2009 and 2010 and represented the fully paid and registered capital of Mianyang Xincheng.

Details of movement of the share capital of the Company are as follows:

	Number of shares	Amount HK\$
Ordinary shares of HK\$0.01 each		
Authorized:		
At date of incorporation, December 31, 2011 and September 30, 2012	8,000,000,000	80,000,000
Issued and fully paid:		
Issue of new shares at date of incorporation	1,000	10
Issue of new shares on August 29, 2011	1,000	10
Capitalization issue on October 25, 2011	799,998,000	7,999,980
Issue of new shares on October 31, 2011	46,200,000	462,000
Issue of new shares on October 31, 2011	93,999,794	939,998
At December 31, 2011 and September 30, 2012	940,199,794	9,401,998
		At December 31, 2011 and September 30, 2012
		RMB'000
Presented in financial statements		7,693

At the date of its incorporation on March 10, 2011, the authorized share capital of the Company was HK\$80,000,000 divided into 8,000,000,000 ordinary shares of HK\$0.01 each. On the same day, 1,000 ordinary shares were allotted and issued at HK\$0.01 each by the Company to Brilliance Investment for cash.

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In order to complete the Group Reorganization as stated in Note 2, on August 29, 2011, the Company issued 1,000 ordinary shares of HK\$0.01 each to Xinhua Investment by waive of loans repayable to Xinhua Investment of HK\$433,000,000 (equivalent to RMB354,654,000).

On October 25, 2011, the Company issued and allotted 399,999,000 ordinary shares of the Company of HK\$0.01 each, to each of Brilliance Investment and Xinhua Investment, by way of capitalization of the sum of HK\$7,999,980 (equivalent to RMB6,551,000) out of the special reserve account of the Company (the “Capitalization Issue”). Upon completion of the Capitalization Issue, each of Brilliance Investment and Xinhua Investment held 400,000,000 Shares, representing 50% of the then issued share capital of the Company.

On October 31, 2011, Dong Feng Motors Engineering Co., Limited 東風汽車工程有限公司 (“Dongfeng Motors Engineering”), a subsidiary of Dongfeng, entered into a subscription agreement with the Company, pursuant to which Dongfeng Motors Engineering subscribed for 46,200,000 ordinary shares of the Company, representing approximately 4.914% of the enlarged issued share capital of the Company at a consideration of approximately HK\$1.0817 per share, totalling approximately HK\$49,976,000 (equivalent to RMB40,707,000), as determined by the Mianyang Xinchun Valuation Report.

On October 31, 2011, Lead In, incorporated in the BVI on May 18, 2011, subscribed for 93,999,794 ordinary shares of the Company, representing approximately 9.998% of the enlarged issued share capital of the Company (“Lead In Subscribed Shares”) at a consideration of approximately HK\$1.0817 per share, totalling approximately HK\$101,682,000 (equivalent to RMB82,823,000), as determined based on the Mianyang Xinchun Valuation Report. The Lead In Subscribed Shares are held on trust for the beneficiaries under two separate trust arrangements as described in Note 41.

The new shares rank pari passu with the existing shares in all aspects.

33. RESERVES

THE COMPANY

	Share premium RMB'000	Special reserve RMB'000	Accumulated losses RMB'000	Total RMB'000
At January 1, 2011	—	—	—	—
Issuance of new shares (see Note 32)	122,388	—	—	122,388
Arising from group reorganization	—	348,103	—	348,103
Loss and total comprehensive expense for the year	—	—	(8,061)	(8,061)
At December 31, 2011	122,388	348,103	(8,061)	462,430
Loss and total comprehensive expense for the period	—	—	(1,136)	(1,136)
At September 30, 2012	122,388	348,103	(9,197)	461,294

34. CAPITAL RISK MANAGEMENT

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimization of the debt and equity balances. The Group’s overall strategy remains unchanged during the Track Record Period.

The capital structure of the Group consists of net debts (which include bank borrowings, non trade-related amounts due to related companies, loans from related companies and other loan), net of cash and cash equivalents and equity attributable to owners of the Company, comprising paid-in capital/ share capital, retained profits and other reserves.

The management of the Group reviews the capital structure periodically. As part of this review, the management considers the cost of capital and the risks associated with the capital. Based on

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recommendations of the management, the Group will balance its overall capital structure through the payment of dividends and raising of new capital as well as the issue of new debt or the redemption of existing debt.

35. FINANCIAL INSTRUMENTS

(a) Categories of financial instruments

THE GROUP

	Carrying amount at December 31,			Carrying amount at September 30,
	2009	2010	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000
<i>Financial assets</i>				
Loans and receivables (including cash and cash equivalents)	<u>1,009,898</u>	<u>1,347,226</u>	<u>2,136,631</u>	<u>2,267,668</u>
<i>Financial liabilities</i>				
At amortized cost	<u>985,159</u>	<u>1,204,380</u>	<u>1,618,785</u>	<u>1,639,062</u>

THE COMPANY

	Carrying amount at December 31,	Carrying amount at September 30,
	2011	2012
	RMB'000	RMB'000
<i>Financial assets</i>		
Loans and receivables (including cash and cash equivalents)	<u>146,161</u>	<u>144,749</u>
<i>Financial liabilities</i>		
At amortized cost	<u>33,692</u>	<u>33,416</u>

(b) Financial risk management objectives and policies

The management monitors and manages the financial risks relating to the operations of the Group through internal risk assessment which analyses exposures by degree and magnitude of risks. The risks included market risk (including interest rate risk), credit risk and liquidity risk. The policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group is exposed to cash flow interest rate risk on the variable rate of interest earned on the pledged bank deposits and bank balances and variable rate of interest incurred on bank borrowings. The Group is also exposed to fair value interest rate risk in relation to fixed-rate bank borrowings and loans from related companies. It is the Group's policy to maintain an appropriate level between its fixed-rate and variable-rate borrowings so as to minimise the fair value and cash flow interest rate risk. The Group's exposures to interest rates on financial liabilities are detailed in the liquidity risk management section of this note. The Group monitors interest rate exposure and will consider hedging significant interest rate exposure should the need arise.

Sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to interest rates for non-derivative instruments. The analysis is prepared assuming the financial instruments outstanding at

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the end of the reporting period were outstanding for the whole year/period. The following sensitivity analysis represents management's assessment of the reasonably possible change in interest rates.

Variable-rate borrowings

If interest rates of the variable-rate borrowings had been 50 basis points higher/lower than the lending benchmark interest rate stipulated by the People's Bank of China and all other variables were held constant, the Group's profit for the years ended December 31, 2009, 2010 and 2011 and nine months ended September 30, 2012 would decrease/increase by approximately RMB325,000, RMB265,000, RMB170,000 and RMB321,000, respectively.

Variable-rate bank balances

If interest rate of variable-rate bank balances had been 10 basis points higher/lower and all other variables were held constant, the Group's profit for the years ended December 31, 2009, 2010 and 2011 and nine months ended September 30, 2012 would increase/decrease by approximately RMB37,000, RMB67,000, RMB155,000 and RMB280,000, respectively.

Credit risk

At the end of each reporting period, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties is arising from the carrying amount of the respective recognized financial assets as stated in the consolidated statements of financial position and outstanding endorsed and discounted bills receivable as disclosed in Note 38.

In order to minimise the credit risk, the management of the Group reviews the recoverable amount of each individual debt at the end of the reporting period to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the management of the Group considers that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings.

The credit risk on bills receivable, including endorsed and discounted, is considered as minimal as such amounts are to be settled by or placed with banks with good reputation.

The Group has concentration of credit risk as 83%, 88%, 87% and 80% of the Group's total trade receivables and amounts due from related companies (trade related) as at December 31, 2009, 2010 and 2011 and September 30, 2012, respectively, were due from the five largest customers. Those five largest customers are with good creditworthiness based on historical settlement record. In order to minimise the concentration of credit risk, the management has delegated staff responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure follow-up action is taken to recover overdue debts. The management also performs periodic evaluations and customer visits to ensure the Group's exposure to bad debts is not significant and adequate impairment losses are made for irrecoverable amount. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

Liquidity risk

In the management of the liquidity risk, the Group closely monitors its cash position resulting from its operations and maintains a level of cash and cash equivalents deemed adequate by the management to

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meet in full its financial obligations as they fall due for the foreseeable future. The management also monitors the utilization of bank and other borrowings.

The following table details the Group's remaining contractual maturity for its financial liabilities based on the agreed repayment terms as at December 31, 2009, 2010 and 2011 and September 30, 2012. The table has been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows. To the extent that interest flows are floating rate, the undiscounted amount is derived from the interest rate at the end of the reporting period.

In addition, the following table details the Group's liquidity analysis for outstanding endorsed and discounted bills receivable. The tables have been drawn up based on the undiscounted contractual net cash outflows on endorsed and discounted bills receivable that could be required to be paid if the relevant bank defaults on payment. The liquidity analysis for the Group's endorsed and discounted bills receivable are prepared based on the contractual maturities as the management considers that the contractual maturities are essential for an understanding of the timing of the cash flows of endorsed and discounted bills receivable.

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Liquidity and interest risk tables

THE GROUP

	Weighted average interest rate	Repayable on demand or within 3 months	3-6 months	6 months to 1 year	Over 1 year	Total undiscounted cash flows	Carrying amount
	%	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At December 31, 2009							
Trade and other payables	—	397,413	201,531	6,409	—	605,353	605,353
Amounts due to related companies	—	30,987	10,140	6,385	—	47,512	47,512
Accrued purchase of raw material . .	—	167,294	—	—	—	167,294	167,294
Loans from related companies	5.00	—	—	42,000	—	42,000	40,000
Bank borrowings							
—Fixed rate	5.48	822	822	29,643	33,650	64,937	60,000
—Variable rate	5.58	53,906	12,112	—	—	66,018	65,000
Outstanding endorsed and discounted bills receivable		353,039	—	—	—	353,039	—
		<u>1,003,461</u>	<u>224,605</u>	<u>84,437</u>	<u>33,650</u>	<u>1,346,153</u>	<u>985,159</u>
At December 31, 2010							
Trade and other payables	—	531,141	196,871	14,091	—	742,103	742,103
Amounts due to related companies	—	40,091	28,662	7,218	—	75,971	75,971
Accrued purchase of raw material . .	—	165,356	—	—	—	165,356	165,356
Loans from related companies	5.00	40,000	—	—	—	40,000	40,000
Bank borrowings							
—Fixed rate	5.45	1,688	43,688	83,964	—	129,340	123,950
—Variable rate	5.36	53,474	—	—	—	53,474	53,000
Other loan	—	—	—	—	4,000	4,000	4,000
Outstanding endorsed and discounted bills receivable		627,225	—	—	—	627,225	—
		<u>1,458,975</u>	<u>269,221</u>	<u>105,273</u>	<u>4,000</u>	<u>1,837,469</u>	<u>1,204,380</u>
At December 31, 2011							
Trade and other payables	—	580,574	438,199	27,114	—	1,045,887	1,045,887
Amounts due to related companies	—	70,523	40,975	5,200	—	116,698	116,698
Accrued purchase of raw material . .	—	255,479	—	—	—	255,479	255,479
Loans from shareholders	—	—	—	32,771	—	32,771	32,771
Bank borrowings							
—Fixed rate	6.05	1,874	93,494	32,525	—	127,893	123,950
—Variable rate	6.94	694	694	40,925	—	42,313	40,000
Other loan	—	—	—	—	4,000	4,000	4,000
Outstanding endorsed and discounted bills receivable		678,857	—	—	—	678,857	—
		<u>1,588,001</u>	<u>573,362</u>	<u>138,535</u>	<u>4,000</u>	<u>2,303,898</u>	<u>1,618,785</u>
At September 30, 2012							
Trade and other payables	—	628,251	229,491	76,260	—	934,002	934,002
Amounts due to related companies	—	58,212	38,797	4,047	—	101,056	101,056
Accrued purchase of raw material . .	—	372,459	—	—	—	372,459	372,459
Loans from shareholders	—	32,595	—	—	—	32,595	32,595
Bank borrowings							
—Fixed rate	6.29	61,775	42,966	22,499	—	127,240	123,950
—Variable rate	6.85	1,215	72,029	—	—	73,244	71,000
Other loan	—	—	—	4,000	—	4,000	4,000
Outstanding endorsed and discounted bills receivable		583,521	—	—	—	583,521	—
		<u>1,738,028</u>	<u>383,283</u>	<u>106,806</u>	<u>—</u>	<u>2,228,117</u>	<u>1,639,062</u>

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THE COMPANY

	Weighted average interest rate	Repayable on demand or within 3 months	3-6 months	6 months to 1 year	Over 1 year	Total undiscounted cash flows	Carrying amount
	%	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At December 31, 2011							
Trade and other payables	—	95	—	—	—	95	95
Amounts due to related companies	—	826	—	—	—	826	826
Loans from shareholders	—	—	—	32,771	—	32,771	32,771
		<u>921</u>	<u>—</u>	<u>32,771</u>	<u>—</u>	<u>33,692</u>	<u>33,692</u>
At September 30, 2012							
Amounts due to related companies	—	821	—	—	—	821	821
Loans from shareholders	—	32,595	—	—	—	32,595	32,595
		<u>33,416</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>33,416</u>	<u>33,416</u>

The amounts included above for outstanding endorsed and discounted bills receivable are the maximum amounts the Group could be required to settle under the arrangement for the bills for the full guaranteed amount if that amount is defaulted by the counterparties to the guarantee. Based on expectations at the end of the reporting period, the Group considers that it is more likely than not that no amount will be payable under the arrangement. However, the estimate is subject to change depending on the probability of the default of the counterparties under the arrangement which is a function of the likelihood that the financial receivables held by the counterparties suffer credit losses.

(c) Fair value

The fair value of financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market conditions.

The directors of the Company consider that the carrying amounts of financial assets and financial liabilities recorded at amortized cost in the Financial Information approximate their fair values.

36. OPERATING LEASE

The Group as lessee

Minimum lease payments paid under operating lease during the Track Record Period:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
Warehouse	<u>120</u>	<u>100</u>	<u>100</u>	<u>75</u>	<u>75</u>

Operating lease payments represent rental payable by the Group for warehouse. Lease is negotiated and rental is fixed for an average of 1 year.

The Group had no commitments for future minimum lease payments under non-cancellable operating lease as lease is paid in full at initial date.

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37. CAPITAL COMMITMENTS

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Capital expenditure in respect of the acquisition of property, plant and equipment, prepaid lease payments and intangible assets:				
—contracted for but not provided in the Financial Information	5,999	57,098	52,357	19,241
—authorized but not contracted for	178,795	194,550	95,542	[326,615]
	<u>184,794</u>	<u>251,648</u>	<u>147,899</u>	<u>345,856</u>
Capital expenditure in respect of investment in a jointly controlled entity				
—contracted for but not provided in the Financial Information	—	—	125,000	75,000

38. CONTINGENT LIABILITIES

During the Track Record Period, the Group (i) endorsed certain bills receivable for the settlement of trade and other payables; and (ii) discounted certain bills receivable to banks for raising of cash. In the opinion of the directors, the obligations to the corresponding counterparties were discharged in accordance with the commercial practice in the PRC and the risk of the default in payment of the endorsed and discounted bills receivable is low because all endorsed and discounted bills receivable are issued and guaranteed by the reputable PRC banks. The maximum exposure to the Group that may result from the default of these endorsed and discounted bills receivable at the end of each reporting period are as follows:

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Settlement of trade and other payables	124,524	397,635	170,974	477,622
Discounted bills for raising of cash	228,515	229,590	507,883	105,899
Outstanding endorsed and discounted bills receivable with recourse	<u>353,039</u>	<u>627,225</u>	<u>678,857</u>	<u>583,521</u>

Maturity analysis of the outstanding endorsed and discounted bills receivable:

	At December 31,			At September 30,
	2009	2010	2011	2012
	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>	<u>RMB'000</u>
Within 3 months	180,074	188,351	242,544	491,422
3 to 6 months	172,965	438,874	436,313	92,099
	<u>353,039</u>	<u>627,225</u>	<u>678,857</u>	<u>583,521</u>

The directors of the Company consider that the carrying amounts of the endorsed and discounted bills receivable approximate their fair values.

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39. RELATED PARTY DISCLOSURES

The related party transactions in respect of items listed below and in Note 41 are expected to continue after the [●]:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
<u>Sale of goods</u>					
Brilliance China Group	627,041	805,233	416,192	290,908	381,755
Huachen Group	36,430	270,414	661,627	383,559	485,440
Wuliangye Group	—	—	—	—	182
Jointly controlled entity	—	—	—	—	46,786
	<u>663,471</u>	<u>1,075,647</u>	<u>1,077,819</u>	<u>674,467</u>	<u>914,163</u>
<u>Purchase of goods</u>					
Brilliance China Group	24,204	36,035	39,274	28,866	35,431
Huachen Group	—	—	7	7	10
Wuliangye Group	109,712	162,738	154,639	111,750	107,425
	<u>133,916</u>	<u>198,773</u>	<u>193,920</u>	<u>140,623</u>	<u>142,866</u>
<u>Rental charged</u>					
Wuliangye Group	120	100	100	75	75
<u>Maintenance and construction cost charged</u>					
Wuliangye Group	2,646	1,245	5,547	3,383	6,826

In addition to the above, the Group also had the following material related party transactions which are expected to be discontinued after the [●]:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB'000	RMB'000	RMB'000	RMB'000 (unaudited)	RMB'000
<u>Interest expense charged</u>					
Brilliance China Group	1,000	1,000	900	750	—
Wuliangye Group	1,000	1,000	1,000	750	—
	<u>2,000</u>	<u>2,000</u>	<u>1,900</u>	<u>1,500</u>	<u>—</u>

The above transactions were carried out in the ordinary course of business and conducted in accordance with the terms and conditions mutually agreed by both parties.

Balances with Brilliance China Group, Huachen Group and Wuliangye Group are disclosed in Notes 19, 20, 23, 26 and 27.

Transactions/balances with other state-controlled entities in the PRC

The Group operates in an economic environment currently predominated by entities directly or indirectly owned or controlled by the PRC government (“state-controlled entities”). The Group has entered into various transactions in the ordinary course of business, including deposits placements,

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borrowings and other general banking facilities, with banks which are PRC government related entities. In addition, the Group itself is jointly controlled by a subsidiary of Brilliance China and a subsidiary of Wuliangye, each of which are ultimately controlled by the PRC government. Apart from the transactions with Brilliance China Group, Huachen Group and Wuliangye Group disclosed above, the Group also conducts business with other state-controlled entities. The directors consider those state-controlled entities to be independent third parties so far as the Group’s business transactions with them are concerned.

Compensation of key management personnel

The remuneration of directors and other members of key management during the Track Record Period were as follows:

	Year ended December 31,			Nine months ended September 30,	
	2009	2010	2011	2011	2012
	RMB’000	RMB’000	RMB’000	RMB’000 (unaudited)	RMB’000
Short-term benefits	4,251	4,568	4,767	2,259	2,366
Post-employment benefits	—	—	—	—	—
	<u>4,251</u>	<u>4,568</u>	<u>4,767</u>	<u>2,259</u>	<u>2,366</u>

The directors and certain senior management have also been employed by the Brilliance China Group and Wuliangye Group and the payment of their post-employment benefits representing contributions to retirement benefits scheme was centralized and made by the Brilliance China Group and Wuliangye Group for the Track Record Period, and such amounts are considered as insignificant.

40. RETIREMENT BENEFIT PLAN

The employees of the Group are members of the state-managed retirement benefit scheme operated by the PRC government. Mianyang Xincheng is required to contribute a certain percentage of basic payroll costs to the retirement benefit scheme to fund the benefits. The only obligation of the Group with respect to the retirement benefit scheme is to make the required contributions under the scheme.

41. SHARE INCENTIVE SCHEME

During the year ended December 31, 2011, the Company established a share incentive scheme to provide an incentive to directors, management, employees and relevant personnel of the Group who have contributed or will make contributions to the development and growth of the Group (“Beneficiaries”) (the “Incentive Scheme”) which contains two trust arrangements, namely a fixed trust (the “Fixed Trust”) and a discretionary trust (the “Discretionary Trust”). On October 31, 2011, the Company issued 93,999,794 shares of the Company, representing approximately 9.998% of the enlarged issued share capital of the Company, to Lead In, which held on trust for the relevant Beneficiaries under the two trust arrangements at subscription price of HK\$1.0817 per share (see Note 32). The subscription price of HK\$1.0817 per share is considered as fair value since it was determined based on the Mianyang Xincheng Valuation Report, which was issued by an independent valuer for the purpose of Group Reorganization (see Note 2) and it was also used to determine the consideration for the shares issued to Dongfeng Motors Engineering (i.e. HK\$1.0817 per Share), which is an independent third party prior to its investment.

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Under the Fixed Trust, on October 31, 2011, the relevant Beneficiaries subscribed for 57,021,834 shares of the Company at HK\$1.0817 per share, which represented a price approximated fair value of each share at the date of issuance. Therefore, those shares granted under the Fixed Trust have not resulted in share-based payment expense for the Group.

The following table discloses the movements in the number of outstanding shares awarded during the year under the Fixed Trust:

	Number of shares awarded during the year and at December 31, 2011 and September 30, 2012	Vesting period
Directors	5,916,474	(a)
	5,916,474	(b)
	2,958,236	(c)
Employees	16,892,260	(a)
	16,892,260	(b)
	8,446,130	(c)
	<u>57,021,834</u>	
Exercisable at the end of the year/period	<u>—</u>	

The shares of the Company under the Fixed Trust are subject to three vesting periods: (a) from the [●] of the Company until the expiry date of the six-month period from the [●] (the “[●] Period”) (vesting period “a”); (b) the date following the first anniversary from the expiry date of the [●] Period (vesting period “b”); and (c) the date following the second anniversary from the expiry date of the [●] Period (vesting period “c”). The Fixed Trust will be terminated on (i) the date which is 10 years from the date of the trust deed (i.e. October 25, 2011); or (ii) the date on which the transfer of all the trust assets to the relevant Beneficiaries under the Fixed Trust is completed, whichever is earlier.

To the extent that Lead In receives any dividends from the Company prior to the transfer, Lead In will retain such dividends for the sole purpose of future subscriptions of the shares of the Company to award future Beneficiaries.

Under the Discretionary Trust, the relevant Beneficiaries will be entitled to subscribe for shares of the Company at the same subscription price paid by Lead In of HK\$1.0817 per share. During the year ended December 31, 2011, Lead In subscribed for 36,977,960 shares in the Company at HK\$1.0817 per share for the purpose of granting shares to the relevant Beneficiaries for services rendered or to be rendered to the Group. However, up to the date of this report, the Beneficiaries under the Discretionary Trust have not been identified and no shares of the Company held under the Discretionary Trust have been granted. Therefore, no share-based payment expenses have been recognized up to the date of this report.

Details of the trust arrangements are more fully explained under the paragraph “Incentive Scheme Established by Lead In” in the section headed “History and Reorganization” in the Document.

B. DIRECTORS’ REMUNERATION

Save as disclosed herein, no remuneration has been paid or is payable to the Company’s directors by the Company or any of its subsidiaries during the Track Record Period. Under the arrangements

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presently in force, the aggregate remunerations, excluding any discretionary bonus, if any, of the Company’s directors for the year ended December 31, 2012 is approximately RMB1,000,000.

C. SUBSEQUENT EVENTS

The Company has conditionally adopted a share option scheme on [●], 2012 to provide incentives or rewards to participants for their contribution to the Group and/or to enable the management of the Group to recruit and retain employees that are valuable to the Group. Details of the principal terms of the share option scheme are summarized under the paragraph “E. Share Option Scheme” in the section headed “Statutory and General Information” in Appendix V to the Document.

D. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements of the Group, the Company or any of its subsidiaries have been prepared in respect of any period subsequent to September 30, 2012.

Yours faithfully

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong

APPENDIX IV

SUMMARY OF THE CONSTITUTION OF THE COMPANY AND CAYMAN ISLANDS COMPANY LAW

Set out below is a summary of certain provisions of the Memorandum and Articles of Association of the Company and of certain aspects of Cayman Islands company law.

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on March 10, 2011 under the Companies Law. The Company's constitutional documents consist of its Amended and Restated Memorandum of Association (the "**Memorandum**") and the Amended and Restated Articles of Association (the "**Articles**").

1. MEMORANDUM OF ASSOCIATION

- (a) The Memorandum provides, inter alia, that the liability of members of the Company is limited and that the objects for which the Company is established are unrestricted (and therefore include acting as an investment company), and that the Company shall have and be capable of exercising any and all of the powers at any time or from time to time exercisable by a natural person or body corporate whether as principal, agent, contractor or otherwise and since the Company is an exempted company that the Company will not trade in the Cayman Islands with any person, firm or corporation except in furtherance of the business of the Company carried on outside the Cayman Islands.
- (b) By special resolution the Company may alter the Memorandum with respect to any objects, powers or other matters specified therein.

2. ARTICLES OF ASSOCIATION

The Articles were adopted on [Date]. The following is a summary of certain provisions of the Articles:

(a) Shares

(i) *Classes of shares*

The share capital of the Company consists of ordinary shares.

(ii) *Share certificates*

Every person whose name is entered as a member in the register of members shall be entitled to receive a certificate for his shares. The Companies Law prohibits the issue of bearer shares to any person other than an authorised or recognised custodian defined in the Companies Law. The requirement on all service providers to implement appropriate due diligence procedures on the identity of a client in order to "know your client" as a result of proceeds of crime legislation mandates that special procedures should be followed when issuing bearer shares.

Every certificate for shares, warrants or debentures or representing any other form of securities of the Company shall be issued under the seal of the Company, and shall be signed autographically by one Director and the Secretary, or by 2 Directors, or by some other person appointed by the Board for the purpose. As regards any certificates for shares or debentures or other securities of the Company, the Board may by resolution determine that such signatures or either of them shall be dispensed with or affixed by some method or system of mechanical signature other than autographic or may be printed thereon as specified in such resolution or that such certificates need

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not be signed by any person. Every share certificate issued shall specify the number and class of shares in respect of which it is issued and the amount paid thereon and may otherwise be in such form as the Board may from time to time prescribe. A share certificate shall relate to only one class of shares, and where the capital of the Company includes shares with different voting rights, the designation of each class of shares, other than those which carry the general right to vote at general meetings, must include the words "restricted voting" or "limited voting" or "non-voting" or some other appropriate designation which is commensurate with the rights attaching to the relevant class of shares. The Company shall not be bound to register more than 4 persons as joint holders of any share.

(b) Directors*(i) Power to allot and issue shares and warrants*

Subject to the provisions of the Companies Law, the Memorandum and Articles and without prejudice to any special rights conferred on the holders of any shares or class of shares, any share may be issued with or have attached thereto such rights, or such restrictions, whether with regard to dividend, voting, return of capital, or otherwise, as the Company may by ordinary resolution determine (or, in the absence of any such determination or so far as the same may not make specific provision, as the Board may determine). Any share may be issued on terms that upon the happening of a specified event or upon a given date and either at the option of the Company or the holder thereof, they are liable to be redeemed.

The Board may issue warrants to subscribe for any class of shares or other securities of the Company on such terms as it may from time to time determine.

Where warrants are issued to bearer, no certificate thereof shall be issued to replace one that has been lost unless the Board is satisfied beyond reasonable doubt that the original certificate thereof has been destroyed and the Company has received an indemnity in such form as the Board shall think fit with regard to the issue of any such replacement certificate.

Subject to the provisions of the Companies Law, the Articles and, where applicable, the rules of any stock exchange of the Relevant Territory (as defined in the Articles) and without prejudice to any special rights or restrictions for the time being attached to any shares or any class of shares, all unissued shares in the Company shall be at the disposal of the Board, which may offer, allot, grant options over or otherwise dispose of them to such persons, at such times, for such consideration and on such terms and conditions as it in its absolute discretion thinks fit, but so that no shares shall be issued at a discount.

Neither the Company nor the Board shall be obliged, when making or granting any allotment of, offer of, option over or disposal of shares, to make, or make available, any such allotment, offer, option or shares to members or others whose registered addresses are in any particular territory or territories where, in the absence of a registration statement or other special formalities, this is or may, in the opinion of the Board, be unlawful or impracticable. However, no member affected as a result of the foregoing shall be, or be deemed to be, a separate class of members for any purpose whatsoever.

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(ii) Power to dispose of the assets of the Company or any subsidiary

While there are no specific provisions in the Articles relating to the disposal of the assets of the Company or any of its subsidiaries, the Board may exercise all powers and do all acts and things which may be exercised or done or approved by the Company and which are not required by the Articles or the Companies Law to be exercised or done by the Company in general meeting, but if such power or act is regulated by the Company in general meeting, such regulation shall not invalidate any prior act of the Board which would have been valid if such regulation had not been made.

(iii) Compensation or payments for loss of office

Payments to any present Director or past Director of any sum by way of compensation for loss of office or as consideration for or in connection with his retirement from office (not being a payment to which the Director is contractually or statutorily entitled) must be approved by the Company in general meeting.

(iv) Loans and provision of security for loans to Directors

There are provisions in the Articles prohibiting the making of loans to Directors and their associates which are equivalent to provisions of Hong Kong law prevailing at the time of adoption of the Articles.

The Company shall not directly or indirectly make a loan to a Director or a director of any holding company of the Company or any of their respective associates, enter into any guarantee or provide any security in connection with a loan made by any person to a Director or a director of any holding company of the Company or any of their respective associates, or if any one or more of the Directors hold (jointly or severally or directly or indirectly) a controlling interest in another company, make a loan to that other company or enter into any guarantee or provide any security in connection with a loan made by any person to that other company.

(v) Disclosure of interest in contracts with the Company or with any of its subsidiaries

With the exception of the office of auditor of the Company, a Director may hold any other office or place of profit with the Company in conjunction with his office of Director for such period and, upon such terms as the Board may determine, and may be paid such extra remuneration therefor (whether by way of salary, commission, participation in profits or otherwise) in addition to any remuneration provided for by or pursuant to any other Articles. A Director may be or become a director or other officer or member of any other company in which the Company may be interested, and shall not be liable to account to the Company or the members for any remuneration or other benefits received by him as a director, officer or member of such other company. The Board may also cause the voting power conferred by the shares in any other company held or owned by the Company to be exercised in such manner in all respects as it thinks fit, including the exercise thereof in favour of any resolution appointing the Directors or any of them to be directors or officers of such other company.

No Director or intended Director shall be disqualified by his office from contracting with the Company, either as vendor, purchaser or otherwise, nor shall any such

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contract or any other contract or arrangement in which any Director is in any way interested be liable to be avoided, nor shall any Director so contracting or being so interested be liable to account to the Company for any profit realised by any such contract or arrangement by reason only of such Director holding that office or the fiduciary relationship thereby established. A Director who is, in any way, materially interested in a contract or arrangement or proposed contract or arrangement with the Company shall declare the nature of his interest at the earliest meeting of the Board at which he may practically do so.

There is no power to freeze or otherwise impair any of the rights attaching to any Share by reason that the person or persons who are interested directly or indirectly therein have failed to disclose their interests to the Company.

A Director shall not vote (nor shall he be counted in the quorum) on any resolution of the Board in respect of any contract or arrangement or other proposal in which he or his associate(s) is/are materially interested, and if he shall do so his vote shall not be counted nor shall he be counted in the quorum for that resolution, but this prohibition shall not apply to any of the following matters namely:

- (aa) the giving of any security or indemnity to the Director or his associate(s) in respect of money lent or obligations incurred or undertaken by him or any of them at the request of or for the benefit of the Company or any of its subsidiaries;
 - (bb) the giving of any security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which the Director or his associate(s) has/have himself/themselves assumed responsibility in whole or in part whether alone or jointly under a guarantee or indemnity or by the giving of security;
 - (cc) any proposal concerning an offer of shares or debentures or other securities of or by the Company or any other company which the Company may promote or be interested in for subscription or purchase, where the Director or his associate(s) is/are or is/are to be interested as a participant in the underwriting or sub-underwriting of the offer;
 - (dd) any proposal or arrangement concerning the adoption, modification or operation of a share option scheme, a pension fund or retirement, death or disability benefits scheme or other arrangement which relates both to Directors, his associate(s) and employees of the Company or of any of its subsidiaries and does not provide in respect of any Director, or his associate(s), as such any privilege or advantage not generally accorded to the employees to which such scheme or fund relates; or
 - (ee) any contract or arrangement in which the Director or his associate(s) is/are interested in the same manner as other holders of shares or debentures or other securities of the Company by virtue only of his/their interest in shares or debentures or other securities of the Company.
- (vi) *Remuneration*

The Directors shall be entitled to receive, as ordinary remuneration for their services, such sums as shall from time to time be determined by the Board, or the Company in

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general meeting, as the case may be, such sum (unless otherwise directed by the resolution by which it is determined) to be divided amongst the Directors in such proportions and in such manner as they may agree or failing agreement, equally, except that in such event any Director holding office for only a portion of the period in respect of which the remuneration is payable shall only rank in such division in proportion to the time during such period for which he has held office. The Directors shall also be entitled to be repaid all traveling, hotel and other expenses reasonably incurred by them in attending any Board meetings, committee meetings or general meetings or otherwise in connection with the discharge of their duties as Directors. Such remuneration shall be in addition to any other remuneration to which a Director who holds any salaried employment or office in the Company may be entitled by reason of such employment or office.

Any Director who, at the request of the Company performs services which in the opinion of the Board go beyond the ordinary duties of a Director may be paid such special or extra remuneration (whether by way of salary, commission, participation in profits or otherwise) as the Board may determine and such extra remuneration shall be in addition to or in substitution for any ordinary remuneration as a Director. An executive Director appointed to be a managing director, joint managing director, deputy managing director or other executive officer shall receive such remuneration (whether by way of salary, commission or participation in profits or otherwise or by all or any of those modes) and such other benefits (including pension and/or gratuity and/or other benefits on retirement) and allowances as the Board may from time to time decide. Such remuneration shall be in addition to his ordinary remuneration as a Director.

The Board may establish, either on its own or jointly in concurrence or agreement with other companies (being subsidiaries of the Company or with which the Company is associated in business), or may make contributions out of the Company's monies to, such schemes or funds for providing pensions, sickness or compassionate allowances, life assurance or other benefits for employees (which expression as used in this and the following paragraph shall include any Director or former Director who may hold or have held any executive office or any office of profit with the Company or any of its subsidiaries) and former employees of the Company and their dependents or any class or classes of such persons.

In addition, the Board may also pay, enter into agreements to pay or make grants of revocable or irrevocable, whether or not subject to any terms or conditions, pensions or other benefits to employees and former employees and their dependents, or to any of such persons, including pensions or benefits additional to those, if any, to which such employees or former employees or their dependents are or may become entitled under any such scheme or fund as mentioned above. Such pension or benefit may, if deemed desirable by the Board, be granted to an employee either before and in anticipation of, or upon or at any time after, his actual retirement.

(vii) Appointment, retirement and removal

At any time or from time to time, the Board shall have the power to appoint any person as a Director either to fill a casual vacancy on the Board or as an additional Director to the existing Board subject to any maximum number of Directors, if any, as may be determined by the members in general meeting. Any Director appointed by

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the Board to fill a casual vacancy shall hold office only until the first general meeting of the Company after his appointment and be subject to re-election at such meeting. Any Director appointed by the Board as an addition to the existing Board shall hold office only until the next following annual general meeting of the Company and shall then be eligible for re-election.

At each annual general meeting, one third of the Directors for the time being will retire from office by rotation. However, if the number of Directors is not a multiple of three, then the number nearest to but not greater than one third shall be the number of retiring Directors. The Directors who shall retire in each year will be those who have been longest in the office since their last re-election or appointment but as between persons who become or were last re-elected Directors on the same day those to retire will (unless they otherwise agree among themselves) be determined by lot.

No person, other than a retiring Director, shall, unless recommended by the Board for election, be eligible for election to the office of Director at any general meeting, unless notice in writing of the intention to propose that person for election as a Director and notice in writing by that person of his willingness to be elected shall have been lodged at the head office or at the registration office. The period for lodgment of such notices will commence no earlier than the day after the despatch of the notice of the meeting appointed for such election and end no later than 7 days prior to the date of such meeting and the minimum length of the period during which such notices to the Company may be given must be at least 7 days.

A Director is not required to hold any shares in the Company by way of qualification nor is there any specified upper or lower age limit for Directors either for accession to the Board or retirement therefrom.

A Director may be removed by an ordinary resolution of the Company before the expiration of his term of office (but without prejudice to any claim which such Director may have for damages for any breach of any contract between him and the Company) and the Company may by ordinary resolution appoint another in his place. The number of Directors shall not be less than two.

In addition to the foregoing, the office of a Director shall be vacated:

- (aa) if he resigns his office by notice in writing delivered to the Company at the registered office or head office of the Company for the time being or tendered at a meeting of the Board;
- (bb) if he dies or becomes of unsound mind as determined pursuant to an order made by any competent court or official on the grounds that he is or may be suffering from mental disorder or is otherwise incapable of managing his affairs and the Board resolves that his office be vacated;
- (cc) if, without special leave, he is absent from meetings of the Board for six (6) consecutive months, and the Board resolves that his office is vacated;
- (dd) if he becomes bankrupt or has a receiving order made against him or suspends payment or compounds with his creditors generally;

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- (ee) if he is prohibited from being a director by law;
- (ff) if he ceases to be a director by virtue of any provision of law or is removed from office pursuant to the Articles;
- (gg) if he has been validly required by the stock exchange of the Relevant Territory (as defined in the Articles) to cease to be a Director and the relevant time period for application for review of or appeal against such requirement has lapsed and no application for review or appeal has been filed or is underway against such requirement; or

From time to time the Board may appoint one or more of its body to be managing director, joint managing director, or deputy managing director or to hold any other employment or executive office with the Company for such period and upon such terms as the Board may determine and the Board may revoke or terminate any of such appointments. The Board may also delegate any of its powers to committees consisting of such Director or Directors and other person(s) as the Board thinks fit, and from time to time it may also revoke such delegation or revoke the appointment of and discharge any such committees either wholly or in part, and either as to persons or purposes, but every committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may from time to time be imposed upon it by the Board.

(viii) Borrowing powers

Pursuant to the Articles, the Board may exercise all the powers of the Company to raise or borrow money, to mortgage or charge all or any part of the undertaking, property and uncalled capital of the Company and, subject to the Companies Law, to issue debentures, debenture stock, bonds and other securities of the Company, whether outright or as collateral security for any debt, liability or obligation of the Company or of any third party. The provisions summarised above, in common with the Articles of Association in general, may be varied with the sanction of a special resolution of the Company.

(ix) Register of Directors and officers

Pursuant to the Companies Law, the Company is required to maintain at its registered office a register of directors, alternate directors and officers which is not available for inspection by the public. A copy of such register must be filed with the Registrar of Companies in the Cayman Islands and any change must be notified to the Registrar within 30 days of any change in such directors or officers, including a change of the name of such directors or officers.

(x) Proceedings of the Board

Subject to the Articles, the Board may meet anywhere in the world for the despatch of business and may adjourn and otherwise regulate its meetings as it thinks fit. Questions arising at any meeting shall be determined by a majority of votes. In the case of an equality of votes, the chairman of the meeting shall have a second or casting vote.

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(c) Alterations to the constitutional documents

To the extent that the same is permissible under Cayman Islands law and subject to the Articles, the Memorandum and Articles of the Company may only be altered or amended, and the name of the Company may only be changed by the Company by special resolution.

(d) Variation of rights of existing shares or classes of shares

Subject to the Companies Law, if at any time the share capital of the Company is divided into different classes of shares, all or any of the special rights attached to any class of shares may (unless otherwise provided for by the terms of issue of the shares of that class) be varied, modified or abrogated either with the consent in writing of the holders of not less than three-fourths in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of that class. To every such separate general meeting the provisions of the Articles relating to general meetings shall mutatis mutandis apply, but so that the necessary quorum (other than at an adjourned meeting) shall be not less than two persons together holding (or in the case of a shareholder being a corporation, by its duly authorised representative) or representing by proxy not less than one-third in nominal value of the issued shares of that class. Every holder of shares of the class shall be entitled on a poll to one vote for every such share held by him, and any holder of shares of the class present in person or by proxy may demand a poll.

Any special rights conferred upon the holders of any shares or class of shares shall not, unless otherwise expressly provided in the rights attaching to the terms of issue of such shares, be deemed to be varied by the creation or issue of further shares ranking *pari passu* therewith.

(e) Alteration of capital

The Company may, by an ordinary resolution of its members, (a) increase its share capital by the creation of new shares of such amount as it thinks expedient; (b) consolidate or divide all or any of its share capital into shares of larger or smaller amount than its existing shares; (c) divide its unissued shares into several classes and attach thereto respectively any preferential, deferred, qualified or special rights, privileges or conditions; (d) subdivide its shares or any of them into shares of an amount smaller than that fixed by the Memorandum; and (e) cancel shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled; (f) make provision for the allotment and issue of shares which do not carry any voting rights; (g) change the currency of denomination of its share capital; and (h) reduce its share premium account in any manner authorised and subject to any conditions prescribed by law.

Reduction of share capital — subject to the Companies Law and to confirmation by the court, a company limited by shares may, if so authorised by its Articles of Association, by special resolution, reduce its share capital in any way.

(f) Special resolution — majority required

In accordance with the Articles, a special resolution of the Company must be passed by a majority of not less than three-fourths of the votes cast by such members as, being entitled

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so to do, vote in person or by proxy or, in the case of members which are corporations, by their duly authorised representatives or, where proxies are allowed, by proxy at a general meeting of which not less than 21 clear days' notice, specifying the intention to propose the resolution as a special resolution, has been duly given.

Under Companies Law, a copy of any special resolution must be forwarded to the Registrar of Companies in the Cayman Islands within 15 days of being passed.

An "ordinary resolution", by contrast, is defined in the Articles to mean a resolution passed by a simple majority of the votes of such members of the Company as, being entitled to do so, vote in person or, in the case of members which are corporations, by their duly authorised representatives or, where proxies are allowed, by proxy at a general meeting of which not less than fourteen clear days' notice has been given and held in accordance with the Articles. A resolution in writing signed by or on behalf of all members shall be treated as an ordinary resolution duly passed at a general meeting of the Company duly convened and held, and where relevant as a special resolution so passed.

(g) Voting rights (generally and on a poll) and right to demand a poll

Subject to any special rights, restrictions or privileges as to voting for the time being attached to any class or classes of shares at any general meeting on a show of hands, every member who is present in person or by proxy or being a corporation, is present by its duly authorised representative shall have one vote, and on a poll every member present in person or by proxy or, in the case of a member being a corporation, by its duly authorised representative shall have one vote for every share which is fully paid or credited as fully paid registered in his name in the register of members of the Company but so that no amount paid up or credited as paid up on a share in advance of calls or instalments is treated for the foregoing purpose as paid up on the share. Notwithstanding anything contained in the Articles, where more than one proxy is appointed by a member which is a Clearing House (as defined in the Articles) (or its nominee(s)), each such proxy shall have one vote on a show of hands. On a poll, a member entitled to more than one vote need not use all his votes or cast all the votes he does use in the same way.

At any general meeting a resolution put to the vote of the meeting shall be decided by way of a poll save that the Chairman of the meeting may, in good faith and in compliance with the [●], allow such resolution to be voted on by a show of hands. Where a show of hands is allowed, before or at the declaration of the result of the show of hands, a poll may be demanded by:-

- (i) the chairman of the meeting; or
- (ii) at least two members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy for the time being entitled to vote at the meeting; or
- (iii) any member or members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy and representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or
- (iv) a member or members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy and holding shares in

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the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

Should a Clearing House or its nominee(s), be a member of the Company, such person or persons may be authorised as it thinks fit to act as its representative(s) at any meeting of the Company or at any meeting of any class of members of the Company provided that, if more than one person is so authorised, the authorisation shall specify the number and class of shares in respect of which each such person is so authorised. A person authorised in accordance with this provision shall be entitled to exercise the same rights and powers on behalf of the Clearing House or its nominee(s), as if such person were an individual member including the right to vote individually on a show of hands.

Where the Company has knowledge that any member is, under the [●], required to abstain from voting on any particular resolution of the Company or restricted to voting only for or only against any particular resolution of the Company, any votes cast by or on behalf of such member in contravention of such requirement or restriction shall not be counted.

(h) Annual general meetings

The Company must hold an annual general meeting each year. Such meeting must be held not more than 15 months after the holding of the last preceding annual general meeting, or such longer period as may be authorised by the [●] at such time and place as may be determined by the Board.

(i) Accounts and audit

The Board shall cause proper books of account to be kept of the sums of money received and expended by the Company, and the matters in respect of which such receipt and expenditure take place, and of the assets and liabilities of the Company and of all other matters required by the Companies Law necessary to give a true and fair view of the state of the Company's affairs and to show and explain its transactions.

The books of accounts of the Company shall be kept at the head office of the Company or at such other place or places as the Board decides and shall always be open to inspection by any Director. No member (other than a Director) shall have any right to inspect any account or book or document of the Company except as conferred by the Companies Law or ordered by a court of competent jurisdiction or authorised by the Board or the Company in general meeting.

The Board shall from time to time cause to be prepared and laid before the Company at its annual general meeting balance sheets and profit and loss accounts (including every document required by law to be annexed thereto), together with a copy of the Directors' report and a copy of the auditors' report not less than 21 days before the date of the annual general meeting. Copies of these documents shall be sent to every person entitled to receive notices of general meetings of the Company under the provisions of the Articles together with the notice of annual general meeting, not less than 21 days before the date of the meeting.

Subject to the rules of the stock exchange of the Relevant Territory (as defined in the Articles), the Company may send summarised financial statements to shareholders who

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has, in accordance with the rules of the stock exchange of the Relevant Territory (as defined in the Articles), consented and elected to receive summarised financial statements instead of the full financial statements. The summarised financial statements must be accompanied by any other documents as may be required under the rules of the stock exchange of the Relevant Territory (as defined in the Articles), and must be sent to the shareholders not less than twenty-one days before the general meeting to those shareholders that have consented and elected to receive the summarised financial statements.

The Company shall appoint auditor(s) to hold office until the conclusion of the next annual general meeting on such terms and with such duties as may be agreed with the Board. The auditors' remuneration shall be fixed by the Company in general meeting or by the Board if authority is so delegated by the members.

The auditors shall audit the financial statements of the Company in accordance with generally accepted accounting principles of Hong Kong, the International Accounting Standards or such other standards as may be permitted by the [●].

(j) Notices of meetings and business to be conducted thereat

An annual general meeting and any extraordinary general meeting at which it is proposed to pass a special resolution must be called by at least 21 days' notice in writing, and any other extraordinary general meeting shall be called by at least 14 days' notice in writing. The notice shall be exclusive of the day on which it is served or deemed to be served and of the day for which it is given, and must specify the time, place and agenda of the meeting, and particulars of the resolution(s) to be considered at that meeting, and, in the case of special business, the general nature of that business.

Except where otherwise expressly stated, any notice or document (including a share certificate) to be given or issued under the Articles shall be in writing, and may be served by the Company on any member either personally or by sending it through the post in a prepaid envelope or wrapper addressed to such member at his registered address as appearing in the Company's register of members or by leaving it at such registered address as aforesaid or (in the case of a notice) by advertisement in the newspapers. Any member whose registered address is outside Hong Kong may notify the Company in writing of an address in Hong Kong which for the purpose of service of notice shall be deemed to be his registered address. Where the registered address of the member is outside Hong Kong, notice, if given through the post, shall be sent by prepaid airmail letter where available. Subject to the Companies Law and the [●], a notice or document may be served or delivered by the Company to any member by electronic means to such address as may from time to time be authorised by the member concerned or by publishing it on a website and notifying the member concerned that it has been so published.

Although a meeting of the Company may be called by shorter notice than as specified above, such meeting may be deemed to have been duly called if it is so agreed:

- (i) in the case of a meeting called as an annual general meeting, by all members of the Company entitled to attend and vote thereat; and
- (ii) in the case of any other meeting, by a majority in number of the members having a right to attend and vote at the meeting, being a majority together holding not less than 95% in nominal value of the issued shares giving that right.

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All business transacted at an extraordinary general meeting shall be deemed special business and all business shall also be deemed special business where it is transacted at an annual general meeting with the exception of the following, which shall be deemed ordinary business:

- (aa) the declaration and sanctioning of dividends;
- (bb) the consideration and adoption of the accounts and balance sheet and the reports of the directors and the auditors;
- (cc) the election of Directors in place of those retiring;
- (dd) the appointment of auditors;
- (ee) the fixing of the remuneration of the Directors and of the auditors;
- (ff) the granting of any mandate or authority to the Board to offer, allot, grant options over, or otherwise dispose of the unissued shares of the Company representing not more than 20% in nominal value of its existing issued share capital (or such other percentage as may from time to time be specified in the rules of the [●]) and the number of any securities repurchased by the Company since the granting of such mandate; and
- (gg) the granting of any mandate or authority to the Board to repurchase securities in the Company.

(k) Transfer of shares

Subject to the Companies Law, all transfers of shares shall be effected by an instrument of transfer in the usual or common form or in such other form as the Board may approve provided always that it shall be in such form prescribed by the [●] and may be under hand or, if the transferor or transferee is a Clearing House or its nominee(s), under hand or by machine imprinted signature or by such other manner of execution as the Board may approve from time to time.

Execution of the instrument of transfer shall be by or on behalf of the transferor and the transferee provided that the Board may dispense with the execution of the instrument of transfer by the transferor or transferee or accept mechanically executed transfers in any case in which it in its discretion thinks fit to do so, and the transferor shall be deemed to remain the holder of the share until the name of the transferee is entered in the register of members of the Company in respect thereof.

The Board may, in its absolute discretion, at any time and from time to time remove any share on the principal register to any branch register or any share on any branch register to the principal register or any other branch register.

Unless the Board otherwise agrees, no shares on the principal register shall be removed to any branch register nor shall shares on any branch register be removed to the principal register or any other branch register. All removals and other documents of title shall be lodged for registration and registered, in the case of shares on any branch register, at the relevant registration office and, in the case of shares on the principal register, at the place at which the principal register is located.

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The Board may, in its absolute discretion, decline to register a transfer of any share (not being a fully paid up share) to a person of whom it does not approve or any share issued under any share option scheme upon which a restriction on transfer imposed thereby still subsists, and it may also refuse to register any transfer of any share to more than four joint holders or any transfer of any share (not being a fully paid up share) on which the Company has a lien.

The Board may decline to recognise any instrument of transfer unless a fee of such maximum sum as the [●] may determine to be payable or such lesser sum as the Board may from time to time require is paid to the Company in respect thereof, the instrument of transfer is properly stamped (if applicable), is in respect of only one class of share and is lodged at the relevant registration office or the place at which the principal register is located accompanied by the relevant share certificate(s) and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer (and if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do).

The register of members may, subject to the [●] (as defined in the Articles), be closed at such time or for such period not exceeding in the whole 30 days in each year as the Board may determine.

Fully paid shares shall be free from any restriction with respect to the right of the holder thereof to transfer such shares (except when permitted by the [●]) and shall also be free from all liens.

(l) Power of the Company to purchase its own shares

The Company is empowered by the Companies Law and the Articles to purchase its own shares subject to certain restrictions and the Board may only exercise this power on behalf of the Company subject to any applicable requirement imposed from time to time by the Articles, code, rules or regulations issued from time to time by the [●] and/or the [●] of Hong Kong.

Where the Company purchases for redemption a redeemable Share, purchases not made through the market or by tender shall be limited to a maximum price, and if purchases are by tender, tenders shall be available to all members alike.

(m) Power of any subsidiary of the Company to own shares in the Company

There are no provisions in the Articles relating to the ownership of shares in the Company by a subsidiary.

(n) Dividends and other methods of distribution

The Company in general meeting may declare dividends in any currency to be paid to the members but no dividend shall be declared in excess of the amount recommended by the Board.

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Except in so far as the rights attaching to, or the terms of issue of, any share may otherwise provide:

- (i) all dividends shall be declared and paid according to the amounts paid up on the shares in respect whereof the dividend is paid, although no amount paid up on a share in advance of calls shall for this purpose be treated as paid up on the share; and
- (ii) all dividends shall be apportioned and paid pro rata in accordance with the amount paid up on the shares during any portion or portions of the period in respect of which the dividend is paid. The Board may deduct from any dividend or other monies payable to any member all sums of money (if any) presently payable by him to the Company on account of calls, instalments or otherwise.

Where the Board or the Company in general meeting has resolved that a dividend should be paid or declared on the share capital of the Company, the Board may resolve:

- (aa) that such dividend be satisfied wholly or in part in the form of an allotment of shares credited as fully paid up, provided that the members entitled thereto will be entitled to elect to receive such dividend (or part thereof) in cash in lieu of such allotment; or
- (bb) that the members entitled to such dividend will be entitled to elect to receive an allotment of shares credited as fully paid up in lieu of the whole or such part of the dividend as the Board may think fit.

Upon the recommendation of the Board the Company may by ordinary resolution in respect of any one particular dividend of the Company determine that it may be satisfied wholly in the form of an allotment of shares credited as fully paid up without offering any right to members to elect to receive such dividend in cash in lieu of such allotment.

Any dividend, bonus or other sum payable in cash to the holder of shares may be paid by cheque or warrant sent through the post addressed to the holder at his registered address, but in the case of joint holders, shall be addressed to the holder whose name stands first in the register of members of the Company in respect of the shares at his address as appearing in the register, or addressed to such person and at such address as the holder or joint holders may in writing so direct. Every such cheque or warrant shall be made payable to the order of the person to whom it is sent and shall be sent at the holder's or joint holders' risk and payment of the cheque or warrant by the bank on which it is drawn shall constitute a good discharge to the Company. Any one of two or more joint holders may give effectual receipts for any dividends or other moneys payable or property distributable in respect of the shares held by such joint holders.

Whenever the Board or the Company in general meeting has resolved that a dividend be paid or declared, the Board may further resolve that such dividend be satisfied wholly or in part by the distribution of specific assets of any kind.

The Board may, if it thinks fit, receive from any member willing to advance the same, and either in money or money's worth, all or any part of the money uncalled and unpaid or instalments payable upon any shares held by him, and in respect of all or any of the moneys so advanced may pay interest at such rate (if any) not exceeding 20 % per annum, as the Board may decide, but a payment in advance of a call shall not entitle the member to receive any dividend or to exercise any other rights or privileges as a member in respect

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of the share or the due portion of the shares upon which payment has been advanced by such member before it is called up.

All dividends, bonuses or other distributions unclaimed for one year after having been declared may be invested or otherwise made use of by the Board for the benefit of the Company until claimed and the Company shall not be constituted a trustee in respect thereof. All dividends, bonuses or other distributions unclaimed for six years after having been declared may be forfeited by the Board and, upon such forfeiture, shall revert to the Company.

No dividend or other monies payable by the Company on or in respect of any share shall bear interest against the Company.

The Company may exercise the power to cease sending cheques for dividend entitlements or dividend warrants by post if such cheques or warrants remain uncashed on two consecutive occasions or after the first occasion on which such a cheque or warrant is returned undelivered.

(o) Proxies

Any member of the Company entitled to attend and vote at a meeting of the Company is entitled to appoint another person as his proxy to attend and vote instead of him. A member who is the holder of two or more shares may appoint more than one proxy to represent him and vote on his behalf at a general meeting of the Company or at a class meeting. A proxy need not be a member of the Company and shall be entitled to exercise the same powers on behalf of a member who is an individual and for whom he acts as proxy as such member could exercise. In addition, a proxy shall be entitled to exercise the same powers on behalf of a member which is a corporation and for which he acts as proxy as such member could exercise if it were an individual member. On a poll or on a show of hands, votes may be given either personally (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy.

The instrument appointing a proxy shall be in writing under the hand of the appointor or of his attorney duly authorised in writing, or if the appointor is a corporation, either under seal or under the hand of an officer or attorney duly authorised. Every instrument of proxy, whether for a specified meeting or otherwise, shall be in such form as the Board may from time to time approve, provided that any form issued to a member for use by him for appointing a proxy to attend and vote at an extraordinary general meeting or at an annual general meeting at which any business is to be transacted shall be such as to enable the member, according to his intentions, to instruct the proxy to vote in favour of or against (or, in default of instructions, to exercise his discretion in respect of) each resolution dealing with any such business.

(p) Calls on shares and forfeiture of shares

The Board may from time to time make such calls as it may think fit upon the members in respect of any monies unpaid on the shares held by them respectively (whether on account of the nominal value of the shares or by way of premium) and not by the conditions of allotment thereof made payable at fixed times. A call may be made payable either in one sum or by instalments. If the sum payable in respect of any call or instalment is not paid on or before the day appointed for payment thereof, the person or persons from whom the

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sum is due shall pay interest on the same at such rate not exceeding 20% per annum as the Board shall fix from the day appointed for the payment thereof to the time of actual payment, but the Board may waive payment of such interest wholly or in part. The Board may, if it thinks fit, receive from any member willing to advance the same, either in money or money's worth, all or any part of the money uncalled and unpaid or instalments payable upon any shares held by him, and in respect of all or any of the monies so advanced the Company may pay interest at such rate (if any) not exceeding 20% per annum as the Board may decide.

If a member fails to pay any call or instalment of a call on the day appointed for payment thereof, the Board may, at any time thereafter during such time as any part of the call or instalment remains unpaid, serve not less than 14 days' notice on him requiring payment of so much of the call or instalment as is unpaid, together with any interest which may have accrued and which may still accrue up to the date of actual payment. The notice will name a further day (not earlier than the expiration of 14 days from the date of the notice) on or before which the payment required by the notice is to be made, and it shall also name the place where payment is to be made. The notice shall also state that, in the event of non-payment at or before the time appointed, the shares in respect of which the call was made will be liable to be forfeited.

If the requirements of any such notice are not complied with, any share in respect of which the notice has been given may at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the Board to that effect. Such forfeiture will include all dividends and bonuses declared in respect of the forfeited share and not actually paid before the forfeiture.

A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares but shall, nevertheless, remain liable to pay to the Company all moneys which, at the date of forfeiture, were payable by him to the Company in respect of the shares together with (if the Board shall in its discretion so require) interest thereon from the date of forfeiture until payment at such rate not exceeding 20 per cent per annum as the Board may prescribe.

(q) Inspection of corporate records

Members of the Company have no general right under the Companies Law to inspect or obtain copies of the register of members or corporate records of the Company. However, the members of the Company will have such rights as may be set forth in the Articles. The Articles provide that for so long as any part of the share capital of the Company is [●] on the [●], any member may inspect any register of members of the Company maintained in Hong Kong (except when the register of member is closed) without charge and require the provision to him of copies or extracts thereof in all respects as if the Company were incorporated under and were subject to the Hong Kong Companies Ordinance.

An exempted company may, subject to the provisions of its articles of association, maintain its principal register of members and any branch registers at such locations, whether within or outside the Cayman Islands, as its directors may, from time to time, think fit.

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(r) Quorum for meetings and separate class meetings

No business shall be transacted at any general meeting unless a quorum is present when the meeting proceeds to business, and continues to be present until the conclusion of the meeting.

The quorum for a general meeting shall be two members present in person (or in the case of a member being a corporation, by its duly authorised representative) or by proxy and entitled to vote. In respect of a separate class meeting (other than an adjourned meeting) convened to sanction the modification of class rights, the necessary quorum shall be two persons holding or representing by proxy not less than one-third in nominal value of the issued shares of that class.

(s) Rights of minorities in relation to fraud or oppression

There are no provisions in the Articles concerning the rights of minority members in relation to fraud or oppression. However, certain remedies may be available to members of the Company under Cayman Islands law, as summarised in paragraph 3(f) of this Appendix.

(t) Procedures on liquidation

A resolution that the Company be wound up by the court or be wound up voluntarily shall be a special resolution.

Subject to any special rights, privileges or restrictions as to the distribution of available surplus assets on liquidation for the time being attached to any class or classes of shares:

- (i) if the Company shall be wound up and the assets available for distribution amongst the members of the Company shall be more than sufficient to repay the whole of the capital paid up at the commencement of the winding up, then the excess shall be distributed *pari passu* amongst such members in proportion to the amount paid up on the shares held by them respectively; and
- (ii) if the Company shall be wound up and the assets available for distribution amongst the members as such shall be insufficient to repay the whole of the paid-up capital, such assets shall be distributed so that, as nearly as may be, the losses shall be borne by the members in proportion to the capital paid up, on the shares held by them respectively.

In the event that the Company is wound up (whether the liquidation is voluntary or compelled by the court) the liquidator may, with the sanction of a special resolution and any other sanction required by the Companies Law divide among the members in specie or kind the whole or any part of the assets of the Company whether the assets shall consist of property of one kind or shall consist of properties of different kinds and the liquidator may, for such purpose, set such value as he deems fair upon any one or more class or classes of property to be divided as aforesaid and may determine how such division shall be carried out as between the members or different classes of members and the members within each class. The liquidator may, with the like sanction, vest any part of the assets in trustees upon such trusts for the benefit of members as the liquidator shall think fit, but so that no member shall be compelled to accept any shares or other property upon which there is a liability.

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(u) Untraceable members

The Company may exercise the power to cease sending cheques for dividend entitlements or dividend warrants by post if such cheques or warrants remain uncashed on two consecutive occasions or after the first occasion on which such a cheque or warrant is returned undelivered.

In accordance with the Articles, the Company is entitled to sell any of the shares of a member who is untraceable if:

- (i) all cheques or warrants, being not less than three in total number, for any sum payable in cash to the holder of such shares have remained uncashed for a period of 12 years;
- (ii) upon the expiry of the 12 years and 3 months period (being the 3 months notice period referred to in sub-paragraph (iii)), the Company has not during that time received any indication of the existence of the member; and
- (iii) the Company has caused an advertisement to be published in accordance with the rules of the stock exchange of the Relevant Territory (as defined in the Articles) giving notice of its intention to sell such shares and a period of three months has elapsed since such advertisement and the stock exchange of the Relevant Territory (as defined in the Articles) has been notified of such intention. The net proceeds of any such sale shall belong to the Company and upon receipt by the Company of such net proceeds, it shall become indebted to the former member of the Company for an amount equal to such net proceeds.

(v) Subscription rights reserve

Pursuant to the Articles, provided that it is not prohibited by and is otherwise in compliance with the Companies Law, if warrants to subscribe for shares have been issued by the Company and the Company does any act or engages in any transaction which would result in the subscription price of such warrants being reduced below the par value of the shares to be issued on the exercise of such warrants, a subscription rights reserve shall be established and applied in paying up the difference between the subscription price and the par value of such shares.

3. CAYMAN ISLANDS COMPANY LAW

The Company was incorporated in the Cayman Islands as an exempted company on March 10, 2011 subject to the Companies Law. Certain provisions of Cayman Islands company law are set out below but this section does not purport to contain all applicable qualifications and exceptions or to be a complete review of all matters of the Companies Law and taxation, which may differ from equivalent provisions in jurisdictions with which interested parties may be more familiar.

(a) Company operations

As an exempted company, the Company must conduct its operations mainly outside the Cayman Islands. Moreover, the Company is required to file an annual return each year with the Registrar of Companies of the Cayman Islands and pay a fee which is based on the amount of its authorised share capital.

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(b) Share capital

In accordance with the Companies Law, a Cayman Islands company may issue ordinary, preference or redeemable shares or any combination thereof. The Companies Law provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called the "share premium account". At the option of a company, these provisions may not apply to premiums on shares of that company allotted pursuant to any arrangements in consideration of the acquisition or cancellation of shares in any other company and issued at a premium. The Companies Law provides that the share premium account may be applied by the company subject to the provisions, if any, of its memorandum and articles of association, in such manner as the company may from time to time determine including, but without limitation, the following:

- (i) paying distributions or dividends to members;
- (ii) paying up unissued shares of the company to be issued to members as fully paid bonus shares;
- (iii) any manner provided in section 37 of the Companies Law;
- (iv) writing-off the preliminary expenses of the company; and
- (v) writing-off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company.

Notwithstanding the foregoing, the Companies Law provides that no distribution or dividend may be paid to members out of the share premium account unless, immediately following the date on which the distribution or dividend is proposed to be paid, the company will be able to pay its debts as they fall due in the ordinary course of business.

It is further provided by the Companies Law that, subject to confirmation by the court, a company limited by shares or a company limited by guarantee and having a share capital may, if authorised to do so by its articles of association, by special resolution reduce its share capital in any way.

The Articles include certain protections for holders of special classes of shares, requiring their consent to be obtained before their rights may be varied. The consent of the specified proportions of the holders of the issued shares of that class or the sanction of a resolution passed at a separate meeting of the holders of those shares is required.

(c) Financial assistance to purchase shares of a company or its holding company

There are no statutory prohibitions in the Cayman Islands on the granting of financial assistance by a company to another person for the purchase of, or subscription for, its own, its holding company's or a subsidiary's shares. Therefore, a company may provide financial assistance provided the directors of the company when proposing to grant such financial assistance discharge their duties of care and acting in good faith, for a proper purpose and in the interests of the company. Such assistance should be on an arm's-length basis.

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(d) Purchase of shares and warrants by a company and its subsidiaries

A company limited by shares or a company limited by guarantee and having a share capital may, if so authorised by its articles of association, issue shares which are to be redeemed or are liable to be redeemed at the option of the company or a member and, for the avoidance of doubt, it shall be lawful for the rights attaching to any shares to be varied, subject to the provisions of the company's articles of association, so as to provide that such shares are to be or are liable to be so redeemed. In addition, such a company may, if authorised to do so by its articles of association, purchase its own shares, including any redeemable shares. Nonetheless, if the articles of association do not authorise the manner and terms of purchase, a company cannot purchase any of its own shares without the manner and terms of purchase first being authorised by an ordinary resolution of the company. A company may not redeem or purchase its shares unless they are fully paid. Furthermore, a company may not redeem or purchase any of its shares if, as a result of the redemption or purchase, there would no longer be any issued shares of the company other than shares held as treasury shares. In addition, a payment out of capital by a company for the redemption or purchase of its own shares is not lawful unless immediately following the date on which the payment is proposed to be made, the company shall be able to pay its debts as they fall due in the ordinary course of business.

Under Section 37A(1) the Companies Law, shares that have been purchased or redeemed by a company or surrendered to the company shall not be treated as cancelled but shall be classified as treasury shares if (a) the memorandum and articles of association of the company do not prohibit it from holding treasury shares; (b) the relevant provisions of the memorandum and articles of association (if any) are complied with; and (c) the company is authorised in accordance with the company's articles of association or by a resolution of the directors to hold such shares in the name of the company as treasury shares prior to the purchase, redemption or surrender of such shares. Shares held by a company pursuant to section 37A(1) of the Companies Law shall continue to be classified as treasury shares until such shares are either cancelled or transferred pursuant to the Companies Law.

A Cayman Islands company may be able to purchase its own warrants subject to and in accordance with the terms and conditions of the relevant warrant instrument or certificate. Thus there is no requirement under Cayman Islands law that a company's memorandum or articles of association contain a specific provision enabling such purchases. The directors of a company may under the general power contained in its memorandum of association be able to buy and sell and deal in personal property of all kinds.

Under Cayman Islands law, a subsidiary may hold shares in its holding company and, in certain circumstances, may acquire such shares.

(e) Dividends and distributions

With the exception of sections 34 and 37A(7) of the Companies Law, there are no statutory provisions relating to the payment of dividends. Based upon English case law which is likely to be persuasive in the Cayman Islands, dividends may be paid only out of profits. In addition, section 34 of the Companies Law permits, subject to a solvency test and the provisions, if any, of the company's memorandum and articles of association, the payment of dividends and distributions out of the share premium account (see sub-paragraph 2(n) of this Appendix for further details). Section 37A(7)(c) of the Companies Law provides that for so long as a company holds treasury shares, no dividend

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may be declared or paid, and no other distribution (whether in cash or otherwise) of the company's assets (including any distribution of assets to members on a winding up) may be made to the company, in respect of a treasury share.

(f) Protection of minorities and shareholders' suits

It can be expected that the Cayman Islands courts will ordinarily follow English case law precedents (particularly the rule in the case of *Foss v. Harbottle* and the exceptions thereto) which permit a minority member to commence a representative action against or derivative actions in the name of the company to challenge:

- (i) an act which is ultra vires the company or illegal;
- (ii) an act which constitutes a fraud against the minority and the wrongdoers are themselves in control of the company; and
- (iii) an irregularity in the passing of a resolution the passage of which requires a qualified (or special) majority which has not been obtained.

Where a company (not being a bank) is one which has a share capital divided into shares, the court may, on the application of members thereof holding not less than one-fifth of the shares of the company in issue, appoint an inspector to examine the affairs of the company and, at the direction of the court, to report thereon.

Moreover, any member of a company may petition the court which may make a winding up order if the court is of the opinion that it is just and equitable that the company should be wound up.

In general, claims against a company by its members must be based on the general laws of contract or tort applicable in the Cayman Islands or be based on potential violation of their individual rights as members as established by a company's memorandum and articles of association.

(g) Disposal of assets

There are no specific restrictions in the Companies Law on the power of directors to dispose of assets of a company, although it specifically requires that every officer of a company, which includes a director, managing director and secretary, in exercising his powers and discharging his duties must do so honestly and in good faith with a view to the best interest of the company and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

(h) Accounting and auditing requirements

Section 59 of the Companies Law provides that a company shall cause proper records of accounts to be kept with respect to (i) all sums of money received and expended by the company and the matters with respect to which the receipt and expenditure takes place; (ii) all sales and purchases of goods by the company and (iii) the assets and liabilities of the company.

Section 59 of the Companies Law further states that proper books of account shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

If the Company keeps its books of account at any place other than at its registered office or at any other place within the Cayman Islands, it shall, upon service of an order or notice by the Tax Information Authority pursuant to the Tax Information Authority Law (2009 Revision) of the Cayman Islands, make available, in electronic form or any other medium, at its registered office copies of its books of account, or any part or parts thereof, as are specified in such order or notice.

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(i) Exchange control

There are no exchange control regulations or currency restrictions in effect in the Cayman Islands.

(j) Taxation

Pursuant to section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, the Company has obtained an undertaking from the Governor-in-Council:

- (i) that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciation shall apply to the Company or its operations; and
- (ii) in addition, that no tax be levied on profits, income gains or appreciations or which is in the nature of estate duty or inheritance tax shall be payable by the Company:
 - (aa) on or in respect of the shares, debentures or other obligations of the Company;
or
 - (bb) by way of withholding in whole or in part of any relevant payment as defined in section 6(3) of the Tax Concessions Law (1999 Revision).

The undertaking for the Company is for a period of twenty years from July 26, 2011.

The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciations and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to the Company levied by the Government of the Cayman Islands save certain stamp duties which may be applicable, from time to time, on certain instruments.

(k) Stamp duty on transfers

There is no stamp duty payable in the Cayman Islands on transfers of shares of Cayman Islands companies save for those which hold interests in land in the Cayman Islands.

(l) Loans to directors

The Companies Law contains no express provision prohibiting the making of loans by a company to any of its directors. However, the Articles provide for the prohibition of such loans under specific circumstances.

(m) Inspection of corporate records

The members of the company have no general right under the Companies Law to inspect or obtain copies of the register of members or corporate records of the company. They will, however, have such rights as may be set out in the company's articles of association.

(n) Register of members

A Cayman Islands exempted company may maintain its principal register of members and any branch registers in any country or territory, whether within or outside the Cayman

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Islands, as the Company may determine from time to time. The Companies Law contains no requirement for an exempted company to make any returns of members to the Registrar of Companies in the Cayman Islands. The names and addresses of the members are, accordingly, not a matter of public record and are not available for public inspection.

However, an exempted company shall make available at its registered office, in electronic form or any other medium, such register of members, including any branch register of member, as may be required of it upon service of an order or notice by the Tax Information Authority pursuant to the Tax Information Authority Law (2009 Revision) of the Cayman Islands.

(o) Winding up

A Cayman Islands company may be wound up either by (i) an order of the court; (ii) voluntarily by its members; or (iii) under the supervision of the court

The court has authority to order winding up in a number of specified circumstances including where, in the opinion of the court, it is just and equitable that such company be so wound up.

A voluntary winding up of a company occurs where the Company so resolves by special resolution that it be wound up voluntarily, or, where the company in general meeting resolves that it be wound up voluntarily because it is unable to pay its debt as they fall due; or, in the case of a limited duration company, when the period fixed for the duration of the company by its memorandum or articles expires, or where the event occurs on the occurrence of which the memorandum or articles provides that the company is to be wound up. In the case of a voluntary winding up, such company is obliged to cease to carry on its business from the commencement of its winding up except so far as it may be beneficial for its winding up. Upon appointment of a voluntary liquidator, all the powers of the directors cease, except so far as the company in general meeting or the liquidator sanctions their continuance.

In the case of a members' voluntary winding up of a company, one or more liquidators shall be appointed for the purpose of winding up the affairs of the company and distributing its assets.

As soon as the affairs of a company are fully wound up, the liquidator must make a report and an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed off, and thereupon call a general meeting of the company for the purposes of laying before it the account and giving an explanation thereof.

When a resolution has been passed by a company to wind up voluntarily, the liquidator or any contributory or creditor may apply to the court for an order for the continuation of the winding up under the supervision of the court, on the grounds that (i) the company is or is likely to become insolvent; or (b) the supervision of the court will facilitate a more effective, economic or expeditious liquidation of the company in the interests of the contributories and creditors. A supervision order shall take effect for all purposes as if it was an order that the company be wound up by the court except that a commenced voluntary winding up and the prior actions of the voluntary liquidator shall be valid and binding upon the company and its official liquidator.

For the purpose of conducting the proceedings in winding up a company and assisting the court, there may be appointed one or more persons to be called an official liquidator or official liquidators; and the court may appoint to such office such person or persons, either provisionally or otherwise, as it thinks fit, and if more than one persons are appointed to such office, the court shall declare whether any act required or authorised to be done by

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the official liquidator is to be done by all or any one or more of such persons. The court may also determine whether any and what security is to be given by an official liquidator on his appointment; if no official liquidator is appointed, or during any vacancy in such office, all the property of the company shall be in the custody of the court.

(p) Reconstructions

Reconstructions and amalgamations are governed by specific statutory provisions under the Companies Law whereby such arrangements may be approved by a majority in number representing 75% in value of members or creditors, depending on the circumstances, as are present at a meeting called for such purpose and thereafter sanctioned by the courts. Whilst a dissenting member would have the right to express to the court his view that the transaction for which approval is being sought would not provide the members with a fair value for their shares, nonetheless the courts are unlikely to disapprove the transaction on that ground alone in the absence of evidence of fraud or bad faith on behalf of management and if the transaction were approved and consummated the dissenting member would have no rights comparable to the appraisal rights (i.e. the right to receive payment in cash for the judicially determined value of their shares) ordinarily available, for example, to dissenting members of a United States corporation.

(q) Take-overs

Where an offer is made by a company for the shares of another company and, within four months of the offer, the holders of not less than 90% of the shares which are the subject of the offer accept, the offeror may at any time within two months after the expiration of the said four months, by notice require the dissenting members to transfer their shares on the terms of the offer. A dissenting member may apply to the court of the Cayman Islands within one month of the notice objecting to the transfer. The burden is on the dissenting member to show that the court should exercise its discretion, which it will be unlikely to do unless there is evidence of fraud or bad faith or collusion as between the offeror and the holders of the shares who have accepted the offer as a means of unfairly forcing out minority members.

(r) Indemnification

Cayman Islands law does not limit the extent to which a company's articles of association may provide for indemnification of officers and directors, save to the extent any such provision may be held by the court to be contrary to public policy, for example, where a provision purports to provide indemnification against the consequences of committing a crime.

4. GENERAL

Appleby, the Company's legal adviser on Cayman Islands law, has sent to the Company a letter of advice which summarises certain aspects of the Cayman Islands company law. This letter, together with a copy of the Companies Law, is available for inspection as referred to in the paragraph headed "Documents Available for Inspection" in Appendix VI. Any person wishing to have a detailed summary of Cayman Islands company law or advice on the differences between it and the laws of any jurisdiction with which he is more familiar is recommended to seek independent legal advice.

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A. FURTHER INFORMATION ABOUT OUR COMPANY AND OUR SUBSIDIARIES**1. Incorporation**

Our Company was incorporated in the Cayman Islands under the Companies Law as an exempted company with limited liability on March 10, 2011. Our Company has established a place of business in Hong Kong at Suites 1602-05, Chater House, 8 Connaught Road Central, Hong Kong and was registered in Hong Kong as a non-Hong Kong company under Part XI of the Companies Ordinance on April 18, 2012. Mr. Wu Xiao An and Mr. Wang Yunxian were appointed as the authorized representatives of our Company for the acceptance of service of process and notice on behalf of our Company in Hong Kong at the above address.

As our Company was incorporated in the Cayman Islands, it operates subject to the Companies Law and to its constitution comprising the Memorandum and Articles. A summary of certain provisions of its constitution and certain aspects of the Companies Law is set out in Appendix IV to this document.

2. Changes in the share capital of our company

Our Company was incorporated with an authorized share capital of HK\$80,000,000 divided into 8,000,000,000 Shares of HK\$0.01 each. The following alterations in the share capital of our Company have taken place since its date of incorporation:

- (i) on March 10, 2011, our Company issued and allotted one fully paid Share to the initial subscriber, and such Share was subsequently transferred to Brilliance Investment on the same date;
- (ii) on March 10, 2011, our Company issued and allotted 999 fully paid Shares to Brilliance Investment;
- (iii) on August 29, 2011, our Company allotted and issued 1,000 Shares, credited as fully paid at par, to Xinhua Investment, representing the then 50% equity interest in our Company, in full settlement of the loan from Xinhua Investment to us in the amount of HK\$433 million under the Loan Agreement;
- (iv) on October 25, 2011, our Company issued and allotted 399,999,000 Shares, credited as fully paid at par, to each of Brilliance Investment and Xinhua Investment by way of capitalization of the sum of HK\$7,999,980 (being the amount necessary to pay up such Shares at par) out of the share premium account of the Company;
- (v) on October 31, 2011, our Company issued and allotted 46,200,000 fully paid Shares, representing approximately 4.914% of the issued share capital of our Company after the [●] Investment and the subscription of Shares by Lead In, to Dongfeng Motors Engineering, at a consideration of HK\$49,975,714.94; and
- (vi) on October 31, 2011, our Company issued and allotted 93,999,794 Shares, representing approximately 9.998% of the issued share capital of our Company after the [●] Investment and the subscription of Shares by Lead In, to Lead In, at a consideration of HK\$101,681,967.73.

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4. Corporate Reorganization

The companies comprising our Group underwent the Reorganization in preparation for the [●] of our Shares on the [●]. For information relating to the Reorganization, please refer to the section headed “History and Reorganization — Reorganization”.

Following the completion of the Reorganization, our Company became the ultimate holding company of our principal operating subsidiary.

5. Changes in the share capital of our subsidiaries

Our subsidiaries are referred to in the Accountants’ Report, the text of which is set out in Appendix I to this document.

The following alterations in the share capital of the subsidiaries of our Company have taken place within the two years preceding the date of this document:

Southern State

On July 1, 2011, Brilliance China and our Company entered into a share transfer form, pursuant to which our Company acquired 100% equity interest in Southern State at a consideration of US\$1.

Mianyang Xincheng

On July 1, 2011, Southern State and Xinhua Combustion Engine entered into an equity transfer agreement, pursuant to which Southern State agreed to acquire 50% equity interest in Mianyang Xincheng at a consideration of RMB354,654,500.

On August 24, 2011, Xinhua Investment, as lender, and our Company, as borrower, entered into the Loan Agreement in the amount of HK\$433,000,000, for the sole purpose of facilitating our Company and Southern State to acquire 50% equity interest in Mianyang Xincheng held by Xinhua Combustion Engine. Our Company shall issue 50% of our then enlarged issued share capital to Xinhua Investment at the request of Xinhua Investment under the Loan Agreement.

On August 29, 2011, the transfer of 50% equity interest in Mianyang Xincheng to Southern State was completed, as a result of which Mianyang Xincheng became a direct wholly-owned subsidiary of Southern State.

Save as described above, there has been no other alteration in the share capital of the subsidiaries of our Company within the two years preceding the date of this document.

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6. Corporate information of our subsidiaries

A summary of the corporate information of our subsidiaries are set out below:

Name:	Southern State Investment Limited
Place of incorporation:	British Virgin Islands
Date of incorporation:	September 30, 1997
Authorized share capital:	US\$50,000
Issued share capital:	US\$50,000
Interest held by us:	100%
Scope of business:	Investment holding
Name:	Mianyang Xincheng Engine Co., Ltd.* (綿陽新晨動力機械有限公司)
Place of establishment:	PRC
Date of establishment:	March 23, 1998
Total investment:	US\$29,900,000
Registered capital:	US\$24,120,000
Interest held by us:	100%
Scope of business:	Design, manufacture, sales and after-sales services of automotive engines

7. Repurchases of our own securities

This section includes information relating to the repurchase of the Shares, including information required by the [●] to be included in this document concerning such repurchase.

(i) *Relevant legal and regulatory requirements in Hong Kong*

The [●] permit companies with a primary [●] on the [●] to repurchase their own securities on the [●] subject to certain restrictions, and the key restrictions are summarized below:

(a) *Shareholders' approval*

All the proposed repurchases of Shares (which must be fully paid up) must be approved in advance by an ordinary resolution of the shareholders in general meeting, either by way of general mandate or by specific approval of a particular transaction.

(b) *Source of funds*

Repurchases by our Company must be funded out of funds legally available for such purpose in accordance with the Articles and the applicable laws and regulations of the Cayman Islands. A [●] company may not repurchase its own securities on the [●] for a consideration other than cash or for settlement otherwise than in accordance with the trading rules of the [●] from time to time.

(c) *Trading restrictions*

The total number of Shares which our Company may repurchase on the [●] is shares representing up to a maximum of 10% of the existing issued share capital. The Shares proposed to be repurchased must be fully paid-up. Our Company may not issue or announce a proposed issue of Shares for a period of 30 days immediately following a repurchase of Shares, other than an issue of securities pursuant to an

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exercise of share options or similar instruments requiring our Company to issue securities which were outstanding prior to such repurchase, without the prior approval of the [●]. Our Company is also prohibited from repurchasing Shares on the [●] if the repurchase would result in the number of [●] Shares which are in the hands of the public falling below the relevant prescribed minimum percentage as required by the [●]. Our Company is required to procure that the broker appointed by us to effect a repurchase of Shares discloses to the [●] such information with respect to the repurchase as the [●] may require. Also, our Company shall not purchase its Shares on the [●] if the purchase price is higher by 5% or more than the average closing market price for the five preceding trading days on which the Shares were [●] on the [●].

The Controlling Shareholders as disclosed in this document shall not or shall procure not to dispose of its Shares in the six-months period commencing from the [●]. No further Shares or securities convertible into equity securities of our Company may be issued or form the subject of any agreement to such an issue within six months from the [●] unless such an issue falls within one of the exceptions under the [●].

(d) Status of repurchased Shares

All repurchased Shares (whether effected on the [●] or otherwise) will be automatically cancelled and the certificates for those Shares must be cancelled and destroyed.

(e) Suspension of repurchase

Pursuant to the [●], our Company may not make any repurchase of Shares after a price sensitive development has occurred or has been the subject of a decision until such time as the price sensitive information has been made publicly available. In particular, during the period of one month immediately preceding the earlier of: (aa) the date of the board meeting (as such date is first notified to the [●] in accordance with the [●]) for the approval of our Company’s results for any year, half-year, quarterly or any other interim period (whether or not required under the [●]); and (bb) the deadline for our Company to publish an announcement of our results for any year or half-year under the [●], or quarterly or any other interim period (whether or not required under the [●]), and in each case ending on the date of the results announcement, our Company may not repurchase our Shares on the [●], unless the circumstances are exceptional. In addition, the [●] may prohibit a repurchase of the Shares on the [●] if our Company has breached the [●].

(f) Reporting requirements

In the event that our Directors exercise the power to repurchase Shares under the Repurchase Mandate, under the [●], repurchases of securities on the [●] or otherwise must be reported to the [●] in the prescribed form no later than 8.30 a.m. (Hong Kong time) on the following business day. In addition, our Company is required to disclose in our annual report details regarding repurchases of securities made during the year, including but not limited to, in respect of each month, the number of securities repurchased and the aggregate prices paid.

(g) Connected parties

Our Company is prohibited from knowingly repurchasing Shares on the [●] from a “connected person”, that is, a director, chief executive or substantial shareholders of our Company or any of its subsidiaries or their associates and a connected person shall not knowingly sell his securities to our Company on the [●].

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(ii) *Reasons for repurchases*

Our Directors believe that it is in the best interests of our Company and the Shareholders to have a general authority from our Shareholders to enable our Directors to repurchase Shares in the market. Such repurchases may, depending on market conditions and funding arrangements at the time, lead to an enhancement of our Company’s net assets and/or our earnings per Share and will only be made where our Directors believe that such repurchases will benefit our Company and the Shareholders.

Our Directors do not propose to exercise the Repurchase Mandate to such an extent as would, in the circumstances, have a material adverse effect on the working capital requirements of our Company or the gearing levels which in the opinion of our Directors are from time to time appropriate for our Company.

(iii) *General*

The exercise in full of the Repurchase Mandate, on the basis of 1,253,599,726 Shares in issue immediately following completion of the [●], would result in up to 125,359,972 Shares being repurchased by our Company during the period prior to the next annual general meeting of our Company following the passing of the resolutions referred to above.

None of our Directors nor, to the best of their knowledge having made all reasonable enquiries, any of their associates, has any present intention, in the event that the Repurchase Mandate is exercised, to sell any Shares to our Company or its subsidiaries.

Our Directors has undertaken to the [●] that, so far as the same may be applicable, they will exercise the Repurchase Mandate in accordance with the [●] and the applicable laws of the Cayman Islands.

If, as a result of any repurchase of Shares, a Shareholder’s proportionate interest in the voting rights of our Company is increased, such increase will be treated as an acquisition for the purposes of the [●]. Accordingly, a Shareholder or a group of Shareholders acting in concert, depending on the level of increase of the Shareholders’ interest, could obtain or consolidate control of our Company and become obliged to make a [●] in accordance with [●].

No connected person of our Company has notified our Company that he or she has a present intention to sell Shares to our Company, or has undertaken not to do so, if the Repurchase Mandate is exercised.

B. FURTHER INFORMATION ABOUT OUR BUSINESS

1. Summary of material contracts

The following contracts (not being contracts entered into in the ordinary course of business) are or may be material and have been entered into by us within the two years preceding the date of this document:

- (i) share transfer form dated July 1, 2011 executed by Brilliance China and our Company, pursuant to which Brilliance China transferred the entire issued share capital of Southern State to our Company at a consideration of US\$1;
- (ii) an equity transfer agreement dated July 1, 2011 entered into between Xinhua Combustion Engine as the transferor and Southern State as the transferee, pursuant to which Southern State agreed to acquire 50% equity interest in Mianyang Xincheng from Xinhua Combustion Engine through a public auction listed on the Southwest United Equity Exchange Co., Ltd. at a consideration of RMB354,654,500;

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- (iii) the Loan Agreement dated August 24, 2011 entered into between Xinhua Investment as the lender and our Company as the borrower, pursuant to which Xinhua Investment has agreed to lend to our Company an amount of HK\$433,000,000 for the sole purpose of assisting our Company and Southern State to pay for the consideration for the acquisition by Southern State of the 50% equity interest of Mianyang Xincheng held by Xinhua Combustion Engine. Our Company shall issue 50% of our then enlarged issued share capital to Xinhua Investment at the request of Xinhua Investment under the Loan Agreement;
- (iv) a loan agreement dated October 18, 2011 entered into between Brilliance Investment as the lender and our Company as the borrower, pursuant to which Brilliance Investment has agreed to lend to our Company an amount of HK\$20,000,000 for the sole purpose of onward lending to Lead In for Lead In's purchase of the Lead In Subscribed Shares referred to in (vi) below;
- (v) a loan agreement dated October 18, 2011 entered into between Xinhua Investment as the lender and our Company as the borrower, pursuant to which Xinhua Investment has agreed to lend to our Company an amount of HK\$20,000,000 for the sole purpose of onward lending to Lead In for Lead In's purchase of the Lead In Subscribed Shares referred to in (vi) below;
- (vi) a loan agreement dated October 18, 2011 entered into between our Company as the lender and Lead In as the borrower, pursuant to which our Company has agreed to lend to Lead In an amount of HK\$40,000,000 for the sole purpose of enabling Lead In to purchase the Lead In Subscribed Shares;
- (vii) the Subscription Agreement dated October 31, 2011 entered into between Dongfeng Motors Engineering and our Company, pursuant to which Dongfeng Motors Engineering has agreed to acquire 46,200,000 Shares, representing approximately 4.914% of the then enlarged issued share capital of our Company (after giving effect to the subscription of Shares by Lead In and without giving effect to the completion of the [●]), at a consideration of HK\$49,975,714.94;
- (viii) a supplemental loan agreement dated October 16, 2012 entered into between Brilliance Investment as the lender and our Company as the borrower, pursuant to which the expiry date of the term of the loan agreement set out in (iv) above was extended from October 17, 2012 to October 17, 2013;
- (ix) a supplemental loan agreement dated October 16, 2012 entered into between Xinhua Investment as the lender and our Company as the borrower, pursuant to which the expiry date of the term of the loan agreement set out in (v) above was extended from October 17, 2012 to October 17, 2013;
- (x) a supplemental loan agreement dated October 16, 2012 entered into between our Company as the lender and Lead In as the borrower, pursuant to which the expiry date of the term of the loan agreement set out in (vi) above was extended from October 17, 2012 to October 17, 2013;
- (xi) the Trademark License Agreement dated December 10, 2012 entered into between Xinhua Combustion Engine and Mianyang Xincheng, pursuant to which Xinhua Combustion Engine granted Mianyang Xincheng a non-exclusive license, on a royalty-free basis, to use one of the trademarks of Xinhua Combustion Engine registered in the PRC under the name of Xinhua Combustion Engine on our engines;
- (xii) a supplemental agreement to the Subscription Agreement dated December 16, 2012 entered into between Dongfeng Motors Engineering and our Company, pursuant to which the commencement date upon which Dongfeng Motors Engineering could exercise its

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rights to demand our Company to repurchase all the Shares held by Dongfeng Motors Engineering be extended to take place after December 31, 2013;

- (xiii) the deed of indemnity dated [●], 2013 given by our Controlling Shareholders in favor of our Company (for itself and as trustee for each of our subsidiaries) in respect of, amongst others, taxation and property matters referred to in the sub-section headed “Tax and other indemnities” in this Appendix;
- (xiv) the Deed of Non-competition dated [●], 2013 given by our Controlling Shareholders and Huachen in favor of our Company referred to in the sub-section headed “Relationship with our Controlling Shareholders and Huachen — Deed of Non-competition” in this document;
- (xv) the First Huachen and Brilliance China Undertaking dated [●], 2013 given by Huachen and Brilliance China in favor of our Company referred to in the sub-section headed “Relationship with our Controlling Shareholders and Huachen — Shenyang Xinguang Brilliance — Undertaking from Huachen and Brilliance China” in this document;
- (xvi) the Second Huachen and Brilliance China Undertaking dated [●], 2013 given by Huachen and Brilliance China in favor of our Company referred to in the sub-section headed “Relationship with our Controlling Shareholders and Huachen — Aerospace Mitsubishi — Undertaking from Brilliance China” in this document; and
- (xvii) [●].



2. Intellectual property

Trademarks


As of the Latest Practicable Date, our Group had registered the following trademarks in the PRC:

Trademark	Class	Registration no.	Registration period	Registered owner
	7	1913710	June 14, 2003 to June 13, 2013	Mianyang Xincheng
	7	1913707	March 7, 2003 to March 6, 2013	Mianyang Xincheng
	12	5494007	October 7, 2009 to October 6, 2019	Mianyang Xincheng

As of the Latest Practicable Date, our Group had registered the following trademark in Hong Kong:

Trademark	Class(es)	Trademark no.	Registered owner	Registration date	Next renewal date
 	7 and 12	302113325	The Company	December 14, 2011	December 13, 2021

As of the Latest Practicable Date, our Group had filed an application for registration of the following trademark in Hong Kong:

Trademark	Class(es)	Applicant	Application no.	Application date
	7 and 12	The Company	302425824	November 5, 2012

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3. Domain names

As of the Latest Practicable Date, our Group was the registered proprietor of the following domain names in the PRC:

Domain name	Registrant	Expiration date
(i) www.xinchenpower.com	Our Company	March 28, 2017
(ii) www.xce.com.cn	Mianyang Xincheng	December 3, 2019

4. Patents

As of the Latest Practicable Date, our Group has registered the following patents in the PRC that are material to our business:

	Patent	Type	Application no.	Application date	Patent holder
(i)	Gasoline engine valve guide tube	Invention	ZL03135301.0	June 27, 2003	Mianyang Xincheng
(ii)	Compression height inspector of cylinder	Invention	ZL200510020819.5	April 29, 2005	Mianyang Xincheng
(iii)	Positioning device for accurate heavy workpiece processing	Invention	ZL200810147683.8	November 26, 2008	Mianyang Xincheng
(iv)	Noise-reducing gas exhausting thermal insulating hood for vehicle engine	Utility Patent	ZL200520034056.5	April 29, 2005	Mianyang Xincheng
(v)	Low oil consumption gasoline engine	Utility Patent	ZL200620034103.0	May 1, 2006	Mianyang Xincheng
(vi)	Gasoline engine	Utility Patent	ZL200620034104.5	May 1, 2006	Mianyang Xincheng
(vii)	Environmental friendly gasoline engine	Utility Patent	ZL200620034105.X	May 1, 2006	Mianyang Xincheng
(viii)	Exhaust gas recirculation valve for internal combustion engine	Utility Patent	ZL200720081395.8	October 1, 2007	Mianyang Xincheng
(ix)	Cylinder head for engine	Utility Patent	ZL200720081396.2	October 1, 2007	Mianyang Xincheng
(x)	High speed diesel engine for automobile	Utility Patent	ZL200820222942.4	November 26, 2008	Mianyang Xincheng

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	<u>Patent</u>	<u>Type</u>	<u>Application no.</u>	<u>Application date</u>	<u>Patent holder</u>
(xi)	Gasoline engine with variable valve timing mechanism	Utility Patent	ZL200820222943.9	November 26, 2008	Mianyang Xincheng
(xii)	Variable camshaft phase regulator of engine	Utility Patent	ZL200820222944.3	November 26, 2008	Mianyang Xincheng
(xiii)	Camshaft of engine	Utility Patent	ZL200820222945.8	November 26, 2008	Mianyang Xincheng
(xiv)	Engine cylinder body	Utility Patent	ZL200820222946.2	November 26, 2008	Mianyang Xincheng
(xv)	Lubricating oil pump for engine	Utility Patent	ZL200830266119.9	November 26, 2008	Mianyang Xincheng
(xvi)	Piston for high speed diesel engine for automobile	Utility Patent	ZL200920353048.5	December 30, 2009	Mianyang Xincheng
(xvii)	Positioning column for engine	Utility Patent	ZL200920353049.X	December 30, 2009	Mianyang Xincheng
(xviii)	Cooling jet for engine piston	Utility Patent	ZL200920353051.7	December 30, 2009	Mianyang Xincheng
(xix)	Air outlet manifold branch of engine	Utility Patent	ZL201020120846.6	February 26, 2010	Mianyang Xincheng
(xx)	Air inlet manifold branch of engine	Utility Patent	ZL201020701379.6	December 31, 2010	Mianyang Xincheng
(xxi)	Air outlet manifold branch for engine	Utility Patent	ZL201020701380.9	December 31, 2010	Mianyang Xincheng
(xxii)	Piston with double-wedge shape combustion chamber for engine	Utility Patent	ZL201020701389.x	December 31, 2010	Mianyang Xincheng
(xxiii)	Cooling jet with double balance axle for engine piston	Utility Patent	ZL201020701381.3	December 31, 2010	Mianyang Xincheng
(xxiv)	Cooling device for engine piston	Utility Patent	ZL201020701382.8	December 31, 2010	Mianyang Xincheng
(xxv)	Engine cylinder body	Utility Patent	ZL201020701387.0	December 31, 2010	Mianyang Xincheng

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	<u>Patent</u>	<u>Type</u>	<u>Application no.</u>	<u>Application date</u>	<u>Patent holder</u>
(xxvi)	Lubricating oil pump for engine	Utility Patent	ZL201020701386.6	December 31, 2010	Mianyang Xincheng
(xxvii)	Internal cooling device for engine oil	Utility Patent	ZL201020701385.1	December 31, 2010	Mianyang Xincheng
(xxviii)	Gasoline engine	Invention	201010620096.3	December 31, 2010	Mianyang Xincheng
(xxix)	Gasoline engine	Invention	201010620077.0	December 31, 2010	Mianyang Xincheng
(xxx)	Gasoline engine with single camshaft	Utility Patent	201120576999.6	December 31, 2011	Mianyang Xincheng
(xxxi)	Piston for engine	Utility Patent	201120579190.9	December 31, 2011	Mianyang Xincheng
(xxxii)	Gasoline engine	Utility Patent	201220000877.7	January 2, 2012	Mianyang Xincheng
(xxxiii)	Gasoline engine	Utility Patent	201220000878.1	January 2, 2012	Mianyang Xincheng

As of the Latest Practicable Date, our Group has filed applications for registration of the following patents in the PRC that are material to our business:

	<u>Patent</u>	<u>Type</u>	<u>Application no.</u>	<u>Application date</u>	<u>Applicant</u>
(i)	Device for cooling cast metal mould	Invention	200910265043.1	December 30, 2009	Mianyang Xincheng
(ii)	Snap spring assembling tool	Invention	200910265044.6	December 30, 2009	Mianyang Xincheng
(iii)	Air inlet/outlet mechanism of rotary air valve of internal combustion engine	Invention	200910265079.X	December 31, 2009	Mianyang Xincheng
(iv)	Engine circulation rack	Invention	201110462795.4	December 31, 2011	Mianyang Xincheng
(v)	Dual clutch transmission	Invention	201110462844.4	December 31, 2011	Mianyang Xincheng
(vi)	Dual clutch transmission	Invention	201110462845.9	December 31, 2011	Mianyang Xincheng
(vii)	Cam profile for engine	Invention	201110462846.3	December 31, 2011	Mianyang Xincheng
(viii)	Valve oil seal removal tool	Invention	201110462847.8	December 31, 2011	Mianyang Xincheng
(ix)	Dual clutch transmission	Invention	201110462878.3	December 31, 2011	Mianyang Xincheng

Saved as disclosed above, there are no other copyrights, patents or other intellectual property rights that are material to our business.

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5. Properties

Owned Properties

As at September 30, 2012, the Group had the following owned properties with the details set out below.

No.	Address and description of location	Owner	Use	Restrictions on use	Approximate area	Book value as at September 30, 2012	Material encumbrances, liens, pledges and mortgages	Material environmental issues	Material litigation, breaches, defects	Future plans for construction, renovation, improvement or development and estimated associated costs	Other remarks
1.	#228 Jianmen Road West Mianyang City, Sichuan Province, PRC	Mianyang Xincheng	Factory, offices, warehouses and employees' dormitories	None	The property occupies six parcels of land with an aggregate site area of approximately 59,043.94 sq. m. with an aggregate floor area of approximately 32,184.86 sq. m. erected on these lands	RMB18,999,000	Charged to Shanghai Pudong Development Bank for loans of approximately RMB50 million	None	None	None	None
2.	Mianyang High-Tech Development Zone	Mianyang Xincheng	Factory and offices	None	The property occupies two parcels of land with an aggregate site area of approximately 202,588.14 sq. m. and construction area of approximately 119,000 sq. m.	RMB185,242,000	Charged to Shanghai Pudong Development Bank for a loan of approximately RMB50 million	None	None	Estimated total capital expenditures in relation to land acquisition for, and construction of, new production facilities are approximately RMB245 million.	Construction of new production facilities is expected to be completed and the production facilities commence full commercial operation by September 30, 2013
3.	#78 Linyuan Road Middle, Fucheng Zone, Mianyang City	Mianyang Xincheng	Residential	None	Site area 171.19 sq. m., floor area 239.66 sq. m.	RMB317,000	None	None	None	None	None
4.	Rooms 103 and 203, No. 36, Yongcui Road, Baiyun Zone Guangzhou City	Mianyang Xincheng	Residential	None	Floor area 343.2 sq. m.	RMB1,096,000	None	None	None	None	None
5.	No. 5-101 Yanchuan Shan Ecology Park, Yuhua Zone Changsha City	Mianyang Xincheng	Residential	None	Site area 73.08 sq. m., floor area 203.35 sq. m.	RMB1,159,000	None	None	None	None	None
6.	#89-2 Beihai Road, Dadong Zone Shenyang City	Mianyang Xincheng	Residential	None	Floor area 281.19 sq. m.	RMB1,010,000	None	None	None	None	None

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C. FURTHER INFORMATION ABOUT OUR DIRECTORS, SENIOR MANAGEMENT AND STAFF

1. Directors’ interests and short positions in the share capital and debentures of our Company and its associated corporations

Immediately following the completion of the [●] (but without taking account of any Shares which may be allotted and issued upon the exercise of the [●] or any options which have been or may be granted under the Share Option Scheme), the interest or short positions of our Directors in the Shares, underlying Shares and debentures of our Company or any associated corporation (within the meaning of [●]) which will be required to be notified to our Company and the [●] (including interests or short positions which they were taken or deemed to have under such provisions of the [●]) or which will be required, pursuant to [●], to be entered in the register referred to therein, or which will be required to be notified to our Company and the [●], pursuant to the [●], once the Shares are [●] are as follows:

Interest in the Shares of our Company

Name of Director	Nature of interest	Number and class of Shares	Approximate percentage of shareholding immediately after completion of the [●] ⁽²⁾
Mr. Wu Xiao An ⁽¹⁾	Beneficiary of the Fixed Trust	8,320,041 ordinary	[0.66]%
Mr. Wang Yunxian ⁽¹⁾	Beneficiary of the Fixed Trust	6,471,143 ordinary	[0.52]%
Mr. Li Peiqi ⁽¹⁾	Beneficiary of the Fixed Trust	6,471,143 ordinary	[0.52]%

(1) The trustee of the Fixed Trust is Lead In, and immediately after the [●] (assuming the [●] is not exercised), Lead In will be interested in approximately [7.498]% of the issued share capital of our Company. The beneficiaries of the Fixed Trust comprise certain Directors including Mr. Wu Xiao An, Mr. Wang Yunxian and Mr. Li Peiqi, 48 senior management and employees of our Group. The above Directors are taken or deemed to be interested in their entitlement in the Shares held by Lead In.

(2) These percentages are calculated on the basis of [1,253,599,726] Shares in issue immediately after completion of the [●] (assuming the [●] is not exercised).

2. Particulars of Directors’ service agreements

Each of our executive and non-executive Directors has entered into a service agreement with our Company on [●], 2013 for a term of three years commencing from the [●], and such service agreement may be terminated in accordance with the terms of the service agreements.

Each of our independent non-executive Directors was appointed to our Board pursuant to the respective letters of appointment dated [●], 2013, for an initial term of three year commencing from the [●], and such appointment may be terminated in accordance with the terms of the letters of appointment.

Save as disclosed above, none of our Directors has entered or has proposed to enter into any service agreements with our Company or any member of our Group (other than agreements expiring or terminable by the employer within one year without payment of compensation other than statutory compensation).

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3. Remuneration of Directors

The aggregate amount of salaries, allowances, discretionary bonus and retirement benefits scheme contributions paid and benefits in kind granted to our Directors for each of the three years ended December 31, 2011 and the nine months ended September 30, 2012 were approximately RMB0.8 million, RMB0.8 million, RMB0.8 million and RMB0.6 million, respectively.

Under the arrangements currently in force, the estimated aggregate remuneration payable to, and benefits in kind receivable by (excluding any discretionary bonus), our Directors in respect of the year ending December 31, 2013 will be approximately RMB0.7 million.

4. Agency fees or commissions received

Save as disclosed in this document, no commission, discounts, brokerages or other special terms were granted within the two years preceding the date of this document in connection with the issue or sale of any capital of any member of our Group.

5. Disclaimers

Save as disclosed in this document:

- (i) none of our Directors or chief executive of our Company has any interest or short position in the Shares, underlying Shares or debentures of our Company or any of its associated corporation (within the meaning of the [●]) which will have to be notified to our Company and the [●] pursuant to [●] or which will be required, pursuant to [●], to be entered in the register referred to therein, or which will be required to be notified to our Company and the [●] pursuant to the [●] once the Shares are [●];
- (ii) none of our Directors or experts referred to under the heading “Consents of experts” in this appendix has any direct or indirect interest in the promotion of our Company, or in any assets which have within the two years immediately preceding the date of this document been acquired or disposed of by or leased to any member of our Group, or are proposed to be acquired or disposed of by or leased to any member of our Group;
- (iii) none of our Directors is materially interested in any contract or arrangement subsisting at the date of this document which is significant in relation to the business of our Group taken as a whole;
- (iv) none of our Directors has any existing or proposed service contracts with any member of our Group (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation));
- (v) excluding Shares which may be taken up under the [●], none of our Directors knows of any person (not being a Director or chief executive of our Company) who will, immediately following completion of the [●], have an interest or short position in the Shares or underlying Shares of our Company which would fall to be disclosed to our Company under the provisions of [●] or be interested, directly or indirectly, in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of our Group;
- (vi) none of the experts referred to under the heading “Consents of experts” in this appendix has any shareholding in any member of our Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of our Group; and

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- (vii) so far as is known to our Directors, none of our Directors, their respective associates (as defined under the [●]) or Shareholders of our Company who are interested in more than 5% of the issued share capital of our Company has any interests in the five largest customers or the five largest suppliers of our Group.

D. INCENTIVE SCHEME ESTABLISHED BY LEAD IN

The Incentive Scheme was established in 2011 before the [●] to serve as a retention tool, and to align the interests of the Beneficiaries with that of our Company. Lead In was incorporated for the purpose of holding our Shares on trust for the Beneficiaries pursuant to the Incentive Scheme.

Lead In was incorporated in the BVI on May 18, 2011 and is currently owned as to 50% by Mr. Wu Xiao An and 50% by Mr. Wang Yunxian, both of whom are our executive Directors. On October 31, 2011, Lead In subscribed for 93,999,794 Shares, representing approximately 9.998% of the then enlarged issued share capital of our Company (after giving effect to the subscription of Shares by Dongfeng Motors Engineering and without giving effect to the completion of the [●]) at a consideration of HK\$101,681,967.73, which was determined based on the Mianyang Xinchun Valuation Report. Lead In holds such Shares on trust for the Beneficiaries under two separate trust arrangements, namely the Fixed Trust and the Discretionary Trust. For details of the Fixed Trust and the Discretionary Trust, please see “History and Reorganization — Incentive Scheme Established by Lead In” in this document.

The terms of the Incentive Scheme and the trust arrangements are not subject to the provisions of Chapter 17 of the [●] as these arrangements will not involve the grant of options by us to subscribe for Shares after the [●].

A summary of the Beneficiaries who have been awarded with Shares under the Fixed Trust is set out below:

Name of Beneficiary	Address	Total consideration paid	Number of Shares awarded	Approximate percentage of issued Shares immediately after completion of the [●] ⁽¹⁾
Directors of our Company:				
Mr. Wu Xiao An	Flat C, 48/F Island Lodge 180 Java Road North Point Hong Kong	HK\$9,000,000	8,320,041	[0.66]%
Mr. Wang Yunxian	Room 5, Unit 1, Block 5 No. 228 Jianmen Road West Fucheng District Mianyang Sichuan Province PRC	HK\$7,000,000	6,471,143	[0.52]%
Mr. Li Peiqi	Annex 20 No. 6 Zhuanshu Street Cuiping District Yibin City Sichuan Province PRC	HK\$7,000,000	6,471,143	[0.52]%

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Name of Beneficiary	Address	Total consideration paid	Number of Shares awarded	Approximate percentage of issued Shares immediately after completion of the [●]⁽¹⁾
<i>Director of Mianyang Xincheng (save as disclosed above):</i>				
Mr. Zhang Zitao	No. 11, Unit 1 No. 57 Yongquan Street Cuiping District Yibin City Sichuan Province PRC	HK\$1,432,000	1,323,810	[0.11]%
<i>Senior management:</i>				
Mr. He Xuzong	No. 203, Unit 2, Block 24 No. 228 Jianmen Road West Fucheng District Mianyang PRC	HK\$3,300,000	3,050,681	[0.24]%
Mr. Song Ning	Flat 2D, Boyage Xiaodao Huayuan Youxian District Mianyang PRC	HK\$2,100,000	1,941,342	[0.15]%
Mr. Lai Yong	No. 204, Unit 1, Block 10 No. 228 Jianmen Road West Fucheng District Mianyang PRC	HK\$2,850,000	2,634,679	[0.21]%
Mr. Ma Li	No. 202, Unit 6, Block 2 Yunshuge Xiaodao Huayuan Youxian District Mianyang PRC	HK\$2,300,000	2,126,232	[0.17]%
Mr. Xu Bingchu	No. 401, Unit 2, Block 8 Fulin Xiaoqu No. 17 Anchang Road Mianyang PRC	HK\$3,350,000	3,096,904	[0.25]%
<i>42 other employees</i>	—	HK\$23,350,000	21,585,859	[1.72]%
Total:		HK\$61,682,000	57,021,834	[4.55]%

(1) These percentages are calculated on the basis of [1,253,599,726] Shares in issue immediately after completion of the [●] (assuming the [●] is not exercised).

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Except for Mr. Wu Xiao An, Mr. Wang Yunxian, Mr. Li Peiqi and Mr. Zhang Zitao, none of the Beneficiaries under the Fixed Trust is a connected person of our Group as defined in the [●].

F. OTHER INFORMATION**1. Tax**

Dealings in the Shares will be subject to Hong Kong stamp duty.

Intending holders of the Shares are recommended to consult their professional advisers if they are in any doubt as to the taxation implications of subscribing for, purchasing, holding or disposing of or dealing in the Shares. It is emphasized that none of us, our Directors or any other parties involved in the [●] accepts responsibility for any tax effect on, or liabilities of holders of Shares resulting from their subscription for, purchase, holding or disposal of or dealing in the Shares.

2. Tax and other indemnities

Each of the Controlling Shareholders has entered into a deed of indemnity with and in favor of our Company (for itself and as trustee for each of our subsidiaries) (being the contract referred to in the sub-section headed “Summary of material contracts” in this Appendix) to provide indemnities in respect of, among other matters, (i) taxation resulting from income, profits or gains earned, accrued or received as well as any claim to which our Company or any member of our Group may be subject on or before the date on which the [●] becomes unconditional (the “Effective Date”) which might be payable by any member of our Group; (ii) Hong Kong estate duty which might be payable by any member of our Group, by reason of any transfer of property (within the meaning of Section 35 of the Estate Duty Ordinance, Chapter 111 of the Laws of Hong Kong, as amended by the Revenue (Abolition of Estate Duty) Ordinance) to any member of our Group on or before the Effective Date; and (iii) all claims, liabilities and expenses incurred by our Group in connection with the failure to obtain state-owned land use right certificates from the relevant competent governmental authorities in the PRC in relation to any of the properties owned by us in the PRC.

3. Litigation

Our Directors confirm that, as of the [Latest Practicable Date], save as disclosed in “Business — Legal Proceedings and Compliance”, no litigation, arbitration, proceedings or claims of material importance are pending, in process or threatened against any member of our Group that would have a material adverse effect on the results of operations or financial condition of our Group.

5. Preliminary expenses

The preliminary expenses of our Company are estimated to be approximately HK\$181,000 and are payable by our Company.

12. No material adverse change

Our Directors confirm that there has been no material adverse change in the financial or trading position or prospects of our Group from September 30, 2012 (being the date to which the latest audited consolidated financial statements of our Group were prepared) to December 31, 2012.

The [●] is of the view that there has been no material adverse change in the Group’s financial or trading position or prospects from September 30, 2012 (being the date to which the latest audited consolidated financial statements of our Group were prepared) to December 31, 2012.

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G. MISCELLANEOUS

- (i) Save as disclosed in this document, within the two years preceding the date of this document:
 - (a) no share or loan capital of our Company or any of its subsidiaries has been issued or agreed to be issued fully or partly paid either for cash or for consideration other than cash;
 - (b) no Share or loan capital of our Company or any of its subsidiaries is under option or is agreed conditionally or unconditionally to be put under option;
 - (c) no founders or management or deferred Shares of or any debentures in our Company or any of its subsidiaries have been issued or agreed to be issued;
 - (d) no commissions, discounts, brokerages or other special terms have been granted in connection with the issue or sale of any capital of our Company or any of its subsidiaries;
 - (e) no commission has been paid or payable, except for the commission payable to the [●], for subscription of, agreeing to subscribe or procuring subscription of any shares in our Company or any of its subsidiaries; and
 - (f) we have no outstanding convertible debt securities.
- (ii) Our Directors confirm that there has not been any interruption in the business of our Group which may have or have had a material adverse effect on the financial position of our Group in the 12 months preceding the date of this document.