



沈機集團昆明機床股份有限公司
SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED

(A sino-foreign joint stock limited company established in the People's Republic of China with limited liability)
(Stock Code: 0300)

Annual Report 2007



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IMPORTANT NOTICE

1. The board of directors, supervisory committee, directors, supervisors and senior management officers of the Company have declared that the information in this report does not contain any false information, misleading statements or material omissions. The Board of Directors of the Company also jointly and severally accepts full responsibility for the truthfulness, accuracy and completeness of the content of the report.
2. All directors attended the board of directors' meeting.
3. The financial statements of the year 2007 of the Company were audited by Zonzun Accounting Office Limited and KPMG respectively, and both firms have issued unqualified opinions on the financial statements in their auditor's reports.
4. Mr. Gao Minghui, Chairman and Executive Director, Mr. Pi Jianguo, Financial Controller of the Company, and Ms. Zhao Qiongfeng, Accounting Supervisor, have declared that they assured for the truthfulness and completeness of the financial statements in the Annual Report 2007.

COMPANY INFORMATION

1. Name of the Company (Chinese) : 沈機集團昆明機床股份有限公司
Abbreviated Name (Chinese) : 昆明機床
Name of the Company (English) : SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED
Abbreviated Name (English) : KMTCL
2. Company's Legal Representative : Mr. Gao Minghui
3. Secretary to the Board : Ms. Yu Yan
Telephone number : 86-871-6166612
Facsimile number : 86-871-6166288
E-mail : yuyan@kmtcl.com.cn
Correspondence address : 23 Ciba Road, Kunming City, Yunnan Province, the PRC
Securities Affairs Representative : Mr. Luo Tao
E-mail : luotao@kmtcl.com.cn
Telephone number : 86-871-6166623
Facsimile number : 86-871-6166288
Correspondence address : 23 Ciba Road, Kunming City, Yunnan Province, the PRC
4. The registered office : 23 Ciba Road, Kunming City, Yunnan Province, the PRC
Company business address : 23 Ciba Road, Kunming City, Yunnan Province, the PRC
Post code : 650203
Website of the Company : www.kmtcl.com.cn
E-mail : dsh@kmtcl.com.cn
5. Company's designated newspaper for publishing : China Securities Daily, Shanghai Securities News, Securities Times, Hong Kong Wen Wei Po and The Standard
Company's designated internet website for publishing annual report in the PRC and Hong Kong : <http://www.sse.com.cn>, <http://www.kmtcl.com.cn>
<http://www.hkex.com.hk>
Annual report available at : Rm. 216, Office Building, 23 Ciba Road, Kunming City, Yunnan Province, the PRC

COMPANY INFORMATION

6. Place of A Shares Listing : Shanghai Securities Exchange
- Abbreviation of Company A Shares : Kunming Machine
- Stock code of Company A Shares : 600806
- Place of H Shares Listing : The Stock Exchange of Hong Kong Limited
- Abbreviation of Company H Shares : KUNMING MACHINE
- Stock code of Company H Shares : 0300
7. Other relevant information
- Date of incorporation : 19th October 1993
- Place of registration : Yunnan Commercial and Industrial Administration Bureau
- First change of registration date : 29th March 2002
- Second change of registration date : 1st December 2007
- Place of first change of registration : Yunnan Commercial and Industrial Administration Bureau
- Place of second change of registration : Yunnan Commercial and Industrial Administration Bureau
- Business registration number : 企股滇總字第000682號
- Tax Registration Number : 530111622602196
- Appointed auditor in the PRC : Zonzun Accounting Office Limited
- Address : 4/F., Guoxing Building, 22 Capital Road South, Haiding District, Beijing, the PRC
- Appointed auditors outside the PRC : KPMG
- Address : 8/F., Prince's Building, 10 Chater Road, Central, Hong Kong

FINANCIAL AND OPERATING HIGHLIGHTS

I. PRINCIPAL ACCOUNTING DATA AND FINANCIAL HIGHLIGHTS

1. In accordance with the PRC accounting standards (“PRC GAAP”)

Items	<i>Unit: RMB</i> Amount
Operating profit	282,722,373.57
Profit for the year	297,182,435.72
Net profit attributable to the equity shareholders of the Company	242,957,688.27
Net profit excluding non-recurring items attributable to the equity shareholders of the Company	209,690,728.85
Net cash flow from operating activities	265,050,299.92

2. In accordance with Hong Kong accounting standards (“Hong Kong GAAP”)

Items	<i>Unit: RMB’000</i> Amount
Profit from operations	297,451
Profit from continuing operations	252,118
Profit for the year attributable to equity shareholders of the Company	241,452

II. DIFFERENCE BETWEEN THE PRC GAAP AND HONG KONG GAAP

Items	<i>Unit: RMB’000</i> Net Profit	Net Assets
Consolidated results in accordance with the PRC GAAP	242,957.69	879,379.13
Add: Gain on investment in jointly controlled entity(ies)	(1,330.00)	(8,869.00)
Add: Adjustment on defer gain	(894.73)	57.00
Add: Amortisation of goodwill	–	(1,427.63)
Add: Adjustment on bad debts	939.44	–
Add: Others	(220.00)	220.00
Consolidated results in accordance with Hong Kong GAAP	241,452.40	869,359.50

III. NON-RECURRING ITEMS FOR THE YEAR

Item	<i>Unit: RMB</i> Effected after-tax amount
Insurance indemnities	128,502.28
Return of value-added tax	16,041,596.83
Government grants	4,018,217.41
Gain on disposal fixed assets	508,422.03
Written back provision for inventories impairment loss	546,119.16
Gain on investment	20,725,503.96
Other income	66,815.46
Fine	(165,630.68)
Loss on disposal non-current assets	(1,580,069.73)
Donation	(20,522.70)
Late fee	(553,319.45)
Loss on stand-down by the builder during the construction	(6,448,675.15)
Total	<u>33,266,959.42</u>

FINANCIAL AND OPERATING HIGHLIGHTS

IV. PRINCIPAL ACCOUNTING DATA AND FINANCIAL HIGHLIGHTS FOR THE LATEST 3 YEARS

1. In accordance with the PRC GAAP

Unit: RMB

ITEMS	Year 2007	Year 2006		Increase/ Decrease (%)	Year 2005	
		Before adjustment (restated)	After adjustment		Before adjustment (restated)	After adjustment
Revenue	1,302,385,627.67	848,419,448.35	852,038,766.03	52.86	672,642,923.86	672,642,923.86
Profit for the year	297,182,435.72	123,936,272.07	124,463,951.85	138.77	35,353,680.28	39,383,530.30
Net profit attributable to equity shareholders of the Company	242,957,688.27	97,405,149.70	98,058,774.72	147.77	18,321,052.33	21,302,233.12
Net profit excluding non-recurring items attributable to equity shareholders of the Company	209,690,728.85	94,111,609.12	94,765,234.14	121.27	15,997,596.59	18,978,777.38
Basic earnings per share	0.57	0.23	0.23	147.83	0.07	0.05
Diluted earnings per share	0.57	0.23	0.23	147.83	0.07	0.05
Basic earnings per share excluding non-recurring items	0.49	0.22	0.22	122.72	0.065	0.04
Return on net assets (fully diluted) (%)	27.63	15.43	15.41	Increased 12.22 percentage points	3.44	3.95
Return on net assets (weighted average) (%)	32.06	16.74	16.88	Increased 15.18 percentage points	3.54	4.13
Return on net assets based on net profit excluding non-recurring items (fully diluted) (%)	23.85	14.91	14.89	Increased 8.96 percentage points	3.04	3.52
Return on net assets based on net profit excluding non-recurring items (weighted average) (%)	27.67	16.17	16.31	Increased 11.36 percentage points	3.09	3.68
Net cash flow from operating activities	265,050,299.92	100,324,771.55	97,669,484.86	171.37	61,717,841.48	61,717,841.48
Net cash flow per share from operating activities	0.62	0.24	0.23	171.37	0.25	0.25

FINANCIAL AND OPERATING HIGHLIGHTS

Items	As at 31st December, 2007	As at 31st December, 2006		Increase/ Decrease (%)	As at 31st December, 2005	
		Before adjustment (restated)	After adjustment		Before adjustment (restated)	After adjustment
Total assets	1,779,007,685.98	1,205,028,497.90	1,271,079,886.17	39.96	1,079,184,349.67	1,114,022,926.35
Shareholders' equity	953,384,928.17	631,316,143.21	707,736,356.65	34.71	531,994,238.15	539,179,291.89
Net assets per share attributable to equity shareholders of the Company	2.24	1.49	1.67	34.71	1.25	1.27

2. In accordance with the Hong Kong GAAP

Unit: RMB

	Year 2007	Year 2006 (restated)	Increases/ Decrease (%)	Year 2005	Year 2004	Year 2003
Revenue ('000)	1,266,707	818,085	54.84%	672,643	469,436	330,613
Profit for the year attributable to equity shareholders of the Company ('000)	241,452	102,529	135.50%	11,001	(17,586)	15,324
Total assets ('000)	1,764,718	1,256,360	40.46%	1,070,597	1,123,305	996,048
Total liability ('000)	821,368	557,262	47.39%	488,358	561,467	385,931
Shareholders' equity ('000)	869,359	627,907	38.45%	523,141	512,140	529,726
Earnings per share (dollar)	0.568	0.241	135.68%	0.045	(0.07)	0.063
Net assets per share (dollar)	2.05	1.48	38.51%	2.14	2.09	2.16
Return on net assets (%)	27.77	16.33	11.44%	2.10	(3.45)	2.89
Net assets per share after adjustment (dollar)	2.05	1.48	38.51%	2.14	2.09	2.14
Net cash flow per share from operating activities (dollar)	0.67	0.14	378.57%	0.42	0.47	0.36
Gearing ratio	46.54%	44.36%	2.18%	45.62%	49.98%	38.75%

V. SUPPLEMENTAL INFORMATION DISCLOSED ACCORDING TO DISCLOSURE REQUIREMENT SET OUT IN ISSUE NO.9 OF "THE CONTENT AND FORMAT OF DISCLOSURE INFORMATION BY LISTED COMPANIES" ISSUED BY CHINA SECURITIES SUPERVISION AND ADMINISTRATIVE COMMITTEE

Profit for the reporting period	Return on net assets (%)		Earnings per share (dollar)	
	Fully diluted	Weighted average	Basis earnings per share	Diluted earnings per share
Net profit attributable to equity shareholders of the Company	27.63	32.06	0.57	0.57
Net profit excluding non-recurring items attributable to equity shareholders of the Company	23.85	27.67	0.49	0.49

FINANCIAL AND OPERATING HIGHLIGHTS

VI. MOVEMENT IN SHAREHOLDERS' EQUITY AND REASONS

1. In accordance with the PRC GAAP

Unit: RMB'000

Items	Share capital	Capital reserve	Surplus reserve	Undistributed profit	Shareholders' equity
As at 31st December 2006	245,007.40	313,377.02	20,773.93	57,263.09	636,421.44
Increase for the year	179,857.48	–	21,129.36	242,957.69	443,944.54
Decrease for the year	–	179,857.48	–	21,129.36	200,986.85
As at 31st December, 2007	<u>424,864.88</u>	<u>133,519.54</u>	<u>41,903.29</u>	<u>279,091.41</u>	<u>879,379.13</u>

2. In accordance with the Hong Kong GAAP

Unit: RMB'000

Items	Share capital	Share premium	Capital reserve	Statutory surplus reserve	Statutory public welfare fund	Undistributed profit	Shareholders' equity
As at 31st December 2006	245,007	293,745	10,225	21,810	–	57,120	627,907
Change for the year	179,858	(179,858)	–	–	–	–	–
Profit for the year	–	–	–	–	–	241,452	241,452
Appropriation	–	–	–	21,129	–	(21,129)	–
As at 31st December 2007	<u>424,865</u>	<u>113,887</u>	<u>10,225</u>	<u>42,939</u>	<u>–</u>	<u>277,443</u>	<u>869,359</u>

VII. ITEMS ACCOUNTED FOR AT FAIR VALUE

Unit: RMB

Item	Balance as at the beginning of the reporting period	Balance as at the end of the reporting period	Change during the reporting period	Resulting on profit for the reporting period
Available-for-sale financial assets	11,902,402.80	–	32,035,348.64	20,725,503.96

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

I. CHANGES IN SHARE CAPITAL

1. Table of changes in share capital of the Company

Unit: Share

	Beginning of the year		Increase/(decrease) during the year					End of the year	
	Number of shares	Proportion (%)	Allotment	Bonus shares	Transfer from capital reserve	Others	Sub-total	Number of shares	Proportion (%)
A. Shares subject to selling restrictions									
1. state-owned shares	31,345,554	12.79	-	(4,891,787)	4,891,787	(31,345,554)	(31,345,554)	-	-
2. state-owned legal person shares	71,052,146	29.00	-	(11,088,398)	11,088,398	82,544,404	82,544,404	153,596,550	36.15
3. Other domestic shares	17,609,700	7.19	-	(2,748,170)	2,748,170	8,804,850	8,804,850	26,414,550	6.22
Including:									
Non-state-owned									
legal person shares	17,609,700	7.19	-	(2,748,170)	2,748,170	8,804,850	8,804,850	26,414,550	6.22
Domestic nature person	-	-	-	-	-	-	-	-	-
4. foreign owned shares	-	-	-	-	-	-	-	-	-
Including:									
Shares owned by foreign legal person	-	-	-	-	-	-	-	-	-
Shares owned by foreign nature person	-	-	-	-	-	-	-	-	-
Total	120,007,400	48.98	-	(18,728,355)	18,728,355	60,003,700	60,003,700	180,011,100	42.37
B. Shares not subject to selling restrictions									
1. RMB ordinary shares	60,000,000	24.49	-	18,728,355	9,363,600	44,045,978	72,137,933	132,137,933	31.10
2. Domestic listed foreign shares	-	-	-	-	-	-	-	-	-
3. Overseas listed foreign shares	65,000,000	26.53	-	-	10,143,900	37,571,950	47,715,850	112,715,850	26.53
4. Others	-	-	-	-	-	-	-	-	-
Total	125,000,000	51.02	-	18,728,355	19,507,500	81,617,928	119,853,783	244,853,783	57.63
C. Total number of shares	245,007,400	100.00	-	-	38,235,855	141,621,628	179,857,483	424,864,883	100.00

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

2. Changes in selling restricted shares

Unit: share

Name of shareholders	Number of selling restricted shares at the beginning of the year	Number of shares released from selling restricted shares in 2007	Number of selling restricted shares increased	Number of selling restricted shares at the end of the year	Reasons for selling restriction	Date of selling restriction release
Shenyang Machine Tool (Group) Company Limited	106,578,219	-	-	106,578,219	Committed in the Share Reform Agreement	31 December 2010
Yunnan State-owned Assets Operation Co., Ltd	47,018,331	-	-	47,018,331	Committed in the Share Reform Agreement	31 December 2010
Kunming Jinghua Co., Ltd.	26,414,550	-	-	26,414,550	Committed in the Share Reform that 5% of the total shares of the Company held by Kunming Jinghua Co. would be traded after G+12 months	7 March 2008
Total	180,011,100	-	-	180,011,100		

The approval of the changes in share capital and share transfer:

On September 15, 2005, Xi'an Jiaotong University Industrial (Group) Incorporation and Shenyang Machine Tool (Group) Co., Ltd. (the "Shenyang Group") entered into an agreement in regarding transfer of shares. Shenyang Machine Tool (Group) Co., Ltd. agreed to buy 71,052,146 legal person shares of Jiaoda Kunji High-Tech Co., Ltd. from Xi'an Jiaotong University Industrial (Group) Incorporation, representing 29% of the total shares. The transfer price of the shares was RMB183,000,000. On June 7, 2006, the State-owned Assets Supervision and Administration Commission under the State Council issued the "Written Reply Regarding Jiaoda Kunji High-Tech Co., Ltd. Transfer State-owned Shares" (file no. 國資產權[2006] 628號) to approve the above share transfer.

On April 4, 2006, Yunnan provincial government issued the "Written Reply Regarding Jiaoda Kunji High-Tech Co., Ltd. Transfer of Shares by Yunnan Provincial Government" (file no. 雲政複[2006] 33號) and the State-owned Assets Supervision and Administration Commission under the State Council issued the "Written Reply Regarding Jiaoda Kunji High-Tech Co., Ltd. Transfer of State-owned Shares" (file no. 國資產權[2006] 1412號) to approve the shareholder of Jiaoda Kunji High-Tech Co., Ltd., Yunnan provincial government to transfer its 31,345,600 state-owned shares, representing 12.79% of the total share capital, to Yunnan State-owned Assets Operation Co., Ltd.. After transferring, the nature of the above shares is state-owned legal person shares. And Yunnan State-owned Assets Operation Co., Ltd. became the second largest shareholder of the Company.

China Securities Depositories & Clearing Corporation Limited (Shanghai Branch) issued Transfer Registration Confirmation of State-owned Legal Person Shares (《國有法人股轉讓過戶登記確認書》) (the "Confirmation") on December 1, 2006 and January 19, 2007 respectively to confirmed that Shenyang Machine Tool (Group) Company Limited completed the share transfer registration of transferring 71,052,146 state-owned legal person shares of the Company held by Xi'an Jiaotong University Industrial (Group) Incorporation and Yunnan State-owned Assets Operation Company Limited completed the share transfer registration of transferring 31,345,554 state-owned legal shares of the Company held by Yunnan Provincial Government.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

On January 25, 2007, the Ministry of Commerce of the PRC issued the “Written Reply Regarding Jiadao Kunji High-Tech Co., Ltd. Transfer of Shares and Increase Shares” (file no. 商資批[2007] 133號) to approve the Share Reform Proposal of the Company. The Company increased shares to all shareholders whose names appear on the Company’s register of members on the February 26, 2007 by transferring capital reserves on a basis of 1.5606 shares for every existing 10 shares (“Share Increase 1”). The total increased share capital was 38,235,855 shares, of which, 28,091,955 shares were A Shares, and 10,143,900 shares were H Shares. On March 5, 2007, the holders of non-circulating Shares of the Company used their 18,728,355 shares as consideration shares to pay to the holders of circulating A Shares on a basis of 2.7 shares for every 10 shares. The new A shares were listed on March 7, 2007. Of 18,728,355 shares, Shenyang Machine Tool (Group) Company Limited disbursed 11,088,398 shares; Yunnan State-owned Assets Operation Company Limited disbursed 4,891,787 shares, and Jinghua Company disbursed 2,748,170 shares to the holders of Circulating A Shares. After implementation of the consideration arrangement, non-circulating shares held by the holders of non-circulating Shares of the Company became tradable and listed. After implementation of the above proposal, the total share capital of the Company has changed from 245,007,400 shares to 283,243,255 shares, and the registered capital increased to RMB283,243,255.00. Of the total share capital, Shenyang Machine Tool (Group) holds 71,052,146 shares, representing 25.08% of the total share capital. Yunnan State-owned Assets Operation Co., Ltd. holds 31,345,554 shares, representing 11.07% of the total share capital. Kunming Jinghua holds 17,609,700 shares, representing 6.22% of the total share capital. Holders of A Shares hold 88,091,955 shares, representing 31.10% of the total share capital. Holders of H Shares hold 75,143,900 shares, representing 26.53% of the total share capital.

On April 2007, two shareholders of the Company, Shenyang Machine Tool (Group) Co., Ltd. and Yunnan State-owned Assets Operation Co., Ltd. jointly proposed the Share Increase Proposal (New Shares will be issued to all shareholders of the Company by transferring capital reserves on a basis of five New Shares for every 10 Shares based on 283,243,255 total share capital) (“Share Increase 2”). The Share Increase was approved at the 21st meeting of the board of directors held on April 18, 2007 and the resolution was submitted to 2006 annual general meeting and class meetings held on June 29, 2007 respectively. After receiving the approval from Ministry of Commerce, the Share Increase was implemented on A Shares and H Shares stock market on 20 November 2007 and 5 December 2007 respectively. From then on, the total share capital of the Company has changed to 424,864,883 shares, and the registered capital is RMB424,864,883.00. Of the total share capital, Shenyang Machine Tool (Group) Co., Ltd. holds 106,578,219 shares, representing 25.08% of the total share capital. Yunnan State-owned Assets Operation Co., Ltd. holds 47,018,331 shares, representing 11.07% of the total share capital. Kunming Jinghua holds 26,414,550 shares, representing 6.22% of the total share capital. Holders of A Shares hold 132,137,933 shares, representing 31.10% of the total share capital. Holders of H Shares hold 112,715,850 shares, representing 26.53% of the total share capital.

3. Issuance and listing of securities in the past three years

(1) *Issuance of securities in the past three years*

As at the end of this reporting period, the Company has not issued and listed securities in the past three years

(2) *Changes in total share capital and share structure*

Please refer to the tables in page 9 to page 10

(3) *Information of existing employee shares*

As at the end of this reporting period, there is no employee shares

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

II. NUMBER OF SHAREHOLDERS AND SHAREHOLDING HELD BY TOP TEN SHAREHOLDERS

1. Number of shareholders and shares held by top ten shareholders

Unit: share

Number of shareholders at the end of this year

36,935

Top Ten Shareholders in the Company

Name of shareholders	Nature of shareholders	Proportion (%)	Number of shares held at the end of this year	Increase/Decrease	Number of restricted shares	Number of shares pledge or frozen
HKSCC Nominees Limited	Foreign	25.97	110,356,631	-	-	Unknown
Shenji Machine Tool (Group) Co., Ltd.	State-owned legal person	25.08	106,578,219	-	106,578,219	Frozen 22,500,000
Yunnan State-owned Assets Operation Co., Ltd.	State-owned	11.07	47,018,331	-	47,018,331	-
Kunming Jinghua Co.	Others	6.22	26,414,550	-	26,414,550	-
Industrial and Commercial Bank of China – E fund value growth mixed security investment fund	Others	1.23	5,245,803	-	-	Unknown
Industrial and Commercial Bank of China – Bank of China International Income mixed security investment fund	Others	0.92	3,923,557	-	-	Unknown
Bank of Communication – Zhonghai Excellent Growth security investment fund	Others	0.78	3,332,239	-	-	Unknown
Industrial and Commercial Bank of China – Guangfa Stable Increasing Security Investment Fund	Others	0.73	3,097,496	-	-	Unknown
Tongde Security Investment Fund	Others	0.72	3,074,617	-	-	Unknown
Industrial and Commercial Bank of China – Baoying Pan Coastal Area Increasing Stock Security Investment fund	Others	0.64	2,703,399	-	-	Unknown

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Top ten shareholders with selling unrestricted shares

Name of shareholders	Number of selling unrestricted shares	Type of shares
HKSCC Nominees Limited	110,356,631	H Shares
Industrial and Commercial Bank of China – E fund value growth mixed security investment fund	5,245,803	A Shares
Industrial and Commercial Bank of China – Bank of China International Income mixed security investment fund	3,923,557	A Shares
Bank of Communication – Zhonghai Excellent Growth security investment fund	3,332,239	A Shares
Industrial and Commercial Bank of China – Guangfa Stable Increasing Security Investment Fund	3,097,496	A Shares
Tongde Security Investment Fund	3,074,617	A Shares
Industrial and Commercial Bank of China – Baoying Pan Coastal Area Increasing Stock Security Investment fund	2,703,399	A Shares
Industrial and Commercial Bank of China – China Universal Balance Increasing Stock Security Investment Fund	2,087,318	A Shares
Industrial and Commercial Bank of China – Lion Balance Security Investment Fund	1,644,107	A Shares
Shanghai Tajing Investment Management Co. Ltd	1,401,122	A Shares

Explanation of the connected relationship or consistent action relationship among the above shareholders:

The Company was not notified of any connected relationship and consistent action regulated by “Information Disclosure Management Procedure to Changes of Shareholding of List Company” among the top ten shareholders of circulating shares of the Company. None of the top ten largest shareholders of the Company have relationship with each other and the Company was not rectified by its shareholders that there is any relationship between the shareholders of non-circulating shares, the shareholders of the state-owned shares and the public shareholders.

Other than the substantial shareholders disclosed above, as at 31st December, 2006, there were no other shareholders whose shareholdings exceeded the amount required to be disclosed under Article 60 of “Administration of the Issuing and Trading of Shares Provisional Regulations” of the PRC and Issue no. 2 of “The Content and Format of Disclosure of Information of the Listed Companies” (amended in 2005) and the register of substantial shareholders maintained under the requirement of reporting; and under Issue no. 16 (1) of the Securities (Disclosure of Interest) Ordinance under the Hong Kong Exchanges and Clearing Limited, the Company was not notified of any interests representing 10% or more of the issued share capital of the Company.

Among top ten shareholders, there are four holding 5% or more of the Company’s shares. They are Shenyang Machine Tool (Group) Co., Ltd., which holds the state-owned legal person shares; Yunnan State-owned Assets Operation Co., Ltd. holds state-owned shares. Kunming Jinghua Co., Ltd. holds legal person shares. All of the shares held by the above shareholders are selling restricted shares and are not pledged, frozen, mortgaged, nor designated except the frozen shares of Shenyang Machine Tool (Group) Co., Ltd. HKSCC holds H shares listing in the overseas.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Remark:

- 1). HKSCC Nominees Limited holds shares on behalf of clients. The Company did not receive any notification from HKSCC Nominees Limited that any single H shareholder who held more than 10% in total share capital of the Company. Holders of H Shares who held more than 5% of total issued H Shares as follows: on 16 November 2007, the Company received a notification that Chilton Investment Company Inc. held 12,584,257 H shares of the Company, representing 11.16% of total issued H Shares of the Company.
- 2). Save as disclosed above, the Directors was not notified by any person (who is not a Director or a chief executive officer) who owns the interest or short position in the shares or underlying shares of the Company and shall be disclosed to the Company in compliance with the requirements contained in Division 2 and 3 of Part XV of Securities and Future Ordinance (“SFO”), or the interest or short position that shall be included in the prescribed register in accordance with section 336 of SFO.

2. Top ten shareholders with selling restricted shares and the conditions of selling restriction

Unit: share

No.	Name of shareholders with selling restricted shares	Number of selling restricted shares held at the end of the year	Trading of selling restricted shares		Selling restriction
			Time of trading	Number of additional shares to be traded	
1	Shenyang Machine Tool (Group) Co., Ltd.	106,578,219	31 December, 2010	–	Committed to hold as stated in the Share Reform Agreement
2	Yunnan State-owned Assets Operation Co., Ltd.	47,018,331	31 December, 2010	–	Committed to hold as stated in the Share Reform Agreement
3	Kunming Kunji Co., Ltd.	26,414,550	7 March 2008	–	Representing 5% of the total share capital of the Company can be traded after G+12 months

Remarks: The shares held by Kunming Jinghua Co., Ltd. formerly were non-circulating shares. During the Share Reform, Kunming Jinghua Co., Ltd. and the other two shareholders of the Company, Shenyang Machine Tool (Group) Co., Ltd. and Yunnan State-owned Assets Operation Co., Ltd. had made commitments that: the shares of the Company held by these shareholders would not be traded within 12 months from the listing date being circulating share. After that, the any disposal of such shares shall be less than 5% shares of the Company in issue within twelve months following the Lock-up period and less than 10% of all shares of the Company in issue within twenty-four months following the Lock-up period. In addition, Shenyang Machine Tool (Group) Co., Ltd. and Yunnan State-owned Assets Operation Co., Ltd. had promised that the shares of the Company held by the above two shareholders would not be traded from the listing date being circulating share to 31st December, 2010. After completing the Share Reform on 6 March 2007, all shares of the Company changed to circulating shares. On 6 March 2008, the selling restriction for the shareholder – Kunming Jinghua was expired. 21,243,244 shares held by Kunming Jinghua Co. Ltd. have become unrestricted circulating shares (representing 5% of the total shares of the Company held by Kunming Jinghua Co. Ltd.) and have been listed on the Shanghai Stock Exchange.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

3. Description of agreed holding period of shareholding in respect of strategic investors and general legal persons placing new shares in the Company

<u>Name of strategic investors and general legal persons</u>	<u>Agreed holding period of shareholding</u>
Shenyang Machine Tool (Group) Company Limited	31st December, 2010
Yunnan Provincial Government (Yunnan State-owned Assets Operation Company Limited)	31st December, 2010

Remark:

The above two parties agreed to not to trade the shareholding until 31 December 2010 as committed in the Share Reform Agreement.

4. Substantial shareholders and beneficial controller

(1) *Substantial shareholder of the Company:*

Shenyang Machine Tool (Group) Co., Ltd.

Legal representative: Chen Huiren

Registered capital: RMB712,840,000.00

Date of incorporation: 18 December 1995

Principal operating or managing activities: manufacturing and sales of metal cutting machines, CNC machines and mechanical equipments.

(2) *Beneficial controller*

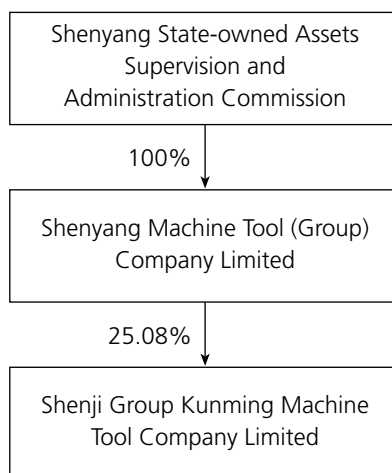
Shenyang State-owned Assets Supervision and Administration Commission

(3) *Changes in controlling shareholders and beneficial controller*

During the reporting period, there was no change in controlling shareholders and beneficial controller

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

(4) Relations between the Company and the beneficial controller



5. Other legal person shareholders holding over 10% shareholding of the Company

Name of shareholders	Legal representative	Registered capital	Date of incorporation	Unit: RMB'000
				Principal operating and managing activities
Yunnan State-owned Assets Operation Co., Ltd. (Yunnan Industrial Investment Holding Group Company Limited)	Gong Lidong	4,600,000	October 2000	Engages in investment, financing, and assets operation and management, merger and acquisition of enterprises, stock trading, state-owned assets trusted management and trusted disposal in various industries and different business; domestic and international trade; other business approved by the Yunnan Provincial Government.

Remark:

In February 2008, Yunnan State-owned Assets Operation Company Limited changed its name to Yunnan Industrial Investment Holding Group Company Limited, and its registered capital increased from RMB1 billion to RMB4.6 billion. Legal representative of this company is Mr. Gong Lidong.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

I. DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Unit: share

Name	Title	Gender	Age	Date of appointment	Date of cessation	Number of shares held on 1st January, 2007	Number of shares held on 31st January, 2007	Authorised number of restricted shares	Increase/decrease shares	Reasons for change	Remuneration	
											Emoluments received within the reporting period (RMB'0000) (before tax)	reward from shareholder's business unit or other associated business unit
Gao Minghui	Chairman, Executive director	M	44	30 December 2006	31 October 2008	-	-	-	-	-	13.26	Yes
	General manager			23 October 2007	-	-	-	-	-	-	13.26	No
Zhang Hanrong	Vice chairman, non-executive director	M	43	1 November 2002	31 October 2008	-	-	-	-	-	115.87	No
	Executive director, general manager			1 November 2002	23 October 2007	-	-	-	-	-		No
Song Xingju	Vice chairman, non-executive director	M	40	23 March 2007	31 October 2008	-	-	-	-	-	4.49	Yes
Pi Jianguo	Executive director	M	35	23 March 2007	31 October 2008	-	-	-	-	-	25.06	No
	Financial controller			30 December 2006	31 October 2008	-	-	-	-	-	25.06	No
Sun Kai	Non-executive director	M	41	30 September 2006	31 October 2008	-	-	-	-	-	4.23	Yes
Wang Sheng	Non-executive director	M	42	30 September 2006	31 October 2008	-	-	-	-	-	4.23	Yes
Wang Xing	Non-executive director	M	42	23 March 2007	31 October 2008	-	-	-	-	-	3.35	Yes
Shen Guorong	Non-executive director	M	61	23 March 2007	28 February 2008	1,000	1,468	1,468	468	Share reform	3.93	Yes
	Supervisor			1 November 2002	23 March 2007	-	-	-	-	-	3.93	Yes
Wayne Yu	Independent non-executive director	M	44	16 June 2005	31 October 2008	-	-	-	-	-	17.75	No
Liu Minghui	Independent non-executive director	M	43	23 March 2007	31 October 2008	-	-	-	-	-	9.03	No
Chen Ying	Independent non-executive director	M	54	23 March 2007	31 October 2008	-	-	-	-	-	9.03	No
Li Dongru	Independent non-executive director	F	52	29 June 2007	31 October 2008	-	-	-	-	-	5.71	No
Li Hongshu	Chairman of the supervisory committee	M	59	23 March 2007	31 October 2008	-	-	-	-	-	3.35	Yes
Zhang Weiming	Supervisor	M	50	23 March 2007	31 October 2008	-	-	-	-	-	2.18	Yes
Yan Shiwen	Supervisor	M	53	30 October 2007	31 October 2008	-	-	-	-	-	0.46	Yes
Li Zhenxiang	Supervisor	M	45	23 March 2007	31 October 2008	-	-	-	-	-	2.18	Yes
Zhao Qiongfeng	Employee supervisor	F	45	30 December 2006	31 October 2008	-	-	-	-	-	27.76	No
Zhang Xiaoyi	Vice general manager	M	44	1 November 2002	31 October 2008	-	-	-	-	-	74.97	No
Zhou Guoxing	Vice general manager	M	45	10 April 2006	31 October 2008	-	-	-	-	-	70.97	No
Ye Nong	Vice general manager	M	47	30 December 2006	31 October 2008	-	-	-	-	-	54.60	No
Zhu Xiang	Vice general manager	M	42	20 August 2007	31 October 2008	-	-	-	-	-	45.08	No
Yu Yan	Secretary to the Board	F	36	30 December 2006	31 October 2008	-	-	-	-	-	64.36	No
Lei Jinlu	Former chairman	M	52	16 June 2005	23 March 2007	-	-	-	-	-	1.04	No
Cheng Yunchuan	Former vice chairman, committee secretary of CCP of the Company	M	45	1 November 2002	23 March 2007	-	-	-	-	-	48.22	No
Wu Ketian	Former executive director	M	59	1 November 2002	23 March 2007	-	-	-	-	-	31.38	No
Guo Shangwu	Former non-executive director	M	60	1 November 2002	23 March 2007	-	-	-	-	-	1.40	Yes
Yu Chengting	Former independent non-executive director	M	67	1 November 2002	23 March 2007	-	-	-	-	-	2.84	No
Tong Yunhuan	Former independent non-executive director	M	56	1 November 2002	23 March 2007	-	-	-	-	-	2.84	No
Liu Gang	Former chairman of supervisory committee	M	39	1 November 2002	23 March 2007	-	-	-	-	-	1.40	Yes
Sun Xingduo	Former supervisor	M	52	1 November 2002	23 March 2007	-	-	-	-	-	0.67	No
Guo Junyu	Former supervisor	F	50	1 November 2002	23 March 2007	-	-	-	-	-	0.67	No
Chi Delin	Former supervisor	M	49	23 March 2007	20 August 2007	-	-	-	-	-	1.26	Yes

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Working experience of Directors, Supervisors and Senior Management in the latest 5 years

- (1). **Gao Minghui**, male, chairman of the Board, executive director, general manager and committee secretary of CCP of the Company. Mr. Gao was born in 1963, holds a bachelor degree and a master degree. He graduated from the Northeastern University with bachelor degree in engineering in 1988. Mr. Gao was a researcher, deputy manager and manager of the Research and Development Department of Shenyang First Machine Tool Factory. Then he was the deputy chief engineer, assistant to general manager, deputy general manager, and general manager of Shenyang First Machine Tool Factory. From January 2002, he is also as the deputy general manager of Shenyang Machine Tool Company Limited. He had been the chairman of the board of directors of Yunnan Machine Tool Factory (changed the name to Yunnan CY Group Company Limited) from August 2004. From 2006, he was the chairman of Shenyang Machine Tool (Group) Kunming Limited. He has become the executive director of the Company since 30 October 2006, and became the Chairman of the Company on 30 December, 2006. From 23 October 2007, he is also the general manager of the Company. His current term is from 30th October, 2006 to 31st October, 2008.
- (2). **Zhang Hanrong**, male, vice-chairman, non-executive director, chairman of Xi'an Jiaotong University Science & Technology Park Company Limited, and vice and general manager of Xi'an Jiaotong University Assets Operation Company Limited. Mr. Zhang was born in 1964 and holds a master degree. He was a visiting scholar of University of Alberta in Canada from 1993 to 1994; Head of Finance Faculty of Management College of Xi'an Jiaotong University from 1995 to 1996; and chief economist and deputy general manager of Nanjiang Zhongda Moulding (Group) Company Limited from 1997 to 2000. He was the deputy general manager and secretary to the board of directors of Xi'an Jiaoda Siyuan Science and Technology Company Limited from 2000 to 2001. He joined the Group in August 2001 and has held the positions of deputy general manager and general manager and vice chairman of the Group. He has been the director of the Company since 1st November, 2002. From 23 October 2007, he resigned the position of general manager of the Company due to job transfer. His current term of directorship will expire on 31 October, 2008.
- (3). **Song Xingju**, male, born in February 1967, holding a master degree, assistant economist, vice chairman and non-executive director of the Company. From July 1986 to June 1997, he worked for Yunnan Provincial Bureau of Finance and was an accountant, and manager. From July 1997 to August 1999, he was the vice head of Jinping county. From September 1999 to October 2000, he was the vice general manager of Yunnan State-owned Assets (Holding) Operation Company. From October 2000 to the date hereof, he has been the vice general manager of Yunnan State-owned Assets Operation Co., Ltd. His current term of directorship is from 23 March 2007 to 31 October 2008.
- (4). **Pi Jianguo**, male, executive director, chief financial officer of the Company. He was born in 1971 and holds a bachelor degree. He is a certified public accountant, certified assets estimator, certified tax commissioner. From October 1999 to January 2002, Mr. Pi worked in the Industrial Department of Chuxiong State-owned Assets Company. From January 2002 to April 2005, he was the vice manager of the auditing department of Yunnan Huitong Accounting Firm. From May to December, 2005, he worked for Yunnan State-owned Assets Operation Company Limited. His current term is from 30th December, 2006 to 31st October, 2008.
- (5). **Sun Kai**, male, non-executive director of the Company. He was born in 1966, holds a master degree and is a senior accountant. He graduated from Dongbei University of Finance & Economics in Finance major. He held the positions of deputy manager of the Import and Export Department of Liaoning Provincial Medical Appliance Company; general manager Assistant of Liaoning Trust and Investment Company; head of Finance Section of Liaoning Province Government; manager of the Finance and Accounting Department, deputy general manager, and the secretary to the board and vice general manager of Shenyang Machine Tool Company Limited. He has been the vice general manager of Shenyang Machine Tool (Group) Company Limited since 2006. From 30th October, 2006, he became a non-executive director of the Company. His current term will expire on 31st October, 2008.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

- (6). **Wang Sheng**, male, non-executive director of the Company. He was born in 1965, member of the Chinese Communist Party. He graduated at Shenyang Industry University with a bachelor degree in Engineering in 1986. In 1989, he graduated at Dalian Polytechnic University with a master degree. From July 1987, he held the positions of technician, deputy section chief, deputy chief engineer, deputy general manager, general manager, and secretary to CCP committee of Zhong Jie You Yi Machine Tool Factory. From January, 2006, he has been the deputy general manager of Shenyang Machine Tool (Group) Company Limited. Today, he is the general manager of Shenyang Machine Tool Company Limited. From 30 October 2006, he has been the non-executive director of the Company. His current term of directorship will expire on 31st October, 2008.
- (7). **Wang Xing**, male, non-executive director of the Company. He was born in 1965 and graduated at Harbin University of Science and Technology in auditing major. He is studying MPAcc at Dongbei University of Finance and Economics. In 1996, he worked for Shenyang First Machine Tool Factory in Auditing Department in 1996. At the beginning of 1996, he worked for Shenyang Machine Tool (Group) Company Limited in finance department. He was the member of the liquidation team of Shenyang Third Machine Tool Factory in 1996. In January 2001, he was the vice general manager, the head of finance department of Zhong Jie Machine Tool Company Limited. At the end of 2003, he was the vice general manager, the head of finance department of Shenyang CNC Machine Tool Company Limited. From the beginning of 2006, he has been a director and the head of finance department of Shenyang Machine Tool (Group) Company Limited. From March 2007 to the date hereof, he has been the vice general manager, the head of finance department of Yunnan CY (Group) Company Limited. From 23 March 2007, he has been a director of the Company. His current term of directorship will expire on 31 October 2008.
- (8). **Shen Guorong**, male, director of the Company. Mr. Shen was born in 1948 and holds a college diploma. Mr. Shen joined in Kunming Machine Tool Factory in 1968, and has extensive experience in labour and human resource management. Since 1995 to the date hereof, he has held the positions of vice section chief and section chief of the organization department of the committee of CCP of the factory, the vice head and the head of labour and personnel department of the factory. He is the general manager, committee secretary of CCP of Kunming Kunji (Group). From November 2002, he has been the supervisor of the Company. His current term of supervisorship was from 1 November 2005 to 23 March 2007. On 28 February 2008, he resigned his directorship due to retirement. His current term of directorship was from 23 March 2007 to 28 February 2008.
- (9). **Wayne Yu**, male, independent non-executive director of the Company. Mr. Yu was born in 1963. He has obtained a doctorate degree in Finance and a master degree in Economics. He is a Chartered Financial Analyst (CFA) in Hong Kong Polytechnic University. During 1998 to 1999, he was an associate professor of the Faculty of Business at Queen's University in Canada; during 1996 to 1998, he was an associate professor of the Faculty of Management at University of Lethbridge in Canada; during 1994 to 1995, he was a visiting professor of the Faculty of Management at Xi'an Jiaotong University; during 1992 to 1996, he was a part-time demonstrator of the Faculty of Business at University of Alberta in Canada. He is now the Chief Editor of "China Accounting and Finance Review", associate professor of the Faculty of Accounting and Finance at Hong Kong Polytechnic University and specialized professor of the Faculty of Accounting at Shanghai University of Finance and Economics. He became the independent non-executive director of the Company since 16th June, 2005. His current term of directorship was from 1 November 2005 to 31 October 2008.
- (10). **Liu Minghui**, male, independent non-executive director, born in 1964, professor, mentor of doctoral students, certified public accountant. From August 1987 to May 2000, he was an assistant lecturer, lecturer, associate professor, professor in Dongbei University of Finance and Economics. From May 2000, he has been a mentor of doctoral students. From March 2001 to January 2004, he was the head of Jinqiao Faculty of Business at Dongbei University of Finance and Economics. From January 2004 to October 2004, he was the general manager of Dongbei University of Finance and Economics Magazine Company. From October 2004, he has been the vice president of Dalian Newspaper Group, president of Dalian Publisher. He is also the director, vice-secretary general of China Accounting Association, a president of a branch of Cost Accounting Association, director of China Auditing Association etc.. From 23 March 2007, he has been the independent non-executive director of the Company. His current term of directorship will expire on 31 October 2008.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

- (11). **Chen Ying**, male, independent non-executive director of the Company, born in 1953, senior engineer. From 1997 to 1999, he was the chairman and general manager of Yunnan Transformer Company Limited. From 1999 to 2003, he was the chairman of Yunnan Transformer Electric Company Limited. From 2000 to 2003, he was the chairman and general manager of Kunming Securamid Electric Co., Ltd. From 2003 to 2004, he was the Mayor Assistant of Kunming City. From 2004 to 2006, he was the vice mayor of Kunming City. From April 2006 to the date hereof, he has been in the position of the chairman of Yunnan Transformer Electric Company Limited. From 23 March 2007, he has been the independent non-executive director of the Company. His current term of directorship will expire on 31 October 2008.
- (12). **Li Dongru**, female, independent non-executive of the Company. She was born in 1955, Han nationality, a member of the Communist Party of China, professional senior engineer, holding a master degree. Madam Li is working at the China Machinery Industry Federation (the "Federation"). From January 2001 to the date hereof, she has been the manager of the Science and Technology Department of the Federation and engaging in the management of the machinery industry. During 1986 to 2001, she worked for former Ministry of Machine-Building Industry as vice section chief and section chief. From 29 June 2007, Madam Li is a independent non-executive director of the Company. Her current term of directorship will expire on 31 October 2008.
- (13). **Li Hongshu**, male, chairman of the supervisory committee of the Company. Mr. Li was born in 1948, holds college diploma, is a senior economist. From January 1995 to August 2000, he was the director of the Transportation Department of Economic and Trade Committee of Yunnan Province. From Augusts 2000, he was the general manager of Yunan State-owned Operation Co., Ltd. From December 2004 to the date hereof, he has been in the position of the Secretary of Communist Party of China of Yunan State-owned Operation Co., Ltd. From 23 March, he has been a supervisor of the Company. His current term of supervisorship will expire on 31 October 2008.
- (14). **Zhang Weiming**, male, supervisor of the Company. Mr. Zhang was born in 1957, holds a master diploma, and he is a senior economist. He graduated at Party School of the Liaoning Committee of CCP in economics management major in 1997. From 1983, he had been in the positions of the Secretary to the Youth League of Shenyang Lubricating Oil Pump Plant, Secretary to the Enterprises Management Bureau of Shenyang Municipal Government, Vice Director of Economic Planning Department of Shenyang Municipal Government etc.. From January 2003, he has been in the positions of Vice Secretary to the committee of Communist Party of China of Shenyang Machine Tool (Group) Company Limited, secretary to the disciplinary inspection committee, and chairman of the labor union of of Shenyang Machine Tool (Group) Co., Ltd.. From 23 March 2007, he has been a supervisor of the Company. His current term of supervisorship will expire on 31 October 2008.
- (15). **Yan Shiwen**, male, supervisor of the Company. Mr. Yan was born in 1953, holds a master diploma. Presently, he is the vice secretary to disciplinary inspection committee and the director of the disciplinary supervision department of Shenyang Group. In January 2002, he was the secretary to the committee of CCP of Shenyang First Machine Tool Factory, secretary to disciplinary inspection committee, vice general manager of human resource department and the chairman of the labor union of Shenyang First Machine Tool Factory. From March 2007 to the date hereof, he has been the secretary to disciplinary inspection committee and the director of the disciplinary supervision department of Shenyang Machine Tool (Group) Co., Ltd.. From 30 October 2007, he has been a supervisory of the Company. His current term of supervisorship will expire on 31 October 2008.
- (16). **Li Zhenxiong**, male, supervisor of the Company. Mr. Li was born in 1962, holds a bachelor degree, and he is an assistant economist. Mr. Li joined Kunming Machine Tool Factory in 1985, was in the positions of technician for construction, the head of construction team. From October 1993 to July 2002, he was the general manager, secretary to the committee of CCP of Kunming Kunji Group Construction Company. From August 2002 to the date hereof, he has been in the positions of general manager assistant, member of party committee and vice general manager of Kunming Kunji Group Company. From 23 March 2007, he has been a supervisor of the Company. His current term of supervisorship will expire on 31 October 2008.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

- (17). **Zhao Qiongfeng**, female, employee supervisor of the Company, general manager assistant, manager of the finance and accounting department of the Company. Ms. Zhao was born in 1962, obtained college education and is an assistant accountant. Ms. Zhao joined Kunming Machine Tool Factory in 1980 and worked in the Finance and Accounting Department. She became the vice manager of the finance and accounting department of Kunming Machine Tool Company Limited in June, 1997. From December 1999, she has been the manager of the finance and accounting department. From August 2003, she has been also the general manager assistant. From 30 December 2006, she has been the employee supervisor of the Company. Her current term will expire on 31 October 2008.
- (18). **Zhang Xiaoyi**, male, vice general manager, member of the committee of CCP of the Company. Mr. Zhang was born in 1964. He worked for Kunming Machine Tool Factory in 1985. He has been engaged in the machinery design and technology management for a long time. He has held the positions of deputy manager, manager of the technical center of the Company, general manager assistant and chief engineer, vice general manager of the Company. His current term is from 1st November, 2005 to 31st October, 2008.
- (19). **Zhou Guoxing**, male, vice general manager of the Company. He was born in 1962, holds a master degree and is a senior engineer. Mr. Zhou joined in Kunming Machine Tool Factory in 1987 and has engaged in machine tool designation and production management for a long time. He was the manager of the laboratory of the Company; the vice manager, manager of the technical center; deputy chief engineer; manager of the manufacture center; general manager assistant and the head of the assembly sub-plant; chief engineer and vice general manager of the Company. His current term is from 10th April, 2006 to 31st October, 2008.
- (20). **Ye Nong**, male, vice general manager of the Company. He was born in 1960, obtained college education and is an engineer. From February 2000 to May 2002, he was the manager of the Technology Department of Shenyang Machine Tool (Group), vice president of Shenyang Machine Tool Designation Institute. From May 2002 to December 2003, he was the manager of the Quality Control Department of Zhongjie Machine Tool Company Limited. He was the manager of Production Department from December 2003 to June 2006. From June 2006 to the date hereof, he has worked for the Company as a general manager assistant. His current term is from 30th December, 2006 to 31st October, 2008.
- (21). **Zhu Xiang**, male, vice general manager and manager of the sales department of the Company. Mr. Zhu was born in 1966. He graduated at Beijing Institute of Technology in optical instruments major. He joined in Kunming Machine Tool Factory since 1988. He engages in machine tool products design and sales management for a long time. He has been in the positions of vice director of Assembly sub-Plant of Kunming Machine Tool Factory, deputy director of the Technology Centre, vice manager of the sales department, manager of Sales Company, and general manager assistant, vice general manager of the Company. His current term is from 20 August 2007 to 31 October 2008.
- (22). **Yu Yan**, female, secretary to the Board of the Company. She was born in 1971 and has post-graduate diploma. She is a certified public accountant and certified tax commissioner, accountant and auditor. From February 1998 to November 1999, she worked for Shaanxi Ruishen Enterprise (Group) as an accounting department manager. From December 1999 to June 2001, she was an auditing manager of Shaanxi Wulian Accounting Firm. She joined the Company in November 2002 as an auditing manager, officer to the board and chief financial officer. Her current term is from 30th December, 2006 to 31st October, 2008.
- (23). **Lei Jinlu**, male, former chairman of the Company. Now, he is the general manager and director of Xi'an Jiaotong University Industrial (Group) Company. He was born in 1955 and graduated at Xi'an Jiaotong University, holds a bachelor degree, a master degree. He was the secretary to committee of CCP of Xi'an Jiaotong University Mechanical Factory. From 1989 to 2003, he was the deputy head and head of Finance Division of Xi'an Jiaotong University. He obtained his MBA degree at the Hong Kong Polytechnic University in 2004. From 16th June, 2005, he was a director and chairman of the Company. From 30 December 2006, he did not hold the chairman position of the Company any more because of the change of substantial shareholder of the Company. His current term was from 1st November, 2005 to 23rd March, 2007.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

- (24). **Cheng Yunchuan**, male, former vice general manager, executive director, secretary to the committee of CCP of the Company. He was born in 1962 and holds a master degree. During August 1999 to September 2000, he held the position of the Factory Head in Dali Paper Manufacturing Factory and the party secretary, chairman and general manager of Dali Paper Manufacturing Company Limited, and vice-chairman and general manager of Yunnan New Concept Bonded Science and Technology Company Limited. He has held the positions of vice general manager, vice-chairman and executive director of the Company. From June 2007, he has been the chief executive of Dali State. His current term of directorship was from 1st November, 2005 to 23rd March, 2007.
- (25). **Wu Ketian**, male, former executive director of the Company. Now, he is the chairman of the Labour Union of the Company. He was born in 1948. He joined Kunming Machine Tool Factory in 1969 and has extensive experience in production, planning and management. He held the positions of deputy head, head of workshops, vice director, director of production section of Kunming Machine Tool Factory, head of production department of the Company and general manager assistant, chairman of labour union of the Company. He has been the director of the Company since 1st November, 2002. His current term was from 1st November, 2005 to 23rd March, 2007.
- (26). **Guo Shangwu**, male, former non-executive director of the Company and general manager, secretary to the committee of CCP of Kunming Kunji Group (he has retired now). He was born in 1946 and holds a bachelor degree. He joined Kunming Machine Tool Factory in 1970 and has extensive experience in workshop production techniques and management. He has held the positions of deputy head, head of workshop of Kunming Machine Tool Factory, factory director of Large Parts Production Plant, general manager assistant and head of sales department, and the deputy chairman of the second supervisory committee of the Company. He has been the director of the Company since 1st November, 2002. His current term was from 1st November, 2005 to 23rd March, 2007.
- (27). **Yu Chengting**, male, former independent non-executive director of the Company. He was born in 1940 and holds a master degree. Mr. Yu worked for Beijing First Machine Tool Factory, American Haoduo Company, Ministry of Machine-Build Industry machine tool section, machine tool division of Ministry of Mechanical Electronics Industry, basic mechanical equipment division of Ministry of Machine-Build Industry as manager, vice factory head, factory head, vice division manager, division manager. From 2000 to the date hereof, he has been the director-general of China Machine Tool and Tool Builders' Association, and has been vice managing director of the association since August 2004. He has been the independent non-executive director of the Company since 1st November, 2002. His current term was from 1st November, 2005 to 23rd March, 2007.
- (28). **Tong Yunhuan**, male, former independent non-executive director of the Company. He was born in 1950 and holds a master degree. He has been a professor of the Faculty of Economics Management and the Faculty of Public Management of Qinghua University, Vice-president of Faculty of Economics Management of Qinghua University since 2001. He has been the independent non-executive director of the Company since 1st November, 2002. His current term was from 1st November, 2005 to 23rd March, 2007.
- (29). **Liu Gang**, male, former chairman of the supervisory committee of the Company, general manager of the Yunnan State-owned Assets Operation Company. He was born in 1967 and holds a bachelor degree. He had been in the positions of legal adviser of the factory head's office, vice section chief, manager of general manager office of Yunnan Natural Gas Chemical Factory. From 2000 to July 2002, he was general manager assistant, secretary to the Board of Yun Tian Chemical Co., Ltd. Effective from August 2002, he was the vice-general manager of Yunnan State-owned Assets Operation Company. In September 2004, he became the general manager. He has been the supervisor of the Company since 1st November, 2002. His current term was from 1st November, 2005 to 23rd March, 2007.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

- (30). **Sun Xingduo**, male, former supervisor of the Company. He was born in 1954, and holds a bachelor degree. Mr. Sun has been responsible for administration and financial management for a long time. Since 1979, Mr. Sun has been worked for Shaanxi Finance and Economics College and held the positions of deputy director of the General Affairs Office, secretary to the committee of the General Departmental, Head of Financial Department, Assistant to Chancellor of College, member of the Chinese Communist Party Committee of Shaanxi Finance and Economics College. In June, 2000, Mr. Sun held the positions of Chairman of the Supervisory Committee of Xi'an Jiaotong University Industrial (Group) Incorporation, and in 2003, he became the Vice-general manager. He is member of the Chinese Communist Party and associate researcher. Now he is the vice general manager of Xi'an Jiaotong University Jiepu Web Technology Company. He has been the supervisor of the Company since 1st November, 2002. His current term is from 1st November, 2005 to 23rd March, 2007.
- (31). **Guo Junyu**, female, former supervisor of the Company. Now, she is the manager of Finance department of Xi'an Jiaotong University Industrial Group Incorporation. She was born in 1956 and holds a college diploma. Ms. Guo has extensive experience in financial management. From 1983 to 1991, she had worked in the Light Industry Department of Shanxi Province. Since 1991 and up till now, she has been working in Xi'an Jiaotong University. She was the financial executive of Xi'an Jiaotong Industrial (Group) Incorporation in 1994. She has been the supervisor of the Company since 1st November, 2002. Her current term was from 1st November, 2005 to 23rd March, 2007.
- (32). **Chi Delin**, male, born in 1958, holding a bachelor degree, is a senior engineer. He graduated at party school in the major of enterprises management. He was the secretary to the committee of Communist Party of China, vice chairman of Shenyang First Industrial Company Limited. He resigned the position of supervisor of the Company since August 2007 due to job transfer. His term of supervisorship was from 23 March 2007 to 20 August 2007.

II. POSITIONS IN SHAREHOLDER'S BUSINESS UNIT

Name	Shareholder's business unit	Position	Remuneration reward (Y/N)
Song Xingju	Yunnan State-own Assets Operation Co., Ltd.	Vice general manager	Y
Sun Kai	Shenyang Machine Tool (Group) Co., Ltd.	Vice general manager	Y
Wang Sheng	Shenyang Machine Tool Co., Ltd.	General manager	Y
Li Hongshu	Yunnan State-own Assets Operation Co., Ltd.	Secretary to the committee of CCP of the Company	Y
Zhang Weiming	Shenyang Machine Tool (Group) Co., Ltd.	Vice secretary to the committee of CCP, secretary to the committee of disciplinary inspection, chairman of labour union	Y
Li Zhenxiong	Yunnan State-own Assets Operation Co., Ltd.	Vice general manager	Y
Yan Shiwen	Shenyang Machine Tool (Group) Co., Ltd.	Vice secretary to the committee of disciplinary inspection, manager of disciplinary supervisory department	Y

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Positions in Other Business Units

Name	Other business unit	Position	Remuneration reward (Y/N)
Gao Minghui	Shenyang Machine Tool (Group) Kunming Co., Ltd.	Chairman	–
	Yunnan CY Group Co., Ltd.	Chairman	
	Kunming Kunji General Machine Co., Ltd.	Chairman	N
Zhang Hanrong	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. ("Xi'an Ser")	Vice chairman	Y
	Xi'an Jiaotong University Siyuan Intelligent Electric Apparatus Co., Ltd. ("Siyuan")	Chairman	Y
	Shaanxi Hengtong Intelligent Machine Co., Ltd. ("Shaanxi Hengtong")	Vice chairman	Y
	TOS Kunming Machine Tool Manufacturing Co., Ltd. ("TOS Kunming")	Vice chairman	Y
	Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite")	Director	Y
Wang Xing	Shenyang Machine Tool (Group) Kunming Co., Ltd.	Vice general manager	Y
	Yunnan CY Group Co., Ltd.	Vice general manager	
	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. ("Xi'an Ser")	Non-executive director	–
Shen Guorong	Kunming Kunji (Group) Co.	General manager	Y
Wayne Yu	Faculty of Accounting and Finance at Hong Kong Polytechnic University	Associate professor, CFA	Y
Liu Minghui	Dalian Newspaper Group	Vice president	Y
Chen Ying	Yunnan Transformer Electric Company Limited	Chairman	Y
Li Dongru	China Machinery Industry Federation	Manager of science of technology department	Y
Zhao Qiongfeng	Kunji Transportation Co., Ltd.	Supervisor	Y
	Kunming Kunji General Machine Co., Ltd.	Director	N
Zhang Xiaoyi	Shaanxi Hengtong	Director	Y
	Xi'an Ser	Director	Y
	TOS Kunming	Director	Y
	Kunji Transportation Co., Ltd.	Chairman	N
	Xi'an Ruite	Director	Y
Zhou Guoxing	TOS Kunming	Member of controlling committee	Y
Ye Nong	TOS Kunming	Director	Y
Zhu Xiang	Kunming Kunji General Machine Co., Ltd.	Executive director, General manager	N
Yu Yan	Winko Machines Co., Ltd. ("Winko")	Chairman of supervisory committee	Y
	Xi'an Ser	Supervisor	Y
	Shaanxi Hengtong	Supervisor	Y
	Siyuan	Supervisor	Y
	Xi'an Ruite	Supervisor	Y

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

III. EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

1. The determination procedure for directors, supervisors and senior management's emoluments: the emoluments of directors and supervisors of the Company will be considered and approved by shareholders' meeting; the emoluments of senior management officers are based on the rules and regulations of the Remuneration Committee of the Company. The factors in determining the emoluments of senior management officers include the profit indicators and other operating indicators accomplished in the year, the improvement in quality of the assets of the Company etc.. Actions, together with rewards and penalties, would be taken according to the assessment results.
2. Basis for emoluments of directors, supervisors and senior management officers
 - (1) general information of the emoluments of domestic directors, supervisors;
 - (2) general information of the emoluments of Hong Kong directors, supervisors;
 - (3) emoluments of senior management officers are based on the comparable information of the emoluments in the same industry in domestic and emoluments of the same district listing companies.

IV. CHANGE OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS DURING THE REPORTING PERIOD AND REASONS THEREOF:

Name	Position	Reasons for change
Song Xingju	Holding the position of vice chairman of the Company	Change of the substantial shareholder of the Company
Pi Jianguo	Holding the position of executive director	Change of the substantial shareholder of the Company
Wang Xing	Holding the position of non-executive director	Change of the substantial shareholder of the Company
Shen Guorong	Holding the position of non-executive director	Job position transfer
Liu Minghui	Holding the position of independent non-executive director	The newly appointed independent non-executive director of the Company
Chen Ying	Holding the position of independent non-executive director	The newly appointed independent non-executive director of the Company
Li Dongru	Holding the position of independent non-executive director	The newly appointed independent non-executive director of the Company
Li Hongshu	Holding the position of chairman of the supervisory committee of the Company	Change of the substantial shareholder of the Company
Zhang Weiming	Holding the position of supervisor of the Company	Change of the substantial shareholder of the Company
Chi Delin	Holding the position of supervisor of the Company	Change of the substantial shareholder of the Company
Li Zhenxiong	Holding the position of supervisor of the Company	Change of the substantial shareholder of the Company
Lei Jinlu	Resigned the position of chairman, non-executive director	Change of the substantial shareholder of the Company
Zhang Hanrong	Resigned the position of general manager	Job position transfer
Cheng Yunchuan	Resigned the position of vice chairman, executive director	Job position transfer
Wu Ketian	Resigned the position of executive director	Job position transfer
Guo Shangwu	Resigned the position of non-executive director	Retirement

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Name	Position	Reasons for change
Shen Guorong	Resigned the position of non-executive director	Retirement
Yu Chengting	Resigned the position of supervisor	Job position transfer
	Resigned the position of independent non-executive director	Resignation
Tong Yunhuan	Resigned the position of independent non-executive director	Resignation
Liu Gang	Resigned the position of chairman of the supervisory committee	Job position transfer
Sun Xingduo	Resigned the position of supervisor shareholder of the Company	Change of the substantial shareholder of the Company
Guo Junyu	Resigned the position of supervisor shareholder of the Company	Change of the substantial shareholder of the Company
Chi Delin	Resigned the position of supervisor	Job position transfer

V. COMPANY STAFF

As at 31st December, 2007, the Company has 2,961 employees. As an equal opportunity employer, the Group's remuneration and bonus policies are determined with reference to the performance, qualifications and experience of individual employee and prevailing market rate. Education and training aids are provided to motivate employees.

Structure of the human resource:

1. Areas of specialization

Areas of specialization	Number of Employees
Recorded number of employees	2961
Of which:	
Production worker	1972
Technician	339
Sales and marketing	54
Finance	48
Administration	190
General services	56
Internal retirement	249
Staff pending for duties	42
Others	11

2. Education Level

	Number of Employees
Post-graduate	27
University graduate	251
College diploma	477
Diploma	460
High school & vocation school	888
Junior high school	858
Professional title	385
Senior	45
Intermediate	142
Junior	198

CORPORATE GOVERNANCE STRUCTURE

- I. The Company complies with the "Company Laws", the "Securities Laws", relevant laws and regulations issued by the China Securities Commission, the Listing Rules of the Shanghai Securities Exchange and the Listing Rules of The Stock Exchange of Hong Kong Limited ("SEHK") to continuously improve its corporate governance and set up an enterprise system. The Company has established the Articles of Association to comply with the requirements of the "Corporate Governance Standards of Listed Company" announced by the China Securities Regulatory Commission ("CSRC") and the State Economic and Trade Commission. Details can be referred to the Corporate Governance Report.

II. INDEPENDENT NON-EXECUTIVE DIRECTORS AND THEIR DUTIES

1. Attendance of Independent Non-executive Directors in the Board Meetings

Name of Independent Non-executive Directors	Required attendance (times)	Attended in Person (times)	Attended by Representative (times)	Absence (times)	Remarks
Wayne Yu	18	18	–	–	
Liu Minghui	17	17	–	–	
Chen Ying	17	16	1	–	Could not attend due to office duties
Li Dongru	11	10	1	–	Could not attend due to office duties
Yu Chengting	1	1	–	–	
Tong Yunhuan	1	1	–	–	

2. Objects raised by Independent Non-executive Directors

There were no objections raised by independent non-executive directors to the Board or other non-board meetings during the year.

III. SEGREGATION OF THE COMPANY AND THE COMPANY'S CONTROLLING SHAREHOLDER ON THE OPERATIONS, PERSONNEL, ASSETS, STRUCTURE AND FINANCE

1. Operations: The Company's operations are completely independent of the holding company and there are not areas of operation which overlap.
2. Personnel: The human resources and payroll management of the Company and its controlling shareholder are completely independent. No operational staff received emoluments from the shareholders' unit.
3. Assets: The relationship between the Company and its controlling shareholder are identical and the Company assets are independent and the ownership of these assets are completely owned by the Company.
4. Structure: The Company's functional departments operate independently nor is there any relationship along the lines of leading and being led between the Company and the controlling shareholder.
5. Finance: The Company has set up an independent finance department and independent systems for accounting and finance management together with the operating of separate bank accounts.

IV. SENIOR MANAGEMENT SALARY AND BONUS APPRAISAL AND REWARD

The remunerations and salaries of the senior management officers are evaluated by the board of directors and the evaluation committee based on review of operations and attainment of results, operations budget and their management effectiveness during the year.

CORPORATE GOVERNANCE STRUCTURE

V. THE ESTABLISHMENT AND SITUATION OF THE COMPANY'S INTERNAL CONTROL SYSTEM

The Company has established and implemented a full internal control system in accordance with the Company Law and the Articles of Association of the Company to ensure the operation standards and effectiveness of the shareholders' meeting, the board of directors, supervisory committee and the management of the Company, to protect the interest of investors and the Company.

1. Internal control organization structure:

- (1). Shareholders' meeting is the power authority of the Company. It can protect all of the shareholders of the Company, especially for minority shareholders having equal status in the Company and ensure all shareholders to fully enforce their rights;
- (2). The board of directors (the "Board") is the decision making authority of the Company. The Board is responsible for the establishment and supervision of the internal control system of the Company. The Board established and perfected the policies and schemes of the internal control system and supervised the implementation of the internal control system.
- (3). Supervisory Committee is the supervisory organization of the Company. It reviewed the financial statements of the Company, provided written opinions regarding the report of the Board, supervised the work of the directors, and senior management officers, and was responsible for the shareholders' meeting and reported their work to the shareholders' meeting.
- (4). Strategic Committee, Nomination Committee, Remuneration and Assessment Committee and Audit Committee are established under the Board. These committees are comprised with directors. Most members of Remuneration and Assessment Committee and Audit Committee are independent non-executive directors, who are also the conveners. The responsibilities of these committees are implemented in accordance with the relevant laws and regulations.
- (5). The management of the Company is responsible for the establishment and implementation of the internal control system. The management utilizes its operation and management authority by command, co-ordination, and supervising the business departments to manage the daily business of the Company. Each branch, business unit and controlling company carried out specific production and operation tasks to ensure the well-operation of the Company.

2. The establishment and implementation of the internal control system

In order to standardize the management and control the operation risk, the Company has established an internal control system in accordance with its management needs. The system penetrates each level and segment of the operating activities of the Company to ensure each work can be run well.

- (1). The subject of the internal control system of the Company: according to the requirements under the "Internal Control Guidance for Listing Companies", complied with the Company Law, Securities Law and other regulations set by China Securities Regulatory Commission ("CSRC") and Shanghai Stock Exchange, the Company has set up the modern enterprise systems, continued to perfect the corporate governance and standardized the its operation. Each system of Company is the inaccordance with requirements of the "Corporate Governance Guide Line for Listing Companies". Based on the established "Articles of Association of the Company", "Rules of Procedures for Shareholders' Meeting", "Rules of Procedures for Board Meeting", "Rules of Procedures for Supervisory Committee's Meeting", "Rules of Procedures for Committees' Meeting", "Working Rules for General Manager", the Company has established "Working System for Independent Non-executive Directors", "Information Disclosure and Management System", "Management Measures for Subsidiaries", "Important Information Internal Reporting System" etc. The internal control systems cover all levels and segments of the operating activities of the Company, including, but not limiting in purchasing, sale, production, development and research, assets management, inventories management, working capital management, human resources, and information disclosure. By establishing and implementing these systems, the Company has made good progress in respect of corporate governance, and daily operation.

CORPORATE GOVERNANCE STRUCTURE

- (2). In accordance with the Company's practice and management needs, the Company has established internal control systems with clear organization structure, and integrity functions. Presently, the Company has 10 departments, 2 business units, 5 controlling subsidiaries and 2 joint stock companies. The Company has defined the targets, responsibilities and rights for each unit, and is perfecting the related authorization, review, and accountability system to ensure each unit can utilize its rights and take the obligations within its authority range. Each unit of the Company led by its management implemented the management systems effectively to ensure a proper operation so that the targets can be achieved.
- (3). In order to strengthen the standards to the controlling companies and joint stock companies to achieve the effective management, to let the shareholders utilize their rights properly, the Company established the Management System for Controlling Companies and Joint Stock Companies. The system has clearly made the management rules and procedures, daily management, obligations and responsibilities of appointing directors and supervisors to form an institutionalized and standardized effective operation system. The Company strengthens the control to the controlling companies and joint stock companies and supervises these companies to establish internal control system which is suitable for their operation.

3. Special corporate governance activities in the year 2007

- (1). In April 2007, the Company started off the corporate governance special activities. A corporate governance special group was established to fully push the corporate governance special activities, the chairman was appointed as the team leader. Members of the group included chairman of the Company, appointed directors, supervisors by controlling shareholder of the Company, secretary to the Board, chief financial officer and securities representatives. The corporate governance special activities was spread out from April to October 2007.

During the period of corporate governance special activities, the Company completed the followings in accordance with the requirements under the Notice of Strengthening Corporate Governance of Listing Companies issued by CSRC (the "Notice"): the target of these activities is standardizing the daily operation, improving corporate governance level, increasing the independence of the Company and improving the quality of the Company practically. According to the Notice, the Company carried through the self-inspection in regarding of the corporate governance.

After self-inspection, the Company considered that the shareholders' meeting, the board meeting the supervisory committee's meeting, and each management level can standardize their operation in accordance with their responsibility. The internal control system of the Company is well-established and the corporate governance structure of the Company is effective. However, the following aspects should be improved: 1) perfecting the internal control system; 2) the Company has not fully effectively controlled its subsidiaries; 3) the management of information disclosure and the relationship with investors should be improved; 4) internal restriction , accountability system should be improved; 5) strengthening trainings of relevant staff to improve the corporate governance quality.

Aiming at the problems found in the self-inspection, the Company summarized the problems with the attitudes of strictly self-discipline and responsible for shareholders. The Company has made and implemented the rectification measures. In the future, the Company will continue to strengthen the internal control system in the daily operation and improve the corporate governance quality.

CORPORATE GOVERNANCE STRUCTURE

- (2). Positively develop management of the relationship with investors and increase the information disclosure. Accordance to the "Management Measures of Information Disclosure of Listing Companies" issued by CSRC on 30 January 2007, the Board meeting held on 25 June 2007 had considered and passed the "Management System of Information Disclosure of Shenji Group Kunming Machine Tool Company Limited".
- (3). The Company will continue to increase trainings for directors, supervisors and senior management officers, to build up risk management concept and cultivate enterprise spirit and internal control culture. After 2008 New Year Festival, the Company organized directors, supervisors and senior management officers to have the training course at Hong Kong Chartered Secretaries in Hong Kong.

The corporate governance special activities provided good opportunities for perfecting the corporate governance structure, improving the corporate governance level and advancing the standardized operation. In the future, the Company will continue to strictly comply with relevant laws, regulations, combining the opinions provided by supervisory organizations and investors, continue to improve corporate governance quality and to achieve the operation target of giving return to shareholders, making benefit to staff and making contribution to the society.

VI. DISCLOSURE OF THE BOARD'S SELF-ASSESSMENT REPORT AND AUDITOR'S REVIEWED ON THE COMPANY'S INTERNAL CONTROL

The Company would not disclose the board's self-assessment report and auditor's reviewed on the Company's internal control

CORPORATE GOVERNANCE REPORT

I. CORPORATE GOVERNANCE PRACTICE

The Company complies with Appendix 14 "Code on Corporate Governance Practices" of listing rules issued by the Stock Exchange of Hong Kong Limited and targets to improve its quality of management.

The implementation of practice of the Company is as follow:

A. Directors

A.1 Board Meetings

The Company holds at least one Board Meeting in each quarter. Eighteen Board Meetings were held during 2007 and thirteen of them were in written, please refer to page 34 for details of directors' attendance. The secretary to the Board would consult each director for issues that would be covered during the meeting and include them in the agenda. Notification and preliminary agenda will be distributed to directors 14 days before the date of meeting.

All directors keep close contact with the Company Secretary. The Company Secretary is responsible for ensuring that the operation of Board Meeting fulfills the required procedures and would express opinions regarding corporate management and conformation with regulations. The minutes of Board Meeting are kept by the Secretary to the Board. Minutes are passed to all directors for reference. Directors may seek for professional advice and the cost is borne by the Company.

If a substantial shareholder or a director has a major conflict of interest, a board meeting should be held. The director involved should abstain from his voting and his attendance should not be included.

A.2 Chairman and Chief Executive Officer

The positions of Chairman and Chief Executive Office were held by the same person, Mr. Gao Minghui from 24 October 2007 to 24 April 2008. On 24 April 2008, nominated by the chairman, Mr. Gao Minghui, considered by the nomination committee, the 40th board meeting approved to appoint Mr. Zhang Xiaoyi to replace the position of general manager.

A.3 Formation for the Board of Directors

The Company discloses the composition of members of Board according to its communications regarding the category of directors including Chairman, Executive Directors, Independent Non-Executive Directors and Non-Executive Directors. There are 4 independent non-executive directors in the Board and it shares 1/3 of total number of directors. During 2007, 3 directors took up the role of management and it shared 1/4 of total number of directors. This has enhanced the review and control of the Company's management procedures. In order to enrich the shareholders understanding to directors and the Board of the Company, the Company has uploaded the role of directors and their responsibilities in relevant media.

A.4 Appointment, Election and Removal

Directors of the Company (including non-executive directors) have specific appointment term. According to the Articles of Association, directors are elected in Shareholders' meeting and each appointment lasts for three years. After the completion of appointment, directors may be re-nominee and re-appointed. Appointment for independence non-executive directors should not exceed 6 years. Approval from shareholders should be obtained before taking up the position.

CORPORATE GOVERNANCE REPORT

A.5 *Directors' Responsibilities*

In order to ensure that directors have a sufficient understanding of the operation and business of the Company, each new director would be given a comprehensive set of introductory material after appointment. This set includes a brief introduction of the Company's business, responsibilities and obligations of directors and other legal requirements. Other than that, each non-executive director will receive strategic proposals, business reports, and economics activities analysis regularly so that they can exert their functions effectively, including providing independent opinions in the board meeting. When potential interest conflicts appear, they can exert the leading function. They were invited to be members of committees under the Board and review the practices of the issuer.

The Secretary to the Board is responsible for ensuring that all listing rules and legal requirement obtained are updated.

A.6 *Provision and Usage of Information*

In order to ensure that the directors of the Company could perform their responsibilities effectively and making decision regarding relevant information, agenda of directors' meeting and documents would be distributed to all directors within ten days before the meeting. Directors could meet the senior management formally or informally before the directors' meeting. Directors and committee members could review the minutes of directors' meeting and relevant material.

B.1 **Remuneration of Director and Senior Management Officers**

Since the establishment of Remuneration and Assessment Committee, remuneration and assessment of directors, supervisor and senior management officers are based on decisions made in committee meetings. Consultation fee payable to independence professional bodies for opinion is borne by the Company.

C. **Accountability and Auditing**

C.1 *Financial Reporting*

Directors would receive integrated reporting including strategic issues, latest information of business, financial goal, plan and measures from the management regularly. In the annual or interim report, or other notices regarding price sensitive and other disclosable financial information, the Board would make a balance, clear and understanding review for the Company's current status and prospects. A declaration of Directors' responsibility for the 2007 annual report is set out in page 199. Statements of the reporting responsibility of the external auditors are set out in the Auditor's Report on page 59 and 126 respectively.

C.2 *Internal Control*

The Company's supervisory committee utilizes its supervisory rights independently in accordance with laws and regulations to protect the legal rights of shareholders, the Company and employees. The size and combination of supervisory committee can fulfill the legal requirement. During 2007, 5 meetings were held and full attendances were noted in every meeting. Shareholder representatives would supervise the financial status of the Company and the performance of directors and senior management officers to ensure their performance validity. Members of supervisory committee present at the board meetings and fulfill their responsibilities.

The Board of Directors is responsible for creation and maintenance of internal control system for checking the financial, operational and supervisory control procedures. The right of shareholders and company's assets are protected. The Board could delegate the authority to management level for implementation of internal control system. Audit committee would inspect the effectiveness of the internal control.

The internal audit department would carry out inspection, supervision and assessment on risk and possibility regarding various businesses and flows. Internal management system and procedures are established for monitoring, operation, construction, finance and administration. Inspection would be carried out on a random basis.

CORPORATE GOVERNANCE REPORT

C.3 *Audit Committee*

Since the establishment of the audit committee, improvements were made on financial reporting and the transparency of financial arrangement has been improved. The Company pays great attention to the documentation systems of minutes of Audit Committee meetings. A specific person is responsible for drafting minutes and distributing to members of the audit committee after the meetings. The draft is prepared for collection of members' opinions, once finalized these will be minutes kept for record.

D. **Transfer of Right of the Board of Directors**

D.1 *Management Function*

The scope of the Board of Directors and management is clearly defined and its function is listed out in the Articles of Association.

D.2 *Committees under the Board of Directors*

The Strategic Committee, Audit Committee, Nomination Committee, Remuneration and Assessment Committee of the Company are established under the board of directors with respective scope of rights and obligations. Each committee performs its duties separately during the reporting period.

E. **Communication with Shareholders**

E.1 *Effective Communication*

The Board of Directors focuses on communication with shareholders. During the Annual General Meeting in 2006, all Executive Directors, and part of Non-Executive Directors and senior management officers participated and enhanced the communication with shareholders.

E.2 *Voting by poll*

Shareholders would be informed regularly about the procedures of voting by poll. The procedures of voting by poll are set out in the notice of annual general meeting and circular. Relevant procedures would be explained at the annual general meeting.

II. SECURITIES TRANSACTION OF DIRECTORS

During the reporting period, the Company followed the Appendix 10 "Model Code for Securities Transactions by Directors of Listed Issuers" of listing rules issued by the Stock Exchange of Hong Kong Limited as regulation for securities transaction of directors.

III BOARD OF DIRECTORS

1. **Formation of the Board of Directors**

Currently, there are 12 directors in the Company and 4 of them are independent non-executive directors. This is the fifth term of Board of Directors since the establishment of the Company. The current term of directors begins on 1st November, 2005 or at the date of appointment to the next election of directors.

CORPORATE GOVERNANCE REPORT

Eighteen board meetings (thirteen of them were in written) have been held during the year and members of the board meetings are as follow:

Name	Position	Required attendance	Attended in person	Attended by representative	Absence	% of attendance
Gao Minghui	Chairman, executive director	18	18	0	–	100
Zhang Hanrong	Vice chairman, non-executive director	18	17	1	–	94
Song Xingju	Vice chairman, non-executive director	17	17	0	–	100
Sun Kai	Non-executive director	18	18	0	–	100
Wang Sheng	Non-executive director	18	17	1	–	94
Wang Xing	Non-executive director	17	17	0	–	100
Pi Jianguo	Executive director	17	17	0	–	100
Shen Guorong	Non-executive director	17	17	0	–	100
Wayne Yu	Independent non-executive director	18	18	0	–	100
Liu Minghui	Independent non-executive director	17	17	0	–	100
Chen Ying	Independent non-executive director	17	16	1	–	94
Li Dongru	Independent non-executive director	11	10	1	–	91

During the reporting period, directors attended almost all the board meetings. Representative would participate the board meeting if the directors were unable to attend the board meeting due to office duties.

According to the Article of Association, notice of a regular board meeting should be given to all directors at least 10 days before the board meeting. In practice, the Company complied with the requirements under Appendix 14A.1.3 of listing rules of the Stock Exchange of Hong Kong Limited, all notices of regular board meetings were sent 14 days before the board meetings.

The secretary to the board is responsible for distributing detail information of board meeting regularly to directors not less than 5 days before the date of meeting to ensure that all directors understand the issues to be considered during the meeting.

Information of temporary board meeting on need of management or meetings held in form of communication should be sent to all directors by e-mail and fax, and give enough time to directors for consideration. The Company Secretary should respond to directors' queries on time. Proper actions should be taken to assist the directors to ensure the compliance with regulations such as the Company Ordinance, Articles of Association and Listing Rules.

Minutes of board meetings should be signed by recorder and directors who attended the meeting. Such minutes should be open for inspection at any reasonable time on reasonable notice by any director.

Where discussion arises on connected transactions with conflict of interests during the board meeting, directors involved in the matter should abstain from voting.

CORPORATE GOVERNANCE REPORT

2. Appointment of Directors

Each appointment of director lasts for three years. Re-election and re-appointment are allowed. Appointment for independent non-executive directors should not exceed six years. Directors' service contract for three years between the Company and directors should be signed (Appointment for any additional directors appointed during the period should last for less than three years). Appointment of directors should be approved by shareholders' meeting. The appointment of directors during this reporting period is recorded on pages 25 to 26 "Change of Directors, Supervisors and Senior Management during the Reporting Period and Reasons thereof" of this annual report.

3. Duties and Positions

The principal duties of the Board of Directors are to exercise management and decision-making power as conferred by the general meeting in respect of corporate development strategies, management structures, investment and financing, planning, financial control and so forth. In the Articles of Association of the Company, it has listed in detail the principal duties of the corporate development strategies as well as those of the management and the responsibilities of the said supervision and examination. The directors acknowledge their responsibility for preparing the financial statements in this annual report.

4. Nature and Independence of Independent Non-executive Directors

Members of independent board committee have different professional backgrounds. They have sufficient experience and professional knowledge in areas including corporate management, financial accounting and manufacturing of machine tools.

The Company has received from each of its Independent Non-executive Director an annual confirmation of independence and considered each of them independent to the Company pursuant to Rule 3.13 of the Listing Rules.

5. Implementation of Measures for Ensuring the Performance of Directors' responsibilities

All directors could obtain relevant material and updated information on regulations which directors of listed companies must comply with, supervision, and contingent responsibilities from the Company Secretary to ensure the understanding of their responsibilities. Procedures of the Board should be implemented and regulations should be properly carried out. The Board of the Company could obtain services from professional bodies for performance its duties and the Company would bear the reasonable expenses.

6. Relationship between Members of the Board

No relationship exists between members of the Board regarding finance, business, family and others.

IV. CHAIRMAN AND GENERAL MANAGER

Different individuals fulfill the positions of Chairman and General Manager, and duties are clearly segregated. Chairman is responsible for work related to the Board such as inspecting the implementation progress of issued approved by board meeting. General Manager is responsible for management of operations of the Company and implementation of strategies formulated by the Board. Rights and obligation of General Manager are set out in the Articles of Association of the Company.

Due to job transfer, the former general manager, Mr. Zhang Hanrong resigned his position of general manager on 23 October 2007. By considered and passed at the 32nd board meeting on 23 October 2007, the chairman of the board, Mr. Gao Minghui also performed the role of the general manager in the interim.

CORPORATE GOVERNANCE REPORT

The reasons for deviation: General Manager plays an important role in the operation management in the enterprises. The general manager must be selected carefully and by considered deliberately. At present, the board of directors and the nomination committee is trying to select a general manager in the range of the Company and even in the industry around the country. The board of directors will comply with the laws and regulations and will abide by the commitments to select a competence general manager in a short time.

On 24 April 2008, nominated by the chairman, Mr. Gao Minghui, considered by the nomination committee and approved by the 40th meeting of the 5th term of board of directors of the Company, the board decided that Mr. Zhang Xiaoyi, the vice general manager of the Company replaces the position of general manager.

V. NON-EXECUTIVE DIRECTORS

According to the Articles of Association, Rules of Procedure for the General Meetings of the Shareholders, and Rules of Procedure for the Meetings of the Board of Directors, the term of non-executive directors under the fifth term of board of directors lasts until 31st October, 2008.

VI. STRATEGIC COMMITTEE, AUDIT COMMITTEE, NOMINATION COMMITTEE AND REMUNERATION AND ASSESSMENT COMMITTEE ARE UNDER THE BOARD OF DIRECTORS

Details are as follows:

No.	Committee	Major responsibilities	Responsible person	Committee members	Workdone during the year
1.	Strategic Committee	Conducting research and providing suggestions on the Company's strategic planning, significant investment and financing issues, significant usage of capital, asset utilization.	Gao Minghui	Gao Minghui, Zhang Hanrong, Song Xingju, Li dongru	
2.	Audit Committee	Reporting on regularly, annual achievements and progress on implementation of internal control	Wayne Yu	Wayne Yu, Liu Minghui, Shen Guorong	Special auditing meeting for annual report and interim report
3.	Nomination Committee	Formulating policy for directors' nomination including nomination procedures, handling steps and criteria for selection of nominated candidates	Liu Minghui	Liu Minghui, Chen Ying, Wang Sheng	Reviewed and nominated senior management officers regarding their appointment or removal for the year
4.	Remuneration and Assessment Committee	Formulating remuneration policy for executive directors, assessing performance of executive directors and approving clauses in directors' servicing contract	Chen Ying	Chen Ying, Wayne Yu, Sun Kai	Formulating more reasonable assessment and appraisal system

Note: Responsible person for the Company's strategic committee is Mr. Gao Minghui, the Chairman and executive director;
Responsible person for the Company's audit committee is Mr. Wayne Yu, Independent non-executive director;
Responsible person for the Company's nomination committee is Mr. Liu Minghui, Independent non-executive director;
Responsible person for the Company's remuneration and assessment committee is Mr. Chen Ying, Independent non-executive director.

CORPORATE GOVERNANCE REPORT

VII. AUDITOR'S FEE

Auditor's fee for 2007 includes the following:

Amount of RMB360,000 is paid to ZonZun Accounting Office Limited, the domestic accounting firm

Amount of RMB1,300,000 is paid to KPMG, the overseas accounting firm

Factors affecting the auditor's fee paid by the Company:

- (1) General remuneration offered for auditing service in PRC
- (2) General remuneration offered for auditing service in Hong Kong
- (3) In accordance with work load on audit workdone in previous accounting period
- (4) In accordance with work load on audit workdone in the previous engagement.

VIII. RIGHTS OF SHAREHOLDERS

The Company keeps good communication with shareholders. The communication channels include the Annual General Meeting, website and electronic mailbox of the Company, facsimile and telephone in the office of the secretary to the board to let shareholders express their opinions and exercise their rights.

SHAREHOLDERS' MEETING

I. ANNUAL GENERAL MEETING ("AGM")

1. The 2006 AGM was held on 29 June 2007 and the results were published on China Securities, Shanghai Securities News, Securities Times on 2 July 2007, and were available at the following websites: <http://www.sse.com.cn>; <http://www.hkex.com.hk>; <http://www.kmtcl.com.cn>.
2. Class meeting for holders of H Shares and class meeting for holders A Shares were held on 29 June 2007 and the results of class meetings were published on China Securities, Shanghai Securities News, Securities Times on 2 July 2007, and were available at the following websites: <http://www.sse.com.cn>; <http://www.hkex.com.hk>; <http://www.kmtcl.com.cn>.

II. EXTRAORDINARY GENERAL MEETING ("EGM")

1. The first EGM of the Company

The first EGM was held on 23 March 2007. The results were published on China Securities, Shanghai Securities, Securities Times, Hong Kong Wen Wei Po and The Standard on 26 March 2007.

2. The second EGM of the Company

The second EGM was held on 31 October 2007. The results were published on China Securities, Shanghai Securities News, Securities Times on 1 November 2007, and were available at <http://www.sse.com.cn>; <http://www.hkex.com.hk>; <http://www.kmtcl.com.cn>.

DIRECTORS' REPORT

I. BUSINESS REVIEW

1. Overview Operations

Leveraging on the advancement of “developing equipment manufacturing industry”, the machine tool manufacturing industry is prospering in respect of production and sales. The Company continued to keep rapid development. In the year 2007, led by the management of the Company, all the staff of the Company worked hard together, participated in the marketing competition and captured the marketing opportunities. After making great efforts, the Company has obtained good results in the operation. The followings were achieved in the year 2007:

- (1) Marketing and sales: The sales of Company have a rapider development as compared with last year, and the sales network building and marketing development have made good foundation for the 2008 expansion.
- (2) Production: The modification of potential productivity in 2007 ensured growth of production in substance and improved the production efficiency significantly.
- (3) Technology: In the year 2007, the technology department increased developing new products, and has well supported the sales department in respect of the before-sale and after-sale service. The technology innovation represents the core competitiveness of the Company and keeps the Company continuing development and thriving. In the future, the Company will concentrate its efforts on new product reserve, technology team consolidation, product research and development, product development assessment and evaluation system and product development procedure to improve the competitiveness of technology, products, and services.
- (4) Quality control: With the large increase in production ability and quantity, the products quality control department basically has controlled the internal and external loss rate. Meanwhile, the quality control concept has been emphasized in the whole Company.
- (5) Technological renovation: The technological renovation projects were developed well in 2007. Of which, the investment project of key production equipments and cast renovations are in the execution. Basically, the Company has completed the technological renovation plan in 2007 and this has been made good foundation for the Company's development in the future.
- (6) The existing problems in respect of the subsidiaries: The existing problems have been making breakthrough after straightening out and neatening the problems. The obstacles were cut off and this has provided the safeguard for the Company's rapid development in the year 2008.

During the reporting period, the Group has obtained a turnover of RMB1,302,386 from continuing operations, and a net profit attributable to equity shareholders of the Company for the year of RMB242,958,000 representing an increase of RMB450,347,000 and RMB144,899,000 respectively as compared with last year's turnover of RMB852,039,000 and net profit of RMB98,059,000. The operating activities for the boring and milling machines had attained a turnover of RMB1,031,993 and a net profit of RMB227,342,000 representing an increase of 59.35% and 148.87% respectively as compared with last year. Non-boring and non-turbo machines had attained a turnover of RMB281,193,000 and a net loss of RMB1,068,000, representing an increase of RMB73,378,000 and a decrease of RMB1,704,000 respectively.

DIRECTORS' REPORT

2. Main products comprising 10% or more of the turnover of gross profit

Business or products	Turnover	Cost	Unit: RMB'000
			Gross Profit(%)
Sales and processing machine tool products	1,017,722	615,130	39.55%
Sales, installation and technical service of highly efficient compressor	233,544	178,575	23.07%

During 2007, the Company had attained a turnover of RMB1,302,386,000 representing an increase of RMB450,347,000 as compared with 2006. The operating activities for the boring and milling machines had attained an increase in income of RMB375,212,000, representing a growth of 58.40%. On the other hand, Ser had attained an increase in income of RMB56,154,000, representing an increase of 31.66%. Based on sales structure, in 2007, the sales of the machine tool products is 78.14% of the total sales revenue, the sales of Ser of turbo machines is 17.93% of the total sales revenue. The sales revenue of the two segments is 96.07% of the total sales revenue, representing 2.73% increase and 2.95% decrease respectively as compared with 2006.

3. Reasons of the change in major operating market and the change in structure of major operating costs

In 2007, the Company's consolidated gross profit rate is 35.93%, representing an increase of 4.38 percentage points as compared with last year's 31.55%. The increase of the consolidated gross profit is caused by the gross profit of boring and milling machines increased 7.06 percentage points. Analysis as follows:

- (1) With increasing of scale of production and sales, the scale efficiency was shown adequately in 2007. The sales of machine tool products was increased 58.40% in 2007, and the operating costs were added 42.74%. The fixed costs in operating cost in respect of depreciation, manufacturing expenses were diluted by the increasing scale of sales. The increasing rate of the cost is lower than that of the sales. The consolidated gross profit was boosted.
- (2) The sales of CNC machine tool products in 2007 was increased by 11.72% than that in 2006. The added-value and profit performance of CNC machines are better than those of conventional machines. Therefore, as the proportion of CNC machines increased, gross profit grew up.

4. Analysis of turnover and market share of main business and products:

Business or products	2006 Turnover	2007 Turnover	Unit: RMB'000
			Increase/decrease(%)
Business			
General facilities production	218,536	316,912	45.02%
Specified facilities production	210,078	346,689	65.03%
Transportation facilities production	65,650	73,809	12.43%
Electric Mechanical Equipment production	—	72,052	—
Other production	97,173	166,853	71.71%
Products			
Horizontal boring and milling machines	241,779	382,227	58.09%
Floor-type boring and milling machines	224,332	443,345	97.63%
Table-type boring and milling machines	48,084	78,008	62.23%
Horizontal machine centers	52,283	56,040	7.19%
Jig boring machines	22,948	10,349	(54.90%)
Others	2,011	6,346	215.56%
Total	591,437	976,315	65.08%

DIRECTORS' REPORT

5. Major Suppliers and Customers

The purchases from the top 5 suppliers of RMB124,564,000 represent 16.38% of the total purchase for the year.

The sales revenue of the top 5 customers is RMB126,488,162.00, representing 9.71% of the total sales revenue for the year.

6. Analysis of the changes in assets structures and proportions

Unit: RMB'000

ITEMS	As at 31st December, 2007	As at 31st December, 2006	Amount increase/ (decrease)	Increase/ (decrease)(%)
Bank balance and cash	370,351	166,794	203,557	122.04%
Bills receivable	134,784	52,131	82,653	158.55%
Other receivables	21,434	14,541	6,893	47.40%
Inventories	427,423	283,919	143,504	50.54%
Construction in progress	46,098	29,912	16,186	54.11%
Advances from customers	432,062	218,326	213,736	97.90%
Tax payable	67,941	28,396	39,545	139.26%
Estimated liabilities	9,117	3,555	5,562	156.46%
Principal operating income	1,302,386	852,039	450,347	52.86%
Principal operating cost	834,436	583,643	250,793	42.97%
Investment Income	28,043	143	27,900	19510.49%
Non-operating income	25,365	6,410	18,955	295.71%
Non-operating expense	10,905	2,332	8,573	367.62%
Sales expense	61,882	40,728	21,154	51.94%
Administrative expense	116,127	85,435	30,692	35.92%
Impairment loss from assets	27,753	14,517	13,236	91.18%
Income tax	45,703	16,922	28,781	170.08%

- (1) Bank balance and cash increased of RMB203,557,000, bills receivable increased of RMB82,653,000, due to sales revenue increased, amount of cash and commercial acceptances notes increased.
- (2) Other receivables increased of RMB6,893,000, due to sales revenue increased during the reporting period.
- (3) Inventories increased of RMB143,504,000, due to the order of machine tools products increased.
- (4) Construction in progress increased of RMB16,186,000, due to the Company continued to enhance the production scale and build new workshops.
- (5) Advances from customers increased of RMB213,736,000, due the order of machines tools products grew up.
- (6) Tax payable increased of RMB39,545,000, due to sales revenue and profit grew up, the value-added tax and income tax increased accordingly.
- (7) Estimated liabilities increased of RMB5,562,000, provision of guarantee service fee increased due to sales revenue increased.
- (8) Principal operating revenue and cost increased of RMB450,347,000 and RMB250,793,000 respectively, due to growing order of machine tool products.

DIRECTORS' REPORT

- (9) Investment income increased of RMB27,900,000 of which, written back provision for diminution in value of short-term investment of RMB24,382,000 to the profit and loss account in the period because of taking back entrusted investment from China Fortune, recognized investment income of RMB4,967,000 from TOS kunming and loss of RMB2,020,000 on equity transfer of Shangxi Shangtong.
- (10) Non-operating revenue increased of RMB18,955,000, value-added tax of RMB16,130,000 was refunded.
- (11) Non-operating expense increased of RMB8,573,000, due to project penalty of RMB8,236,000 was imposed on Siyuan Intelligence Electric,
- (12) Sales expense and Administrative expense increased of RMB21,154,000 and RMB30,692,000, due to extended scale of production and sales.
- (13) Impairment loss of asset increased of RMB13,236,000, due to provision on bad debts of RMB12,192,000 was made.

7. Analysis of major financial data and changes

Unit: RMB'000

Items	At the end of the year	At the beginning of the year	Amount increase/ (decrease)	Increase/ (decrease)(%)
Total assets	1,779,008	1,271,080	507,928	39.96%
Principal operating profit	465,485	266,740	198,745	74.51%
Net profit	242,958	98,059	144,899	147.77%
Net increase in cash and cash equivalents	227,397	(14,219)	241,616	—
Share equity	879,379	636,421	242,958	38.18%

- (1) Total assets increased due to good performance of operation and production this year, receivable collection on time, enlarging scale of total assets. Total assets increased of RMB507,928,000, include current assets increased of RMB455,891,000.
- (2) Principal operating profit increased due to great growth of sales revenue this year.
- (3) Great growth of net profit was contributed by enlarging scale of production and sales, growth of operating profit, investment income increased largely, and refund of value-added tax.
- (4) Increased cash and cash equivalent was contributed by growth of sales revenue, well collection in receivable, increased net cash flow.
- (5) Share equity increased due to net profit increased in the year 2007

8. Analysis of cash flow structure and its major changes, and reasons of net profit fluctuation:

Cash flow generated from operating activities was RMB265,050,000, net cash outflow from investment activities was RMB25,777,000, and net cash outflow from fund raising activities was RMB9,428,000. Net cash flow from operating activities increased RMB167,381,000 due to sales and providing labor services increased RMB737,456,000, and paid cash RMB509,520,000 for purchasing. Net cash from investment activities increased RMB43,355,000 because of cash received from return of investment increased RMB94,322,000 in 2007, cash outflow due from investment increased RMB40,000,000 and cash flow out to purchase fixed asset of RMB17,205,000. Net cash from fund raising activities increased RMB31,987,000 due to repaid bank borrowings this year less decreased RMB40,000,000 as compared with last year.

DIRECTORS' REPORT

9. Discussion and analysis of important issues which are closely related to the company's operation, including the company's usage of equipment, receipt of purchase orders, sales of products or stock turnover and movements of major technical staffs

The amount of contracts newly signed during 2007 is RMB1,539,942,000, of which 70.93% were CNC machines. There was no stock machine and there was no movement of major technical staff

10. Review of operations for subsidiaries and invested companies

Unit: RMB'000

Name of company	Nature of business	Major product or service	Registered share capital	Total assets	Net profit
Xian Ser Turbo Machinery Manufacturing Turbo machine Company Limited ("Xi'an Ser")	Manufacturing	Turbo machine	50,000	348,575	21,602
Xian RuiTe Laser Prototyping Manufacturing & Engineering Research Company Limited ("Xian RuiTe")	Manufacturing	Laser prototyping machine	60,000	80,393	568
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Siyuan")	Manufacturing	Intelligent electrical appliances	35,000	68,412	(17,529)
Winko Machines Company Limited ("Winko")	Manufacturing	Computerized embroidery machine	20,230	21,134	(5,973)
TOS Kunming Machine Tool Manufacturing Company Limited ("Tos Kunming")	Manufacturing	Development, design, sales of self-produced machines and accessories	5 million (Euro)	101,323	9,934
Kunji Transportation Company Limited	Transportation	General cargo transportation	500	1,516	833
Kunming Kunji General Machine Co. Ltd	Manufacturing	Development, design, sales of machine and parts	3,000	87,611	16,061

II. OUTLOOK FOR 2008

2008 will be a critical year in the course of the Company's development. The Company will step into the new historical period and development moment. We will establish an operating model of "making profits by scale, rapidly increase investment of various resources to increase production" and make changes in the thoughts. Relevant works include:

1. Formulating the plan in next 2 to 3 years which focus on comprehended research in market and resources such as human resources, funds, facilities, equipments, workshops;
2. Optimally in design, development, and product structure. The Company should set up comprehensive and advanced platform in design and development, promote design modular, modify appearance of machine, and empower R & D team, to upgrade the original products, develop new products.

DIRECTORS' REPORT

3. Quality control: With the increased production quantity and the expansion of the production scale, the key point of quality control is to keep the principle of continuing improvement. The Company will improve the management workflow to improve the procedure control for the product quality. According to the internal and external loss to dig out problems and solve problems.
4. Marketing and after-sale service: Empowering the marketing and after-sale service team is the critical point in 2008. With the increased scale of the Company, the problems in after-sale service are popping out increasingly. Therefore, mending the pace of technology and production related after-sale service, and emphasizing the corresponding system is a very important integrated concept.
5. Production: In respect of the production, the Company needs to expedite the course of integrated ERP construction to choose the suitable system which corresponds with the product characteristic and running process.
6. Carrying through organization structure adjustment and building related suitable remuneration assessment system: According to the development of the Company, it needs to set up the more reasonable organization structure to adjust some departments' functions. The Company will strengthen the departments' rights and liabilities based on merger and split of the departments, to improve the work efficiency and execution. Meanwhile, the Company will set up a scientific and criteria remuneration assessment system in accordance with liabilities, risk, professional knowledge included, working complexity and working intension bore in the after-adjustment functions and positions.
7. Reserving human resources for the increment development of the Company: Presently, the Company needs to strengthen the teams in respect of technology, sales, finance, management and workforce which match the development of the Company. The human resources training should match the speed of the Company expansion scale.
8. The Company will make the fixed assets (emphasizing key equipments) investment proposal to match the development of the Company, and to arrange the implementation as soon as practical in order to solve the problems in respect of mismatching resources in the production segment.
9. The Company will implement various preparations positively to establish the national-level enterprise technology center. The idea was brought up last year, and was not positive implemented in the later time. The Company will take this as one of the emphasized tasks for this year and try for making some breakthroughs.
10. Operating Goal in 2008

In 2008, the industry development of machine tools will be effected by state adjustment and control of macro economy through monetary tightening police; the cost of main raw material such as iron and casting increased at the beginning of 2008, this will affect the Company's operation in 2008. The Company have adopted proper actions such as modification of design and procedure to reduce the effect on the Company's operation due to the cost of raw materials increase.

Unit: RMB'000

Items	Principal operating Income	Principal operating Cost	Net Profit
Results in 2007	1,302,386	834,436	242,958
Goal in 2008	1,600,000	1,080,000	260,000

DIRECTORS' REPORT

III. INVESTING ACTIVITIES

Information of the Invested Companies

Name of the subsidiaries and joint venture	Place of registration	Scope of business	Registered Capital (RMB'000)	Investment Proportion	Economic nature	Date of investment	Relationship with the Company	note
Xi'an Ser	Xi'an City	Design, development and sales of turbo machinery	50,000	45.00%	Limited liability	2001.12	Subsidiary	
Siyuan	Xi'an City	Development, manufacture and sale of electronic products, electronic machine and products of electronic power, provide technology services	35,000	78.03%	Limited liability	2002.12	Subsidiary	note 1
Winko	Kunming City	Develop, apply and integrate hardware and software, retail, whole sale, purchase on behalf of others and consign electronic products, machinery and electronic machine	20,230	96.74%	Limited liability	2002.11	Subsidiary	note 2
Tos Kunming	Kunming City	Development, design, manufacture an sales of machine tool products and high-tech products, repairs of machines	5 million (Euro)	50%	Sino-foreign operation	2005.04	Joint Venture	
Changsha Ser Turbo Equipment Company Limited ("Changsha Ser")	Changsha City	Design, development and sales of turbo machines	10,000	95.00%	Limited liability	2004.01	Subsidiary of Xi'an Ser	
Hangzhou Ser Gas Engineering Company Limited ("Hangzhou Ser")	Hangzhou City	Design, development and sales of turbo machinery, technology development, retain and whole sale of construction materials, and import and export business	1,200	51.00%	Limited liability	2004.04	Subsidiary of Xi'an Ser	
Xi'an RuiTe Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an RuiTe")	Xi'an City	Fast prototyping series equipments, automobile mould, automobile design mould, producing moulds, structure design, CNC machine, electromechanical equipments, electronic products, computer software hardware and research, develop, producing, sales technology training and technology consultant service for network engineering	60,000	23.34%	Limited liability	2006.12	Associate	note 3
Kunming Transportation Company Limited	Kunming City	General cargo transportation	500	100%	Limited liability	2006.10	Subsidiary	
Kunming Kunji General Machine Co. Ltd	Kunming	Sales, design, development of Machine and parts	3,000	100%	Limited liability	2007.10	Subsidiary	note 4
Shaaxi Hengtong	Xi'an City	Development and sales of machine manufacturing moulds, machinery, equipment, electronic products, software and hardware	27,960	65.34%	Limited liability	2001.12	Subsidiary	note 5

DIRECTORS' REPORT

- Note:
1. On 3rd Apr 2008, the resolution reviewed and approved by the the 38th meeting of the 5th term of the Board of Directors: refer to the asset appraising value (based on the net asset of RMB10,950,000 of Siyuan appraised on 31st Dec 2007), 78.03% share equity of Siyuan was listed on Yunnan Equity Exchange Centre. On 16th Apr 2008, Asset Appraising Report of Siyuan was approved by Shenyang State-owned Asset Supervision Commission (issued by 「沈國資評核[2008]7號」)
 2. On 23rd Oct 2007, the 32nd meeting of the 5th term of the Board of Directors reviewed and approved the resolution of liquidation of Winko. On 26th Oct 2007, the Board of Directors of Winko reviewed and approved the resolution of liquidation of Winko.
 3. On April 2007, the shareholder of Xian Ruite, Shangxi Industrial Technology Institute, transferred 6.67% shares of Xian Ruite representing RMB4,000,000 to the Company. After transfer, the Company holds 23.34% share of Xi'an Ruite from 16.67%.
 4. On 23rd Oct 2007, the 32nd meeting of the 5th term of the Board of Directors reviewed and approved the resolution of set up subsidiary, Kunming Kunji General Machine Co., Ltd., registered capital: RMB3,000,000.00. Mr. Gao Minghui, the Chairman of the Company, was appointed as status representative of Kunming Kunji General Machine Co., Ltd..
 5. On 23rd Mar 2007, the Company will transfer its shareholding of Shaanxi Hengtong Intelligent Company Limited at the consideration of RMB14,000,000.00 to acquire equity interest in the Xi'an RuiTe.

IV. RAISED FUND SITUATION

1) Use of proceeds from raised fund

There were no new proceeds from raised funds during the reporting period and there were no listing proceeds from previous year being utilized during the reporting period.

2) Use of proceeds from non-raised fund

During the reporting period, there were no investment projects use proceeds from non-raised funds.

V. THE INFLUENCE ON THE FINANCIAL SITUATION AND OPERATING PERFORMANCE OF THE COMPANY BY THE CHANGES OF THE ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES

1. the changes of the Accounting Policies

Pursuant to the regulations from Minister of Finance and China Securities Administrative Commission, Since 1st Jan 2007, the new accounting standard has been applied. The financial statements are compiled and reported according to requirement of the new accounting standards. The influence of changes of accounting police is disclosed in note 6 of consolidation financial statements in year 2007.

2. the changes of the Accounting Estimates

In recent years, the significant change in sales revenue and product structure led change of previous cost quota. At the end of 2007, the Company recalculated and modified the previous cost quota of Overestimated of the machine products. The machine products and inventories at the end of year 2006 and 2007 were revalued in modified cost quotas. The inventory at the end of year 2006 was estimated RMB7,527,145.32, and the goods in process was underestimated of RMB30,661,133.38. Due to the difference between inventory and goods in process, the inventory at the end of 2006 was underestimated of RMB23,133,988.06. Therefore, the Company retrospected the related accounts of year 2006, increased goods in process of RMB30,661,133.38, decrease inventory of RMB7,527,145.32, decreased operating cost of RMB23,133,988.06, increased gross profit of RMB23,133,988.06, increase income tax of RMB3,470,098.21, increased tax payable of RMB3,470,098.21, increase net profit of RMB19,663,889.85. The resolution of changes of accounting estimates was reviewed and approved by 40th sessions meeting of 5th term of the Board of Directors of the Company.

DIRECTORS' REPORT

VI. DAY TO DAY OPERATING OF THE BOARD OF DIRECTORS

1. The board of directors' meeting and resolution

- (1) On 6th Feb 2007, the 19th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of adjournment of the 2007 first EGM.
- (2) On 23rd Mar 2007, the 20th Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of change of directors and supervisors.
- (3) On 18th Apr 2007, the 21st Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of the Annual Report and Summary for the year 2006 etc.
- (4) On 27th Apr 2007, the 22nd Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of THE FIRST QUARTERLY REPORT OF 2007.
- (5) On 20th May 2007, the 23rd Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of self inspection.
- (6) On 25th Jun 2007, the 24th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of "Provision for Information Disclosure Management of Jiaoda Kunji High-Tech Company Limited".
- (7) On 29th Jun 2007, the 25th Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of the change of name of the Company and amendment of A&A.
- (8) On 10th Jul 2007, the 26th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of appointment of KPMG as Hong Kong auditor in 2007.
- (9) On 20th Jul 2007, the 27th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of amendment of self inspection.
- (10) On 20th Aug 2007, the 28th Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of The summary of the 2007 interim report of the Company etc.
- (11) On 13th Sep 2007, the 29th Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of the shareholders' motion to revoke the proposal of payment of dividends etc.
- (12) On 27th Sep 2007, the 30th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of undertake in share reform from first and second largest shareholders.
- (13) On 8th Oct 2007, the 31st Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of establishment of wholly owned subsidiary.
- (14) On 23rd Oct 2007, the 32nd Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of the third quarterly report of 2007 of the Company etc.

DIRECTORS' REPORT

- (15) On 30th Oct 2007, the 33rd Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of "Report on special remedies on Corporation Government".
- (16) On 21st Nov 2007, the 34th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of Investment On Renminbi Structured Products
- (17) On 29th Nov 2007, the 35th Session meeting of the 5th term of the Board of directors of the Company in written was held to consider the resolution of comprehensive opinions on corporation government issued by Yunnan Securities Administrative Bureau.
- (18) On 28th Dec 2007, the 36th Session meeting of the 5th term of the Board of directors of the Company was held to consider the resolution of liquidation of Winko etc.

During the year, 18 meeting were held (13 were in written) and all resolutions were passed.

2. Implementation of Resolution of Shareholders' Meeting

During the reporting period, the Board of Directors had acted their statutory power and duties carefully as provided in the Shareholders' meeting, all resolutions approved by Shareholders' Meeting were implemented.

3. Performance of duties of Audit Committee under the Board

During the reporting period, the Audit Committee held three meeting

- (1) On 17th Apr 2007, the meeting on annual report in year 2006 was held. The meeting reviewed and approved the annual report in year 2006, and profit allotment scheme in year 2006, propose the Board of the directors to appoint Zonzun Accountant Office Limited as PRC auditor in 2007
- (2) On 10th July 2007, the meeting on appointing KPMG as Hong Kong Auditor was held.
- (3) On 27th Dec 2007, the meeting on arrangement of annual report in 2007 was held.

Pursuant to the requirement of "Notice on guideline on audit report and related matters on year 2007 for listing company" issued by CSRC, the Audit Committee played significant role in audit of year 2007. Before the end of year 2007, the schedule arrangement of audit was confirmed by the Auditors. The problems happened in audit discussed by the Auditors and the Committee. Initial Audit Report was reviewed carefully by the Committee. The Committee considered that the annual report of year 2007 was shown in truthfulness, accuracy and completeness of the operation performance and financial situation, the Auditors implemented the entrusted jobs well under principles of independence, objective, and fairness and royal to their duties. The Committee submitted summary report on the Auditors and the proposal of appointment of the Auditors in 2008 to the Board of directors.

4. Remuneration and Assessment Committee

On 17th Apr 2007, the Committee held the meeting to review and approve the resolution on the senior management remuneration evaluation and implementation, and the resolution adjustment of remuneration of the Directors and Supervisors. The remuneration of directors, supervisors, and senior managements was reviewed on the meeting. The Committee considered that the remuneration of the senior managements disclosed in annual report year 2007 was relied on the implementation of strategies and decision formulated by the Board of the Directors and operation performance.

DIRECTORS' REPORT

VII. ALLOCATION PLAN OF PROFIT FOR THE YEAR ENDED 31 DECEMBER 2007

In accordance with the PRC accounting standards, the Company has recorded a net profit of RMB211,294,000 for the year ended 31 December 2007. Of which, the amount of RMB21,129,000 should transfer to the statutory surplus reserve firstly. The accumulated undistributed profit is RMB225,816,000. The Group has obtained the consolidated net profit of RMB242,958,000. After transferring the amount to the statutory surplus reserve, the distributable profit is RMB279,091,000. In accordance with the Hong Kong Financial Reporting Standards, the Company has obtained a net profit of RMB198,963,000. After transfer RMB21,129,000 to the statutory surplus reserve, the accumulated undistributed profit is RMB220,823,000. The Group has obtained the consolidated net profit of RMB241,452,000. After transferring RMB21,129,000 to the statutory surplus reserve, the accumulated distributable profit for the shareholders is RMB277,443,000.

The distributable profit to shareholders is the minimum level of RMB220,823,000, which was prepared under the Hong Kong accounting standards. The Board recommended that after transferring RMB21,129,000 from the Company's net profit to the statutory surplus reserve, the distribution of the Company's accumulated undistributed profits will be distributed in the form of a cash dividend of RMB2.70 for every 10 shares, totally distributing RMB114,713,520.00 to all shareholders based on the aggregate of 424,864,883 shares of the Company.

VIII. CERTIFIED ACCOUNTANTS' SPECIAL STATEMENT OF THE CAPITAL IMPROPRIATION BY THE CONTROLLING SHAREHOLDER AND CONNECTED PARTIES

中準會計師事務所有限公司
ZONZUN Accounting Office Ltd.

Special Statement on the Capital Impropriation by Controlling Shareholder and Related Parties of Shenji Group Kunming Machine Tool Co. Ltd

To all shareholders of Shenji Group Kunming Machine Tool Company Limited,

We have accepted the appointment and audited the financial statements of Shenji Group Kunming Machine Tool Co. Ltd ("the Company") for the year ended 31st December, 2007 and have issued the Audit Report with unqualified opinions. In according to the requirements stated in "Notice of Standard Current Funds between Listed Companies and Related Parties and External Guarantees of Listed Companies", we have performed audit procedures in capital impropriation by controlling shareholder and related parties of the Company. The relevant information are explained as follows:

1. There is no occurrence of non-operational capital impropriation by the Company's substantial shareholder and its respective subsidiaries in this year.
2. Other Related Transactions:
 - (1) The operational usage of the Company's capital by the Company's largest shareholder and its respective subsidiaries at the beginning of the year amounted to minus RMB89,900. The accumulated operational usage of capital in the year amounted to RMB494,900, with repayment and provision of goods of RMB103,800. As at 31st December, 2007, the largest shareholder and its respective subsidiaries' operational usage of capital amounted to RMB301,200.
 - (2) The non-operational usage of the Company's capital by the Company's subsidiaries at the beginning of 2007 amounted to RMB15,175,900. The accumulated non-operational usage of the Company's capital interest amounted to RMB230,200, with repayment of RMB1,020,000. As at 31st December, 2007, the company's subsidiaries' non-operational usages of the Company's capital amounted to RMB14,155,900.

DIRECTORS' REPORT

- (3) There is no occurrence of usage of capital by related natural person and its controlling legal person, other related person and its connected company in this year.

We find the company did not provide funds to the other parties save as mentioned above. We were not aware of any circumstances stated in "Notice of Standard Current Funds between Listed Companies and Related Parties and External Guarantee of Listed Companies", which damage the interest of the Company.

- 1) The Company's controlling shareholder and other related parties require the company to pay for their salaries, staff welfare, insurance expenses, advertising expenses and share the production cost and other expenses;
- 2) Guarantee for the loan borrowed from banks and non-financial institutions;
- 3) Appointment of the Company's controlling shareholder and other related parties to engage in securities trading;
- 4) Issuance of commercial acceptance notes for fraudulent business transactions;
- 5) Settlement of loans for the Company's controlling shareholder and other related parties.

Appendix: Movements in Non operating capital and other related capital for the year of 2007

ZONZUN Accounting Office Ltd.

Chinese Certified Public Accountant: Han Feng
Chinese Certified Public Accountant: Cheng Weiguo

Beijing, the PRC

24th, April 2008

Movements in Non operating capital and other related capital for the year of 2007

Unit: RMB

Non-operational use of capital	Names of shareholders/controlling parties	Relationship with the company	Items	Balance at the beginning of the year	Advances during the year (exclusive of interest)	Interest	Repayments during the year	Balance as at year end	Purpose	Nature
Largest shareholder and its respective subsidiaries	-	-	-	-	-	-	-	-	-	-
Sub-total	-	-	-	-	-	-	-	-	-	-

DIRECTORS' REPORT

Other related capital	Names of shareholders/controlling parties	Relationship with the company	Items	Balance at the beginning of the year	Advances during the year (exclusive of interest)	Interest	Repayments during the year	Balance as at year end	Purpose	Nature
Largest shareholder and its respective subsidiaries	Shenji Group Shenyi Co. Ltd Electric Branch	Fellow subsidiary of controlling shareholder	Account payables	-	5,994.00	-	5,994.00	-	Purchase of goods	Operational
	Yunnan CY (Group) Company Products Trading Centre	Fellow subsidiary of controlling shareholder	Account payables	(81,700.00)	86,000.00	-	-	4,300.00	Purchase of goods	Operational
	Yunnan CY (Group) Company Products Trading Centre	Fellow subsidiary of controlling shareholder	Advance from customers	(8,200.00)	295,000.00	-	800.00	286,000.00	Purchase of goods	Operational
	Yunnan CY (Group) Company Jinhui Spraying Factory	Former controlling shareholder	Account payables	-	107,921.00	-	96,992.00	10,929.00	Purchase of goods	Operational
	Subtotal			(89,900.00)	494,915.00	-	103,786.00	301,229.00		
Subsidiaries and other related companies	Winko	subsidiary	Other receivables	15,175,881.50	-	230,216.27	1,020,000.00	14,155,881.50	Temporary payment	Non-operational
	Subtotal			15,175,881.50	-	230,216.27	1,020,000.00	14,155,881.50		
Related persons and legal persons				-	-	-	-	-		
	Subtotal			-	-	-	-	-		
Other related persons and their subsidiaries				-	-	-	-	-		
	Subtotal			-	-	-	-	-		
Total				<u>15,085,981.50</u>	<u>494,915.00</u>	<u>230,216.27</u>	<u>1,123,786.00</u>	<u>14,457,110.50</u>		

IX. THE INDEPENDENT NON-EXECUTIVE DIRECTORS EXPRESS INDEPENDENT OPINION OF THE COMPANY'S ACCUMULATED AND CURRENT EXTERNAL GUARANTEE FOR THE YEAR

In accordance with the requirements under "Notice of Standard Current Funds between Listed Companies and Related Parties and External Guarantees of Listed Companies" (Zheng Jian Fa [2003] No.56), independent non-executive directors of the Company investigated the guarantees by the Company to external parties for the year 2007, and express their independent opinions. The result of the investigation is as follows:

During the reporting period, the Company does not have guarantee to the third party; neither guarantee happened before the reporting period and extended to the reporting period.

Independent non-executive directors

Wayne Yu
Chen Ying
Liu Minghui
Li Dongru

April 24, 2008

SUPERVISORY COMMITTEE'S REPORT

I. PERFORMANCE OF THE SUPERVISORY COMMITTEE

1. The 4th meeting of the supervisory committee elected Mr. Li Hongshu as the chairman of the 5th term of supervisory committee, and considered and all resolutions passed at the 20th meeting of the 5th term of board of directors;
2. The 5th meeting of the supervisory committee considered the supervisory committee's Report for the year 2006 and all resolutions passed at the 21st meeting of the 5th term of board of directors;
3. The 6th meeting of the supervisory committee considered the 2007 interim report of the Company and its summary
4. The 7th meeting of the supervisory committee amended "Rules of Procedures for the Supervisory Committee" in accordance with the amended articles of association of the Company;
5. The 8th meeting of the supervisory committee considered the leaving post auditor report regarding the former general manager of Winko Machines Co., Ltd., Mr. Ma Weiguo.

II. INDEPENDENT OPINION OF THE SUPERVISORY COMMITTEE IN RESPECT OF THE OPERATIONS OF THE COMPANY COMPLYING WITH THE LAWS

The supervisory committee attended the shareholders' meeting and board meetings, and has supervision over the convening procedures, considering resolutions, decision making procedures of the shareholders' meeting and the board meetings, and the execution of the resolutions, connected transactions occurring and the performance of the top management and the internal management.

The supervisory committee considered the board of directors, and the directors, senior management officers of the Company could implement the resolutions of the shareholders' meeting and the board meetings. The procedure of decision making is in compliance with the laws and the regulations of the articles of association of the Company. Each management system works well and the Company is perfecting its internal control system. In the course of supervision, no misconduct or illegal action done by the board of directors, directors and senior management officers was found, and no conflict of interests of the shareholders were noted.

III. INDEPENDENT OPINION OF THE SUPERVISORY COMMITTEE ON THE INSPECTION OF THE FINANCIAL PERFORMANCE OF THE COMPANY

During the reporting period, the supervisory committee considered the 2006 annual report, the allocation plan of profit for the year 2006 and the auditor's reports issued by Xi'an Xigama Certified Public Accountants Firm Limited and Messrs Deloitte Touche Tohmatsu respectively. The supervisory committee considered that the Company's financial statements truly and accurately reflects the financial position and the operation results of the Company, and the supervisory committee agreed with the opinions of the auditors and consented the allocation plan of profit for the year 2006.

IV. INDEPENDENT OPINION OF THE SUPERVISORY COMMITTEE ON ACTUAL RUNNING OF THE COMPANY'S LATEST CAPITAL RAISING

There was no occurrence in the raising of capital during the reporting period.

V. INDEPENDENT OPINION OF THE SUPERVISORY COMMITTEE ON PURCHASE AND SALES OF THE ASSETS

There was no significant purchase and sale transaction during the reporting period.

VI. INDEPENDENT OPINION OF THE SUPERVISORY COMMITTEE ON CONNECTED TRANSACTION

All connected transactions were considered fair and reasonable during the reporting period. No actions detrimental to the Company's interest were found.

SIGNIFICANT EVENTS

I. PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association. The Company did not have any arrangement for the pre-emptive rights during the reporting period.

II. WARRANTS AND OTHERS

During the year, neither the Company nor its subsidiaries have issued any warrants, convertible securities, options or other securities with similar rights, nor had any person exercised any right noted above.

III. PURCHASE, SALE OR REDEMPTION OF LISTED SHARES OF THE COMPANY

Neither the Company nor any of its subsidiaries purchased, sold or redeemed listed shares of the Company during the year ended 31 December 2007.

IV. BANK LOANS, OVERDRAFT AND OTHER BORROWINGS

Details of bank loans, overdrafts and other borrowings at 31 December 2007 are set out in the notes IX.13 IX.20 to the consolidated financial statements.

V. CONTINGENT LIABILITIES

As at 31 December 2007, the Group did not have any significant contingent liabilities.

VI. MAJOR LITIGATION

There was no major litigation in the reporting period.

VII. PURCHASE AND DISPOSAL OF ASSETS OR MERGER AND ACQUISITION ACTIVITIES DURING THE REPORTING PERIOD

During the reporting period, there was no significant purchase and disposal of assets, or merger and acquisition activities occurred in the Company.

VIII. CONTINUING CONNECTED TRANSACTIONS

During the reporting period, on 28 March 2007, the Company entered into a sale agreement with Yunnan CY Group Import and Export Company Limited, which is the controlling subsidiary of the largest shareholder of the Company, for the consideration of RMB10,000,000. The purpose of the transaction is to utilize the existing overseas sales network of Yunnan CY Group Import and Export Co, Lt. to develop the overseas market of the Company. Directors (including independent non-executive directors) considered the transaction was on normal commercial terms and conditions and was in the ordinary and usual course of business of the Company. The sales price was determined by the parties on arm's length basis. Terms of the agreement were fair and reasonable. Entering into the Agreement was in the interest of the Company and the shareholders as a whole.

During the report period, the Company continued to implement the lease agreements, which the Company entered into with the Kunming Kunji Group Co., Ltd. ("Kunji Group") in 17 August 2005, to lease premises and land use right from Kunji Group as production places. The agreements were considered and approved by the 4th term of board of directors of the Company. The consideration of premises is RMB850,080.00 and the consideration of land use right is RMB1,320,000.00. Directors (including independent non-executive directors) considered the transactions were on normal commercial terms and conditions and entering into the lease agreements was in the interest of the Company and the shareholders as a whole.

SIGNIFICANT EVENTS

The Company has received from the auditors of the Company a letter reporting that the above transactions: (i) have received the approval of the Board; (ii) have been entered into in accordance with the pricing policies of the Company; (iii) have been entered into in accordance with the relevant agreements governing the transactions; and (iv) have not exceeded the relevant annual caps.

Details of connected transactions are set out in the notes XI.4 to the consolidated financial statements.

IX. TRUST

During the reporting period, the Company did not enter into any trust arrangement.

X. SUB-CONTRACTING

During the reporting period, the Company did not enter into any sub-contracting arrangement.

XI. LEASE

During the reporting period, the Company did not enter into any lease arrangement.

XII. GUARANTEE

During the reporting period, the Company did not enter into any guarantee arrangement.

XIII. ENTRUSTED INVESTMENT

On February 23, 2004, the Company entered into an agreement with China Fortune Securities ("China Fortune") for the trusteeship of the management of investment in state bonds ("the Trusteeship Agreement") pursuant to which the Company entrusted China Fortune to conduct investment on state bonds with RMB50,000,000.00 (the "Fund ") for one year. However, China Fortune failed to comply with the Trusteeship Agreement to invest in state bonds but using the Fund to invest in stocks and incurred huge losses. In August 2006, China Fortune was performed the liquidation work in accordance with the decision made by China Securities Regulation Commission. As at 31st December, 2006, the Company has recognized provision for impairment loss of RMB38,100,000.00 for the Fund.

At 1st August, 2007, the Company applied to unfreeze the Company's capital account in China Fortune Beijing Operating Department. On August 13, 2007, the Company took back RMB32,030,000.00 of the Fund. The transaction increased the profit of RMB20,725,500 during reporting period.

XIV. OTHER MAJOR CONTRACTS

There were no other major contracts during the reporting period.

SIGNIFICANT EVENTS

XV. COMMITMENTS

1. Commitments by the Company or shareholders holding over 5% of total shares of the Company during the reporting period or extended to the reporting period.
 - (1) Shenyang Group and Yannan State-owned Assets Operation Company had undertaken that the Shares of the Company held by them would not be traded from the listing date of circulating share to 31st December 2010.
 - (2) after completion of the Share Reform in one year, the above two shareholders would propose and consent to the proposal of transfer of capital reserves to new shares in the General Meeting for at least 5 shares would be allocated to shareholders for every 10 existing shares. On Apr 2007, the above two shareholders jointly proposed a motion to increase the Company's share capital by transferring capital reserve. On 18th Apr 2007, the resolution was reviewed and approved on 21st session meeting of 5th term of the Board of the Directors. On 29th June 2007, the resolution was reviewed and approved on 2006 AGM and class shareholders' general meeting respectively. After approval of Minister of Commerce, new shares were issued in A share market on 20th Nov 2007, and in H share market on 5th Dec 2007 respectively.

XVI. APPOINTMENT AND RE-APPOINTMENT OF AUDITORS

1. **During reporting period, the Company removed Xian Xigema Certified Public Accountants as PRC auditor, and appointed Zonzun Accounting Office Ltd as PRC auditor.**

The resolution of appointment of Zonzun Accounting Office Ltd as PRC auditor was reviewed and approved on 21st Session Meeting of 5th term of Board of Directors on 18th Apr 2007, and on 2006 AGM held on 29th June 2007. The Board of the Directors was authorized to determined its remuneration.

2. **During reporting period, the Company removed Messers Deloitte Touche Tohmatsu as Hong Kong auditor, and appointed KPMG as Hong Kong auditor.**

The resolution of re-appointment of Messers Deloitte Touche Tohmatsu as Hong Kong auditor was reviewed and approved on 21st Session Meeting of 5th term of Board of Directors on 18th Apr 2007

But the motion was vetoed on 2006 AGM held on 29th June 2007. On 10th July 2007. The resolution of the appointment of KPMG as Hong Kong Auditor in 2007 to fill out vacation of office of resignation of Messers Deloitte Touche Tohmatsu was reviewed and approved by 26th Session Meeting of 5th term of the Board of the Directors.

The Company had received confirmation provided by Messers Deloitte Touche Tohmatsu that there were no matters that need to be brought to the attention of the shareholders or debtors except for disclosures in the Company's announcement.

XVII. PENALTIES TO THE COMPANY, THE BOARD OF DIRECTORS AND ITS DIRECTORS SUPERVISORS AND THE SENIOR MANAGEMENT OFFICER, THE SHAREHOLDERS AND SUBSTANTIAL CONTROLLER, THE ISSUE OF RECTIFICATION

NIL

SIGNIFICANT EVENTS

XVIII. INVOLVED IN IRREGULAR TRADING SHARES OF THE COMPANY BY THE ITS DIRECTORS, SUPERVISORS AND THE SENIOR MANAGEMENT OFFICER, THE SHAREHOLDERS HELD OVER 5% SHARES OF THE COMPANY. DISCLOSURE ON IRREGULAR INCOME.

NIL

XIX. PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has, during the year and up to the date of this report, maintained a public float of not less than 25% of the Company's issued shares as required under the Listing Rules.

XX. OTHER SIGNIFICANT EVENTS, EFFECTS OF THESE SIGNIFICANT EVENTS AND RESOLUTIONS.

1. The ordinary resolution of "Change of the Company's Name into "Shenji Group Kunming Machine Tool Co. Ltd" from "Jiaoda Kunji High-Tech Co. Ltd" was approved on 2006 AGM on 29th June 2007. New business certification was issued by Yunnan Province Industrial and Commercial Bureau. In Hong Kong, Companies Registry received application document of change of Company's name, and issued registered certification of change of oversea company name on 18th Oct 2007.
2. On 29 December 2007, the Company received The Written Approval By The State Administration of Taxation Kunming Branch Regarding Shenji Group Kunming Machine Tool Company Limited Enjoying The Preferential Tax Policy Of China Western Area Development (file no.: 直屬國稅[2007]183號) (the "Written Approval"). The Written Approval temporarily agrees that the Company has applied 15% as income tax rate from the year 2004 during the execution period of the preferential tax policy of China western area development. The Company should apply for the execution of preferential income tax rate to the relevant tax authorities after the end of each fiscal year during the regulated time limit. Only after receiving the approval from the relevant tax authorities, can the Company execute the preferential income tax rate.
3. On January 25, 2007, the Ministry of Commerce, the PRC issued the "Written Reply Regarding Jiaoda Kunji High-Tech Co., Ltd. Transfer of Shares and Increase Shares" (file no. 商資批[2007] 133號) to approve the Share Reform Proposal of the Company. The Company increased shares to all shareholders whose name appear on the Company's register of members on the February 26, 2007 by transferring capital reserves on a basis of 1.5606 shares for every existing 10 shares ("Share Increase 1"). The total increased share capital was 38,235,855 shares, of which, 28,091,955 shares were A Shares, and 10,143,900 shares were H Shares.

On March 5, 2007, the holders of non-circulating Shares of the Company took their 18,728,355 shares as consideration shares to pay to the holders of circulating A Shares on a basis of 2.7 shares for every 10 shares. The new A shares were listed on March 7, 2007. Of 18,728,355 shares, Shenyang Machine Tool (Group) Company Limited disbursed 11,088,398 shares; Yunnan State-owned Assets Operation Company Limited disbursed 4,891,787 shares, and Jinghua Company disbursed 2,748,170 shares to the holders of Circulating A Shares. After implementation of the consideration arrangement, non-circulating shares held by the holders of non-circulating Shares of the Company became tradable and listed.

After implementation of the above proposal, the total share capital of the Company has changed from 245,007,400 shares to 283,243,255 shares, and the registered capital increased to RMB283,243,255.00. Of the total share capital, Shenyang Machine Too (Group) holds 71,052,146 shares, representing 25.08% of the total share capital. Yunnan State-owned Assets Operation Co., Ltd. holds 31,345,554 shares, representing 11.07% of the total share capital. Kunming Jinghua holds 17,609,700 shares, representing 6.22% of the total share capital. Holders of A Shares hold 88,091,955 shares, representing 31.10% of the total share capital. Holders of H Shares hold 75,143,900 shares, representing 26.53% of the total share capital.

SIGNIFICANT EVENTS

On April 2007, two shareholders of the Company, Shenyang Machine Tool (Group) co., Ltd. and Yunnan State-owned Assets Operation Co., Ltd. jointly proposed the Share Increase Proposal (New Shares will be issued to all shareholders of the Company by transferring capital reserves on a basis of five New Shares for every 10 Shares based on 283,243,255 total share capital). The Share Increase was approved at the 21st meeting of the board of directors held on April 18, 2007 and the resolution was submitted to 2006 annual general meeting and class meetings held on June 29, 2007 respectively. After receiving the approval from Ministry of Commerce, the Share Increase was implemented on A Shares and H Shares stock market on 20 November 2007 and 5 December 2007 respectively. From then on, the total share capital of the Company has changed to 424,864,883 shares, and the registered capital is RMB424,864,883.00. Of the total share capital, Shenyang Machine Tool (Group) Co., Ltd. holds 106,578,219 shares, representing 25.08% of the total share capital. Yunnan State-owned Assets Operation Co., Ltd. holds 47,018,331 shares, representing 11.07% of the total share capital. Kunming Jinghua holds 26,414,550 shares, representing 6.22% of the total share capital. Holders of A Shares hold 132,137,933 shares, representing 31.10% of the total share capital. Holders of H Shares hold 112,715,850 shares, representing 26.53% of the total share capital.

XXI. INFORMATION DISCLOSURE

Published Press “China Securities Daily”, “Shanghai Securities News”, “Wen Wei Po” and “The Standard” (From 25 June 2007 to 24 December 2007, only notification of the announce was published under the requirement of The Stock Exchange of Hong Kong Limited. Full version of announcements were available at www.hkex.com.hk and www.kmtcl.com.cn)

website <http://www.sse.com.cn>; <http://www.hkex.com.hk>; www.kmtcl.com.cn

Event	Date of published
Announcement on 18th session meeting of the Board of the Directors	5th Jan 2007
Announcement on progree of share reform	10th Jan 2007
Announcement on profit estimation	12th Jan 2007
Notice on 2007 first EGM	12th Jan 2007
Announcement on the Board of the Directors	1st Feb 2007
Announcement on implementation of the proposal of increasing share with capital reserves	5th Feb 2007
Adjournment of the 2007 first EGM	9th Feb 2007
Announcement on implementation of the revised share reform proposal	2nd Mar 2007
Announcement on the results of 2007 first EGM	26th Mar 2007
Announcement on 20th Session Meeting of the Board of the Directors	26th Mar 2007
Announcement on 4th Session Meeting of the Supervision Committee	26th Mar 2007
Announcement on connected transaction	26th Mar 2007
Announcement on connected transaction	30th Mar 2007
Announcement on change of short name of A share	4th Apr 2007
Informative announcement	5th Apr 2007
Supplementary Announcement on profit estimate for year 2006	12th Apr 2007
Announcement on Shenji Group equity transfer	16th Apr 2007
Announcement on 21st session of the Board of the Directors	19th Apr 2007
Announcement on 5th Session meeting of Supervision Committee	19th Apr 2007
2005 annual results	20th Apr 2007
Notice on AGM and class General meeting	14th May 2007
Announcement from the Board	12th Jun 2007
Announcement from the Board	14th Jun 2007
Announcement from the Board	22nd Jun 2007
The results on 2006 AGM and class general meeting	2nd July 2007

SIGNIFICANT EVENTS

Event	Date of published
Announcement on 25th Session meeting of the Board of the Directors	2nd July 2007
Announcement from the Board	6th July 2007
Announcement on profit estimate for semi year 2007	18th July 2007
Announcement on 26th Session meeting of the Board of the Directors	20th July 2007
Announcement on 27th Session meeting of the Board of the Directors	25th July 2007
Announcement on 28th Session meeting of the Board of the Directors	8th Aug 2007
Announcement on postponement of share increase and payment of dividends	9th Aug 2007
Announcement from the Board	14th Aug 2007
Announcement on 28th Session meeting of the Board of the Directors	21st Aug 2007
Announcement on 6th Session meeting of Supervision Committee	21st Aug 2007
Announcement on on-line meeting convening on corporation government	27th Aug 2007
Announcement on 29th Session meeting of the Board of the Directors	3rd Sep 2007
Announcement on 29th Session meeting of the Board of the Directors	14th Sep 2007
Announcement on 7th Session meeting of Supervision Committee	14th Sep 2007
Notice on 2007 second EGM	14th Sep 2007
Announcement on performance of holders of non-circulating shares commitment in relation to share reform	28th Sep 2007
Announcement on profit estimate for Jan 1 to Sep 30, 2007	17th Oct 2007
Change of Company name and change of stock short name of H share	24th Oct 2007
Announcement on 32nd Session meeting of the Board of the Directors	24th Oct 2007
Announcement on the resolutions of second 2007 EGM	1st Nov 2007
Announcement on connected transaction	1st Nov 2007
Announcement on implemation of transferring status capital into share	2nd Nov 2007
Report on special remedies on Corporation Government	5th Nov 2007
Announcement on investment on Renminbi Structured Products	20th Dec 2007

AUDITOR'S REPORT

Auditor's Report
zonzunshenzi (2008) No.2242

To all shareholders of Shenji Group Kunming Machine Tool Company Limited,

We have audited the accompanying financial statements of Shenji Group Kunming Machine Tool Company Limited ("the Company"), which comprise the consolidated balance sheet and balance sheet as at 31 December 2007, the consolidated income and profit appropriation statement, income and profit appropriation statement, the consolidated statement of changes in equity, the statement of changes in equity, and consolidated cash flow statement and cash flow statement for the year then ended, and notes to the financial statements.

1. MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Company's management is responsible for the preparation of these financial statements in accordance with the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises issued by the Ministry of Finance of the People's Republic of China. This responsibility includes: (1) designing, implementing and maintaining internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error; (2) selecting and applying appropriate accounting policies; and (3) making accounting estimates that are reasonable in the circumstances.

2. AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with China's Auditing Standards for the Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

3. OPINION

In our opinion, the financial statements comply with the requirements of the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises issued by the Ministry of Finance of the People's Republic of China and present fairly, in all material respects, the consolidated financial position and financial position of the Company as at 31 December 2007, the consolidated results of operations and results of operations and consolidated cash flows and cash flows of the Company for the year then ended.

Zonzun Accounting Office Ltd.
China Certified Public Accountant
Han Feng, Cheng Weiguo

Beijing PRC
24th April 2008

FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH PRC ACCOUNTING STANDARDS

CONSOLIDATION BALANCE SHEET

As at 31st December 2007

Unit: RMB

Items	Note	Closing Balance	Opening Balance
Current Assets			
Cash and Cash equivalents	IX.1	370,350,788.42	166,794,262.63
Trading financial assets		–	–
Bills Receivable	IX.2	134,784,345.56	52,131,390.23
Accounts Receivable	IX.3	156,028,111.50	134,782,948.68
Prepayments	IX.5	41,436,623.72	43,397,932.37
Dividend receivables		–	–
Interest receivables		–	–
Other receivables	IX.4	21,434,300.74	14,540,963.34
Inventories	IX.6	427,422,511.57	283,918,756.67
Non-current assets within one year		–	–
Other current assets		–	–
TOTAL CURRENT ASSETS		1,151,456,681.51	695,566,253.92
NON-CURRENT ASSETS:			
Available-for-sale financial assets	IX.7	–	11,902,402.80
Held-to-maturity investment		–	–
Long term receivables		–	–
Long-term equity investment	IX.8	44,320,560.29	35,341,128.79
Real estate held for investment		–	–
Fixed Assets	IX.9	401,740,740.81	351,701,677.05
Construction in progress	IX.10	46,097,502.88	29,912,136.05
Product materials		–	–
Disposal of fixed assets		–	–
Production biological assets		–	–
Oil assets		–	–
Intangible Assets	IX.11	92,376,761.28	100,854,434.44
Development cost		–	–
Goodwill		7,296,277.00	11,927,608.18
Long term deferred expenditures		163,127.70	198,479.70
Deferred tax assets	IX.12	35,556,034.52	33,675,765.24
Other non-current assets		–	–
TOTAL NON-CURRENT ASSETS		627,551,004.48	575,513,632.25
TOTAL ASSETS		1,779,007,685.98	1,271,079,886.17
CURRENT LIABILITIES:			
Short-term loans	IX.13	–	40,000,000.00
Trading financial liabilities		–	–
Bills payable		4,670,000.00	–
Accounts payable	IX.14	130,879,524.76	113,675,973.10
Advances from customers	IX.15	432,062,138.47	218,325,953.57
Accrued salary	IX.16	42,071,636.57	33,951,419.59
Taxes payable	IX.17	67,941,177.43	28,395,880.69
Interests payable		–	–
Dividends payable		1,176,869.81	1,176,869.81
Other payables	IX.18	64,694,849.97	77,852,888.95
Non-current liabilities within one year		–	684,337.80
Other current liabilities		–	–
TOTAL CURRENT LIABILITIES		743,496,197.01	514,063,323.51

CONSOLIDATION BALANCE SHEET

As at 31st December 2007

Items	Note	Closing Balance	Opening Balance
<i>Unit: RMB</i>			
NON-CURRENT LIABILITIES:			
Long term loans	IX.20	50,000,000.00	20,000,000.00
Bonds payable		-	-
Long-term payable	IX.21	10,184,926.40	10,055,966.60
Specific payable	IX.22	8,100,000.00	11,311,680.50
Estimated liabilities	IX.19	9,117,430.70	3,554,560.13
Deferred income tax liabilities	IX.23	-	241,191.93
Other non-current liabilities		4,724,203.71	4,116,806.85
TOTAL NON-CURRENT LIABILITIES		82,126,560.81	49,280,206.01
TOTAL LIABILITIES		825,622,757.82	563,343,529.52
Shareholders' Equity			
Share capital	IX.24	424,864,883.00	245,007,400.00
Capital reserve	IX.25	133,519,541.72	313,377,024.72
△ Less: treasury stock		-	-
Surplus reserve	IX.26	41,903,289.47	20,773,925.55
Common risk provision		-	-
Inappropriate profits	IX.27	279,091,413.76	57,263,089.40
Foreign currency converting difference		-	-
Total owner's equity attributable to the holders of the parent company		879,379,127.95	636,421,439.67
Minority interests		74,005,800.22	71,314,916.98
TOTAL EQUITY		953,384,928.17	707,736,356.65
TOTAL LIABILITIES AND EQUITY		1,779,007,685.98	1,271,079,886.17

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

BALANCE SHEET

As at 31st December 2007

Unit: RMB

Items	Note	Closing Balance	Opening Balance
Current Assets			
Cash and Cash equivalents		322,698,506.89	113,884,419.17
Trading financial assets		–	–
Bills Receivable	X.1	88,342,942.50	30,149,988.21
Accounts Receivable	X.2	115,021,074.71	88,050,935.92
Prepayments	X.4	9,544,865.11	9,227,357.17
Dividends receivable		2,000,000.00	2,000,000.00
Interests receivables		–	–
Other receivables	X.3	21,760,471.53	20,990,947.69
Inventories		285,715,585.15	195,079,224.17
Non-current assets within one year		–	–
Other current assets		–	–
TOTAL CURRENT ASSETS		845,083,445.89	459,382,872.33
NON-CURRENT ASSETS:			
Available-for-sale financial assets	X.5	–	11,902,402.80
Held-to-maturity investment		–	–
Long term receivables		–	–
Long-term equity investment	X.6	77,493,826.14	92,884,762.94
Real estate held for investment		–	–
Fixed Assets		334,862,588.722	285,185,647.36
Construction in progress		44,346,100.882	6,859,057.05
Project materials		–	–
Disposal of fixed assets		–	–
Production biological assets		–	–
Oil assets		–	–
Intangible Assets		21,507,860.152	3,243,334.54
Development cost		–	–
Goodwill		–	–
Long term deferred expenditures		–	–
Deferred income tax assets	X.7	37,492,215.28	35,114,727.87
Other non-current assets		–	–
TOTAL NON-CURRENT ASSETS		515,702,591.17	475,189,932.56
TOTAL ASSETS		1,360,786,037.06	934,572,804.89
CURRENT LIABILITIES:			
Short-term loans		–	20,000,000.00
Trading financial liabilities		–	–
Bills payable		–	–
Accounts payable		61,554,083.95	71,824,401.84
Advances from customers		309,550,464.02	115,126,650.06
Accrued salary		39,106,679.99	31,053,989.46
Taxes payable		45,700,000.56	24,134,830.18
Interests payables		–	–
Dividends payable		–	–
Other payables		11,947,285.05	22,958,629.92
Non-current liabilities within one year		–	–
Other current liabilities		–	–
TOTAL CURRENT LIABILITIES		467,858,513.57	285,098,501.46

BALANCE SHEET

As at 31st December 2007

Items	Note	Closing Balance	Opening Balance
<i>Unit: RMB</i>			
NON-CURRENT LIABILITIES:			
Long term loans		50,000,000.00	20,000,000.00
Bonds payable		–	–
Long-term payable		2,984,926.40	3,540,304.40
Specific payable		–	3,211,680.50
Estimated liabilities		9,114,994.55	3,554,560.13
Deferred income tax liabilities		–	241,191.93
Other non-current liabilities		4,724,203.71	4,116,806.85
TOTAL NON-CURRENT LIABILITIES		66,824,124.66	34,664,543.81
TOTAL LIABILITIES		534,682,638.23	319,763,045.27
Shareholders' Equity			
Share capital		424,864,883.00	245,007,400.00
Capital reserve		133,519,541.72	313,377,024.72
△ Less: treasury stock		–	–
Surplus reserve		41,903,289.47	20,773,925.55
Common risk provision		–	–
Inappropriate profits		225,815,684.64	35,651,409.35
Foreign currency converting difference		–	–
Total owner's equity attributable to the holders of the parent company		826,103,398.83	614,809,759.62
Minority interests		–	–
TOTAL EQUITY		826,103,398.83	614,809,759.62
TOTAL LIABILITIES AND EQUITY		1,360,786,037.06	934,572,804.89

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

CONSOLIDATION STATEMENT OF INCOME

For the year ended 31 December 2007

Items	Note	Unit: RMB	
		Current year	Last year
1. Principal operating income	<i>IX.28</i>	1,302,385,627.67	852,038,766.03
2. Principal operating cost	<i>IX.29</i>	834,436,283.95	583,642,659.01
Principal operation tax and addition	<i>IX.30</i>	2,816,838.63	1,469,873.90
Selling expenses		61,881,625.26	40,728,064.41
Administrative expenses		116,126,778.56	85,434,599.62
Financial expenses	<i>IX.32</i>	4,691,828.43	6,003,557.53
Losses on impairment of assets	<i>IX.31</i>	27,752,638.68	14,517,010.00
Add: income from the changes from the fair value (“-” for loss)		-	-
Add: investment income (“-” for loss)	<i>IX.33</i>	28,042,739.41	142,749.83
Including: investment income from associates and joint venture companies		4,978,835.82	(353,043.85)
3. Principal operating profits (“-” for loss)		282,722,373.57	120,385,751.39
Add: Non-operating income	<i>IX.34</i>	25,364,687.69	6,409,806.05
Less: Non-operating expenses	<i>IX.35</i>	10,904,625.54	2,331,605.59
4. Profit before tax (“-” for loss)		297,182,435.72	124,463,951.85
Less: Income tax	<i>IX.36</i>	45,703,949.40	16,922,303.06
5. Net profit for the period		251,478,486.32	107,541,648.79
Less: Minority interest		8,520,798.05	9,482,874.07
6. Net profit attribute to the equity holders’ of parent company		242,957,688.27	98,058,774.72
7. Earnings per share		-	-
(1) Basic EPS		0.57	0.23
(2) Diluted EPS		0.57	0.23

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

STATEMENT OF INCOME

For the year ended 31 December 2007

Items	Note	Unit: RMB	
		Current year	Last year
1. Principal operating income	X.8	941,950,867.26	647,623,328.06
2. Principal operating cost	X.9	568,723,160.27	436,875,592.93
Principal operation tax and addition		–	–
Selling expenses		48,040,340.05	28,869,277.56
Administrative expenses		95,156,609.26	60,385,039.24
Financial expenses		3,292,789.00	4,091,097.11
Losses on impairment of assets		31,812,543.85	4,505,489.37
Add: income from the changes from the fair value (“–” for loss)		–	–
Add: investment income (“–” for loss)		27,410,028.42	(7,728,348.15)
Including: investment income from associates and joint venture companies		4,978,835.82	(353,043.85)
3. Principal operating profits (“–” for loss)		222,335,453.25	105,168,483.70
Add: Non-operating income		21,673,381.29	2,347,832.67
Less: Non-operating expenses		1,869,371.71	1,534,886.62
4. Profit before income tax (“–” for loss)		242,139,462.83	105,981,429.75
Less: Income tax		30,845,823.62	14,632,911.44
5. Net profit for the period (“–” for loss)		211,293,639.21	91,348,518.31
Less: Minority interest		–	–
6. Net profit attribute to the equity holders’ of parent company		211,293,639.21	91,348,518.31
7. Earnings per share			
(1) Basic EPS		0.57	0.23
(2) Diluted EPS		0.57	0.23

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

CONSOLIDATION CASH FLOW STATEMENT

For the year ended 31 December 2007

Items	Note	Current year	Unit: RMB Last year
1. Cash flows from operating activities			
Cash received from sales of goods or rendering of services		1,628,780,814.43	891,324,584.09
Return of taxes and surcharges received		17,112,395.96	3,664,276.18
Other cash received relating to operating activities		14,198,378.51	38,684,684.76
Sub-total of cash inflows		<u>1,660,091,588.90</u>	<u>933,673,545.03</u>
Cash paid for goods and services		1,079,713,092.83	570,192,947.24
Cash paid to and on behalf of employee		140,926,293.74	100,705,115.57
Taxes and surcharges paid		112,690,596.30	81,655,391.17
Other cash paid relating to the operating activities	IX.39	61,711,306.11	83,450,606.19
Sub-total of cash outflows		<u>1,395,041,288.98</u>	<u>836,004,060.17</u>
Net cash flows from operating activities		<u>265,050,299.92</u>	<u>97,669,484.86</u>
2. Cash flow from investing activities			
Cash received from sale of investments		105,322,478.67	11,000,000.00
Cash received from return on investment		69,041.10	105,747.07
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		2,021,747.98	1,451,730.96
Cash received from disposal of subsidiaries and other associates		(1,367,894.02)	10,000,000.00
Other cash received relating to investing activities		-	-
Sub-total of cash inflows		<u>106,045,373.73</u>	<u>22,557,478.03</u>
Cash paid to acquire fixed assets, intangible assets, and long-term assets		81,783,013.67	64,588,229.76
Cash paid for investment		50,000,000.00	10,000,000.00
Cash paid to acquire subsidiaries and other associates		-	-
Other cash paid relating to investing activities		39,739.30	17,101,034.75
Sub-total of cash outflows		<u>131,822,752.97</u>	<u>91,689,264.51</u>
Net cash flow from investing activities		<u>(25,777,379.24)</u>	<u>(69,131,786.48)</u>

CONSOLIDATION CASH FLOW STATEMENT

For the year ended 31 December 2007

Items	Note	Current year	Unit: RMB Last year
3. Cash flow from financing activities			
Cash received from capital contribution		–	–
Cash received from minor shareholder investment by subsidiaries		–	–
Cash from borrowings		55,000,000.00	60,000,000.00
Other cash received relating to financing activities		–	4,000,000.00
Sub-total of cash inflows		55,000,000.00	64,000,000.00
Cash repayments of amounts borrowed		60,000,000.00	100,000,000.00
Cash payment for distribution of dividends, profits and payments of interest expenses		4,428,202.39	5,414,793.84
Incl. Dividend and profit paid by subsidiaries to minor shareholders		–	–
Other cash paid relating to financing activities		–	–
Sub-total of cash outflows		64,428,202.39	105,414,793.84
Net cash flow from financing activities		(9,428,202.39)	(41,414,793.84)
4. Effect of foreign exchange rate changes on cash		(2,447,439.44)	(1,342,378.56)
5. Net increase in cash and cash equivalents		227,397,278.85	(14,219,474.02)
Add: Cash and cash equivalents at the beginning of the year	IX.38	143,507,132.60	157,726,606.62
6. Cash and cash equivalents at the end of the year	IX.38	370,904,411.45	143,507,132.60

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

CASH FLOW STATEMENT

For the year ended 31 December 2007

Unit: RMB
Last year

Items	Note	Current year	Last year
1. Cash flows from operating activities			
Cash received from sales of goods or rendering of services		1,327,709,234.29	663,388,195.35
Return of taxes and surcharges received		16,227,273.85	2,242,231.35
Other cash received relating to operating activities		4,158,047.62	4,149,464.78
Sub-total of cash inflows		1,348,094,555.76	669,779,891.48
Cash paid for goods and services		843,697,132.48	380,219,013.89
Cash paid to and on behalf of employees		125,171,680.65	86,547,630.76
Taxes and surcharges paid		91,987,626.12	63,784,436.59
Other cash paid relating to the operating activities		42,801,626.92	41,009,451.59
Sub-total of cash outflows		1,103,658,066.17	571,560,532.83
Net cash flows from operating activities		244,436,489.59	98,219,358.65
2. Cash flow from investing activities			
Cash received from sale of investments		105,322,478.67	1,000,000.00
Cash received from return on investment		69,041.10	105,747.07
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		1,951,150.00	1,451,730.96
Cash received from disposal of subsidiaries and other associates		–	–
Other cash received relating to investing activities		–	10,000,000.00
Sub-total of cash inflows		107,342,669.77	12,557,478.03
Cash paid to acquire fixed assets, intangible assets, and long-term assets		71,088,793.44	56,764,606.44
Cash paid for investment		53,000,000.00	10,500,000.00
Cash paid to acquire subsidiaries and other associates		–	–
Other cash paid relating to investing activities		–	21,098,700.00
Sub-total of cash outflows		124,088,793.44	88,363,306.44
Net cash flow from investing activities		(16,746,123.67)	(75,805,828.41)

CASH FLOW STATEMENT

For the year ended 31 December 2007

Items	Note	Current year	Unit: RMB Last year
3. Cash flow from financing activities			
Cash received from capital contribution		–	–
Cash received from minor shareholder investment by subsidiaries		–	–
Cash from borrowings		50,000,000.00	40,000,000.00
Other cash received relating to financing activities		–	–
Sub-total of cash inflows		50,000,000.00	40,000,000.00
Cash Repayment of amounts borrowed		40,000,000.00	80,000,000.00
Cash payment for distribution of dividends, profits and payments of interest expenses		3,141,708.73	2,584,872.33
Incl. Dividend and profit paid by subsidiaries to minor shareholders		–	–
Other cash paid relating to financing activities		–	–
Sub-total of cash outflows		43,141,708.73	82,584,872.33
Net cash flow from financing activities		6,858,291.27	(42,584,872.33)
4. Effect of foreign exchange rate changes on cash		(2,447,439.44)	(1,342,378.56)
5. Net increase in cash and cash equivalents		232,101,217.75	(21,513,720.65)
Add: Cash and cash equivalents at the beginning of the year		90,597,289.14	112,111,009.79
6. Cash and cash equivalents at the end of the year		322,698,506.89	90,597,289.14

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

CONSOLIDATION STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

Unit : RMB

Items	Current Year						Minor shareholder equity	Total shareholder equity
	Shareholders' Equity Attributable to the Parent Company					Sub-total		
	Share Capital	Capital Reserve	Surplus reserve	Undistributed Profit				
1. Closing balance of last year	245,007,400.00	313,377,024.72	20,773,925.55	57,263,089.40	636,421,439.67	71,314,916.98	707,736,356.65	
Add: Adjustment from accounting policy changes	-	-	-	-	-	-	-	
Correction of errors in previous period	-	-	-	-	-	-	-	
others	-	-	-	-	-	-	-	
2. Opening balance at the beginning of the current year	245,007,400.00	313,377,024.72	20,773,925.55	57,263,089.40	636,421,439.67	71,314,916.98	707,736,356.65	
3. Changes during the period ("-" for decrease)	179,857,483.00	(179,857,483.00)	21,129,363.92	221,828,324.35	242,957,688.27	2,690,883.24	245,648,571.51	
(1) Net profit	-	-	-	242,957,688.27	242,957,688.27	8,520,798.05	251,478,486.32	
(2) Profit and loss directly recorded in owner's equity	-	-	-	-	-	-	-	
(i) Net changes in fair value of available-for-sale financial assets	-	-	-	-	-	-	-	
(ii) Influence of changes in other owner's equity of invested under equity method	-	-	-	-	-	-	-	
(iii) Income tax implication on items related to shareholder's equity accounted for	-	-	-	-	-	-	-	
(iv) Others	-	-	-	-	-	-	-	
Sub-total of (1) and (2)	-	-	-	242,957,688.27	242,957,688.27	8,520,798.05	251,478,486.32	
(3) Addition and reduction of Shareholders' capital	-	-	-	-	-	(5,829,914.81)	(5,829,914.81)	
(i) Addition of shareholders' capital	-	-	-	-	-	-	-	
(ii) The amount of dividend paid to the shareholders' equity	-	-	-	-	-	-	-	
(iii) Others	-	-	-	-	-	(5,829,914.81)	(5,829,914.81)	
(4) Profit distribution	-	-	21,129,363.92	(21,129,363.92)	-	-	-	
(i) Appropriation to surplus reserve	-	-	21,129,363.92	(21,129,363.92)	-	-	-	
(ii) Appropriation to owners (shareholders)	-	-	-	-	-	-	-	
(iii) Others	-	-	-	-	-	-	-	
(5) Shareholders' equity internally carried forward	179,857,483.00	(179,857,483.00)	-	-	-	-	-	
(i) Share capital increase by transferring capital reserve	179,857,483.00	(179,857,483.00)	-	-	-	-	-	
(ii) Share capital increase by transferring surplus reserve	-	-	-	-	-	-	-	
(iii) Losses covered by surplus reserve	-	-	-	-	-	-	-	
(iv) Others	-	-	-	-	-	-	-	
4. Closing balance for the current period	424,864,883.00	133,519,541.72	41,903,289.47	279,091,413.76	879,379,127.95	74,005,800.22	953,384,928.17	

CONSOLIDATION STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

Items	Last Year						
	Shareholders' Equity Attributable to the Parent Company					Minor shareholder equity	Total shareholder equity
	Share Capital	Capital Reserve	Surplus reserve	Undistributed Profit	Sub-total		
1. Closing balance of last year	245,007,400.00	314,193,651.63	16,812,657.84	(36,834,417.61)	539,179,291.86	61,832,042.91	601,011,334.77
Add: Adjustment from accounting policy changes	-	-	-	-	-	-	-
Correction of errors in previous period	-	-	-	-	-	-	-
others	-	-	-	-	-	-	-
2. Opening balance at the beginning of the current year	245,007,400.00	314,193,651.63	16,812,657.84	(36,834,417.61)	539,179,291.86	61,832,042.91	601,011,334.77
3. Changes during the period ("-" for decrease)	-	(816,626.91)	3,961,267.71	94,097,507.01	97,242,147.81	9,482,874.07	106,725,021.88
(1) Net profit	-	-	-	98,058,774.72	98,058,774.72	9,482,874.07	107,541,648.79
(2) Profit and loss directly recorded in owner's equity	-	(816,626.91)	-	-	(816,626.91)	-	(816,626.91)
(i) Net changes in fair value of available-for-sale financial assets	-	-	-	-	-	-	-
(ii) Influence of changes in other owner's equity of invested under equity method	-	-	-	-	-	-	-
(iii) Income tax implication on items related to shareholder's equity accounted for	-	-	-	-	-	-	-
(iv) Others	-	(816,626.91)	-	-	(816,626.91)	-	(816,626.91)
Sub-total of (1) and (2)	-	(816,626.91)	-	98,058,774.72	97,242,147.81	9,482,874.07	106,725,021.88
(3) Addition and reduction of Shareholders' capital	-	-	-	-	-	-	-
(i) Addition of shareholders' capital	-	-	-	-	-	-	-
(ii) The amount of dividend paid to the shareholders' equity	-	-	-	-	-	-	-
(iii) Others	-	-	-	-	-	-	-
(4) Profit distribution	-	-	3,961,267.71	(3,961,267.71)	-	-	-
(i) Appropriation to surplus reserve	-	-	3,961,267.71	(3,961,267.71)	-	-	-
(ii) Appropriation to owners (shareholders)	-	-	-	-	-	-	-
(iii) Others	-	-	-	-	-	-	-
(5) Shareholders' equity internally carried forward	-	-	-	-	-	-	-
(i) Share capital increase by transferring capital reserve	-	-	-	-	-	-	-
(ii) Share capital increase by transferring surplus reserve	-	-	-	-	-	-	-
(iii) Losses covered by surplus reserve	-	-	-	-	-	-	-
(iv) Others	-	-	-	-	-	-	-
4. Closing balance for the current period	245,007,400.00	313,377,024.72	20,773,925.55	57,263,089.40	636,421,439.67	71,314,916.98	707,736,356.65

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

Unit: RMB

Items	Current Year					Total shareholder equity
	Shareholders' Equity Attributable to the Parent Company					
	Share Capital	Share Capital	Share Capital	Share Capital	Share Capital	
1. Closing balance of last year	245,007,400.00	313,377,024.72	20,773,925.55	35,651,409.35	614,809,759.62	614,809,759.62
Add: Adjustment from accounting policy changes	-	-	-	-	-	-
Correction of errors in previous period	-	-	-	-	-	-
others	-	-	-	-	-	-
2. Opening balance at the beginning of the current year	245,007,400.00	313,377,024.72	20,773,925.55	35,651,409.35	614,809,759.62	614,809,759.62
3. Changes during the period ("-" for decrease)	179,857,483.00	(179,857,483.00)	21,129,363.92	190,164,275.29	211,293,639.21	211,293,639.21
(1) Net profit	-	-	-	211,293,639.21	211,293,639.21	211,293,639.21
(2) Profit and loss directly recorded in owner's equity	-	-	-	-	-	-
(i) Net changes in fair value of available-for-sale financial assets	-	-	-	-	-	-
(ii) Influence of changes in other owner's equity of invested under equity method	-	-	-	-	-	-
(iii) Income tax implication on items related to shareholder's equity accounted for	-	-	-	-	-	-
(iv) Others	-	-	-	-	-	-
Sub-total of (1) and (2)	-	-	-	211,293,639.21	211,293,639.21	211,293,639.21
(3) Addition and reduction of Shareholders' capital	-	-	-	-	-	-
(i) Addition of shareholders' capital	-	-	-	-	-	-
(ii) The amount of dividend paid to the shareholders' equity	-	-	-	-	-	-
(iii) Others	-	-	-	-	-	-
(4) Profit distribution	-	-	21,129,363.92	(21,129,363.92)	-	-
(i) Appropriation to surplus reserve	-	-	21,129,363.92	(21,129,363.92)	-	-
(ii) Appropriation to owners (shareholders)	-	-	-	-	-	-
(iii) Others	-	-	-	-	-	-
(5) Shareholders' equity internally carried forward	179,857,483.00	(179,857,483.00)	-	-	-	-
(i) Share capital increase by transferring capital reserve	179,857,483.00	(179,857,483.00)	-	-	-	-
(ii) Share capital increase by transferring surplus reserve	-	-	-	-	-	-
(iii) Losses covered by surplus reserve	-	-	-	-	-	-
(iv) Others	-	-	-	-	-	-
4. Closing balance for the current period	424,864,883.00	133,519,541.72	41,903,289.47	225,815,684.64	826,103,398.83	826,103,398.83

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

Items	Last Year					Total shareholder equity
	Shareholders' Equity Attributable to the Parent Company					
	Share Capital	Share Capital	Share Capital	Share Capital	Share Capital	
1. Closing balance of last year	245,007,400.00	314,797,956.98	16,812,657.84	(51,735,841.25)	524,882,173.57	524,882,173.57
Add: Adjustment from accounting policy changes	-	-	-	-	-	-
Correction of errors in previous period	-	-	-	-	-	-
others	-	-	-	-	-	-
2. Opening balance at the beginning of the current year	245,007,400.00	314,797,956.98	16,812,657.84	(51,735,841.25)	524,882,173.57	524,882,173.57
3. Changes during the period ("-" for decrease)	-	(1,420,932.26)	3,961,267.71	87,387,250.60	89,927,586.05	89,927,586.05
(1) Net profit	-	-	-	91,348,518.31	91,348,518.31	91,348,518.31
(2) Profit and loss directly recorded in owner's equity	-	(1,420,932.26)	-	-	(1,420,932.26)	(1,420,932.26)
(i) Net changes in fair value of available-for-sale financial assets	-	-	-	-	-	-
(ii) Influence of changes in other owner's equity of invested under equity method	-	(1,420,932.26)	-	-	(1,420,932.26)	(1,420,932.26)
(iii) Income tax implication on items related to shareholder's equity accounted for	-	-	-	-	-	-
(iv) Others	-	-	-	-	-	-
Sub-total of (1) and (2)	-	(1,420,932.26)	-	91,348,518.31	89,927,586.05	89,927,586.05
(3) Addition and reduction of Shareholders' capital	-	-	-	-	-	-
(i) Addition of shareholders' capital	-	-	-	-	-	-
(ii) The amount of dividend paid to the shareholders' equity	-	-	-	-	-	-
(iii) Others	-	-	-	-	-	-
(4) Profit distribution	-	-	3,961,267.71	(3,961,267.71)	-	-
(i) Appropriation to surplus reserve	-	-	3,961,267.71	(3,961,267.71)	-	-
(ii) Appropriation to owners (shareholders)	-	-	-	-	-	-
(iii) Others	-	-	-	-	-	-
(5) Shareholders' equity internally carried forward	-	-	-	-	-	-
(i) Share capital increase by transferring capital reserve	-	-	-	-	-	-
(ii) Share capital increase by transferring surplus reserve	-	-	-	-	-	-
(iii) Losses covered by surplus reserve	-	-	-	-	-	-
(iv) Others	-	-	-	-	-	-
4. Closing balance for the current period	245,007,400.00	313,377,024.72	20,773,925.55	35,651,409.35	614,809,759.62	614,809,759.62

Company Representative: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfeng

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

I. GENERAL

Shenyang Group Kunming Machine Tool Co. Ltd ("the Company") was changed name from Jiaoda Kunji High-Tech Co. Ltd ("JKHT"). On 29th June 2007, at the 2006 AGM of JKHT the resolution of changing the company name as "Shenyang Group Kunming Machine Tool Co. Ltd" from "Jiaoda Kunji High-Tech Co. Ltd". On 10th September 2007, the new business certification was issued by Yunnan Province Industrial and Commercial Bureau. Application documents of changing the company name were submitted to Companies Registry in Hong Kong, the Registry Certification of changing oversea company's name was issued on Oct 2007. On Oct 2007, the Company disclosed the Announcement on Change of the name of the Company and short name of H share.

Jiaoda Kunji High-Tech Company Limited (formerly known as Kunming Machine Tool Company Limited) was established in the People's Republic of China as a Sino-foreign joint stock limited company as part of the reorganization of a State-owned enterprise known as Kunming Machine Tool Plant ("KMTP"). Pursuant to the reorganization, the operations, assets and liabilities of KMTP were divided between the Company and Kunming Kunji Group Company ("Kunji Group Company"). The Company was established on 19th October, 1993. The Company's A shares and H shares have been listed on the Shanghai Securities Exchange in Shanghai and the Stock Exchange of Hong Kong Limited in Hong Kong respectively. The Company is engaged principally in the design, development, production and sale of machine tool, precision measuring equipment and precision transducers.

On 25th December, 2000, Xian Jiaotong University Industrial (Group) Incorporation ("Jiaotong Group") entered into an agreement with Yunnan Provincial People's Government ("Yunnan Government"), the Company's former controlling shareholder whereby Yunnan Government would transfer a 29% interest of 71,052,146 State-owned shares in the Company to Jiaotong Group. The Ministry of Finance signed approval of State-owned shares transfer of Jiaoda Kunji High-tech Company Limited (Cai Qi [2001] No. 283), and approved the share transfer. Upon completion of share transfer procedure on 5th June, 2001, Jiaotong Group became substantial shareholder of the Company.

Pursuant to the resolution approved on extraordinary general meeting of the Company on 31st December, 2001, after the assets restructuring, the core business of Company was changed into high-tech and diversified production from a traditional machinery manufacturing.

Pursuant to the approval by Industry and Commerce Administration Bureau, since 29th March, 2002, the Company changes the name as "Jiaoda Kunji High Tech Company Limited".

On 15th September, 2005, Xian Jiaotong University Industrial (Group) Incorporation and Shenyang Machine Tool (Group) Company Limited entered into an agreement regarding transfer of shares. Shenyang Machine Tool (Group) Company Limited agreed to purchase 71,052,146 shares of Jiaoda High-tech Company Limited held by Xi'an Jiaotong University Industrial (Group) Incorporation, representing 29% of the total 245,007,400 shares. The transaction was approved by State-owned Assets Supervision and Administration Committee under the State Council and China Securities Regulation Committee. At 1st December, 2006, the register of equity transfer was completed and Shenyang Group became the largest shareholder of the Company.

On 4th April, 2006, pursuant to the approval of Yunnan Government and Yunnan State-owned Assets Supervision and Administration Committee, Yunnan Committee issued written reply to agree Yunnan Government transfer its 31,315,600 shares of the Company (representing 12.79% total issued shares) to Yunnan State-owned Assets Operation Company Limited at nil based on the date of 31st December, 2005. By 31st December, 2006, the share transfer was approved by the State-owned Assets Supervision and Administration Committee. The transfer was completed on 19th January, 2007.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

I. GENERAL (Continued)

On January 25, 2007, the Ministry of Commerce, the PRC issued the "Written Reply Regarding Jiaoda Kunji High-Tech Co., Ltd. Transfer of Shares and Increase Shares" (file no. 商資批[2007]133號) to approve the Share Reform Proposal of the Company. The Company increased shares to all shareholders whose name appear on the Company's register of members on the February 26, 2007 by transferring capital reserves on a basis of 1.5606 shares for every existing 10 shares. The total increased share capital was 38,235,855 shares, of which, 28,091,955 shares were A Shares, and 10,143,900 shares were H Shares. On March 5, 2007, the holders of non-circulating Shares of the Company used their 18,728,355 shares as consideration shares to pay to the holders of circulating A Shares on a basis of 2.7 shares for every 10 shares. The new A shares were listed on March 7, 2007. Of 18,728,355 shares, Shenyang Machine Tool (Group) Company Limited disbursed 11,088,398 shares; Yunnan State-owned Assets Operation Company Limited disbursed 4,891,787 shares, and Jinghua Company disbursed 2,748,170 shares to the holders of Circulating A Shares. After implementation of the consideration arrangement, non-circulating shares held by the holders of non-circulating Shares of the Company became tradable and listed.

On April 2007, two shareholders of the Company, Shenyang Machine Tool (Group) co., Ltd. and Yunnan State-owned Assets Operation Co., Ltd. jointly proposed the Share Increase Proposal (the "Share Increase") (New Shares will be issued to all shareholders of the Company by transferring capital reserve on a basis of five New Shares for every 10 Shares based on 283,243,255 total share capital). The Share Increase was approved at the 21st meeting of the 5th term of board of directors held on April 18, 2007 and the resolution was submitted to 2006 annual general meeting and class general meetings held on June 29, 2007 respectively.

On 15th Aug 2007, pursuant to the approval of Share Increase Proposal by Minister of Commerce, the share capital of the Company was added to 424,864,883 shares from 283,243,255 shares. The registered capital was added to RMB424,864,883 from RMB283,243,255.

The place of registration of the Company is 23 Ciba Road, Kunming City, Yunnan Province. The business registration number is 530000400000458.

II. STATE OF COMPLIANCE

The financial statements have been prepared in conformity with China Accounting Standards for Business Enterprise issued, truly and fully reflecting the Company's financial condition, operating results, cash flows and relating information.

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS

Since January 1, 2007, the Company prepared financial statements according to the Accounting Standards for Business Enterprises [Cai Kuai (2006) No.3] issued on February 15, 2006 and its supplementary rules. Therefore, according to the new Accounting Standards for Business Enterprises, the significant accounting policies modified and adjusted should have been base and guideline for accounting treatment since 2007. The significant accounting policies, accounting estimations and financial statement preparations are modified shown as follow:

1. Accounting Standards

In accordance with the regulations of "Notice on Printing and Distributing 'Accounting Standards for Business Enterprises No. 1-Inventories' etc. 38 Specific Accounting Standards" (Cai Kuai [2006] No.3) issued by Ministry of Finance ("MOF") dated February, 2006, commencing from 1 January 2007, the Company has adopted the "Accounting Standards for Business Enterprises" and its relevant supplement regulations.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

2. The basis of preparing financial statements

Before January 1, 2007, the financial statements of the Company have been prepared in accordance with the Accounting Standards for Business Enterprises (old edition). Since January 1 2007, the Company has adopted the "Accounting Standards for Business Enterprises" and its relevant supplement regulations. The financial statements year 2007 is first financial statements adopted the new Accounting Standards for Business Enterprises. The financial statements have been prepared on the going concern and accrual basis, and recognized, measured and reported based on actual transactions and events. According to Chapter 5 and Chapter 19 ASBE 38 first time adoption of Accounting Standards For Business and relevant regulations issued by CSSC. The opening balance of accounts in Balance Sheet, comparative accounts in income statement, cash flow statement with last year were adjusted retrospectively, as comparative data in the financial statements.

3. Accounting Fiscal Year

The accounting year of the Company commences on 1st January and ends on 31st December each year.

4. Reporting Currency

The reporting currency of the Company is Renminbi ("RMB").

5. Principle of Accounting and basis of measurement

Recognition, measurement and reporting are based upon accrual system.

The Company should generally apply the historical cost as measurement basis in preparing financial statements. If other measurement bases are applied such as replacement cost, net realizable value, present value, fair value, the Company is required to demonstrate that the accounting elements can be measured reliably in those bases.

6. Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments that readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

7. Foreign Currency Translation

Transactions in foreign currencies are translated by spot exchange rate on the transaction date upon initial recognition. In balance sheet date, items in foreign currencies are translated into RMB at the spot exchange rate on the day. Exchange differences arising from differences between the spot exchange rate on the day and that upon initial recognition or that on the balance sheet date are recognized as expenses in profit and loss for the current period. Non-monetary items in foreign currencies carried at historical cost are still measured at amount of recording currency translated at the spot exchange rate on the day during which the transaction takes place. Non-monetary items in foreign currencies carried at fair value are translated at spot exchange rate on the date of which the fair value is determined. Differences between the amount of recording currency after translation and that before translation are accounted as changes in fair value (inclusive of changes on exchange rate) and included in profit and loss of the current period. Differences between foreign currency borrowings related with the acquisition and production of assets eligible for capitalization are recognized in accordance with the principle of borrowing cost.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

8. Financial Instruments Measurement

(1) *Categories of financial assets and financial liabilities*

At initial recognition, all financial assets are classified into four categories:

- a. financial assets which recognized at at fair value and their changes recognized through profit or loss include trading financial assets and financial assets which are designated by the Group upon recognition at fair value and their changes recognised through profit or loss.
- b. held-to-maturity assets
- c. loans and accounts receivable
- d. available-for-sale financial asset

At initial recognition, all financial liabilities are classified into two categories:

- a. financial liabilities which recognised at fair value and their changes recognised through profit or loss include trading financial liabilities and financial liabilities which are designated by the Group upon recognition at fair value and their changes recognized through profit or loss.
- b. other financial liabilities

(2) *Recognition and measurement*

All financial assets and financial liabilities are recognized in the balance sheet, when and only when, the Group, as appropriate, becomes a party to the contractual provisions of the instrument.

At initial recognition, all financial assets are measured at fair value. After initial recognition, the four financial assets are measured in difference ways.

- a. financial assets at fair value through profit or loss are recognized at fair value at initial recognition, related transaction costs are considered as profit or loss. During holding financial assets, interest or cash bonus are considered as investment revenue. Accounts in balance sheet are measured in fair value. Gain or loss from change of fair value is measured as profit or loss. When disposal of financial assets, the balance between fair value and initial recognition are considered as investment revenue, and adjust profit or loss with change of fair value.
- b. available-for-sale financial assets, are measured at fair value plus transaction cost that are directly attributable to the acquisition or issue of the finance asset. The accounts in balance sheet are measure at fair value. Gain or loss from change of fair value shall be classified as capital reserves. The difference between carrying value and book value shall be classified as investment revenue, and the amount of capital reverse previously which is gain or loss from change of fair value transfer into investment revenue.
- c. receivables from good sales or service are recognized in agreement or quota price. When receiving or disposing the receivable, the difference between carrying value and book value shall be recognised as profit or loss.
- d. the investments which will be held to their maturity are measured at fair value of the investment and transaction cost at initial recognition. The investments shall be measured on the basis of the post-amortization costs by adopting the actual interest rate method in subsequent measurement; The balance between the carrying amount and the fair value shall be computed into the investment revenue when investment is disposed.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

8. Financial Instruments Measurement *(Continued)*

(2) *Recognition and measurement (Continued)*

For the financial liabilities measured at their fair values and of which the variation is recorded into the profits and losses of the current period, they shall be measured at their fair values, and the transaction cost may be recorded into the profits and losses of the current period; in subsequent measurement, they shall be measured at fair value.

For the other financial liabilities, at initial recognition, they are measured at fair value plus transaction cost; in subsequent measurement, they shall be measured on the basis of the post-amortization costs by adopting the actual interest rate method.

(3) *Fair value measurement of financial assets and liabilities*

The fair value of financial assets and liabilities is based on their quoted market price in an active market at the valuation date. If a quoted market price is not available, the fair value of the financial assets is established using valuation techniques. The fair value of initial or original financial assets, or bearing financial liabilities, is determined by market transaction price.

(4) *Impairment of financial assets*

An enterprise shall carry out an inspection, on the balance sheet day, on the carrying amount of the financial assets other than those measured at their fair values and of which the variation is recorded into the profits and losses of the current period. Where there is any objective evidence proving that such financial asset has been impaired, an impairment provision shall be made. An impairment test shall be made on the financial assets with significant single amounts. With regard to the financial assets with insignificant single amounts, an independent impairment test may be carried out, or they may be included in a combination of financial assets with similar credit risk features so as to carry out an impairment-related test.

For loans and receivables, held-to-maturities investments, difference between current value of the predicted future cash flow and book value should make provision on impairment loss. If there is any objective evidence proving that the value of the said financial asset has been restored, the recognized impairment loss should be reversed and be recorded into the profits and losses of the current period.

Where a available-for-sale financial asset is impaired, even if the recognition of the financial asset has not been terminated, the accumulative losses arising from the decrease of the fair value of the owner's equity which was directly included shall be transferred out and recorded into the profits and losses of the current period. As for the available-for-sale debt instruments whose impairment-related losses have been recognized, if, within the accounting period thereafter, the fair value has risen and are objectively related to the subsequent events that occur after the originally impairment-related losses were recognized, the originally recognized impairment-related losses shall be reversed and be recorded into the profits and losses of the current period. The impairment-related losses incurred to a available-for-sale equity instrument investment shall not be reversed through profits and losses.

(5) *financial assets transfer and recognition*

If the group transfers substantially all the risks and rewards of ownership of the financial asset, the group shall derecognize the financial asset. If the group retains substantially all the risks and rewards of ownership of the financial asset, the group shall continue to recognize the financial asset. The Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, if the group has not retained control, it shall derecognized the financial asset; if the entity has retained control, it shall continue to recognize the financial asset to the extent of its continuing involvement in the financial asset, and corresponsive financial liabilities.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

8. Financial Instruments Measurement *(Continued)*

(5) *financial assets transfer and recognition (Continued)*

On derecognition of a financial asset in its entirety, the difference between:

- (a) the carrying amount and
- (b) the sum of (i) the consideration received (including any new asset obtained less any new liability assumed); and (ii) any cumulative gain or loss that had been recognized directly in equity shall be recognized in profit or loss.

If the transferred asset is part of a larger financial asset and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognized and the part that is derecognized, based on the relative fair values of those parts on the date of the transfer.

The difference between:

- (a) the carrying amount allocated to the part derecognized and
- (b) the sum of (i) the consideration received for the part; and (ii) any cumulative gain or loss allocated to it that had been recognized directly in equity; shall be recognized in profit or loss.

9. Provision for bad debt on receivables

- (1) receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, including bills receivable, accounts receivable, prepayments, other receivables, and long-term receivables.
- (2) Measurement: An impairment test shall be made on the receivable account with significant single amounts. Where there is any objective evidence proving that such financial asset has been impaired, an impairment provision shall be made. The carrying amount of receivable shall be written down to the current value of the predicted future cash flow, and the amount as written down shall be recognized as loss of the impairment of the receivable. For the single non significant receivables and tested non impairment receivables, the provision of bad debts is measured on the provision method based on aging analysis.
- (3) Recognition criteria for bad debt: a. the irrecoverable amount of a debtor who has gone bankrupt or has died and has insufficient asset or estate to repay; b. the irrecoverable amount, demonstrated by sufficient evidence, of a debtor who does not comply with his/her repayment obligation over three years.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

9. Provision for bad debt on receivables *(Continued)*

- (4) Accounting basis of bad debt losses: allowance method

Allowance and applicable rate:

An impairment test shall be made on the receivable account with significant single amounts. Where there is any objective evidence proving that such asset has been impaired, an impairment provision shall be made. The carrying amount of receivable shall be written down to the current value of the predicted future cash flow, and the amount as written down shall be recognized as loss of the impairment of the receivable. For the single non significant receivables and tested non impairment receivables, the provision of bad debts is measured on the provision method based on amount in the balance sheet and account's aging analysis.

Accounts aged	applicable rate
Within 1 year	5%
1-2 years	50%
Over 2 years	100%

- (5) Derecognition in bad debt on receivables

The Company should derecognize bad debt on receivable when:

- (1) the irrecoverable amount of debtor who has gone bankrupt or has died and has insufficient asset to repay;
- (2) the irrecoverable amount, demonstrated by sufficient evidence, of a debtor who does not comply with his/her repayment obligation over three years.

Save above irrecoverable receivables should be derecognized with approval of the Board of the Directors.

10. Accounting for Inventories

- (1) Inventory category: Inventories include raw materials, work-in-progress products, semi-finished products, finished goods, low-value consumables, packaging material.

- (2) Valuation method of inventories:

Purchase of raw materials, packaging materials and consumables are stated at cost incurred.

Inventory issued and inventory shipped are recorded based on the weighted average cost method.

Low value consumables are fully charged to cost when they are issued.

Work-in-progress products are recorded based on quota cost method.

- (3) Measurement: Inventories are measured initially at cost. At the balance sheet date, inventories are stated at the lower of cost and net realizable value. The follow ways to measure the net realizable value on difference inventories:

The inventories such as merchandise, finished product, available for sales materials, the net realizable value represents the estimated selling price less the estimated expenses of sales and tax. The inventories such as processing materials, the net realizable value represents the estimated selling price of finished product less the estimated cost of process completion, estimated expense of sales and tax.

- (4) Provision for diminution in value of inventories: provisions for diminution in value of inventories is made by single items. For inventories of low value and many items, provisions for diminution in value of inventories is made by classification of inventories.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

10. Accounting for Inventories *(Continued)*

- (5) At the balance sheet date, inventories are stated at the lower of cost and net realizable value. Whenever the net realizable value is lower than cost, provision is made for diminution in value of each inventory to the profit and loss account in the period.

After provision for diminution in value of inventories is made, where the factors that result in diminution in value of inventories no longer exist and therefore the net realizable value of inventories is higher than its carrying value, the original provision for diminution in value of inventories can be reversed, and the amount of reversal is charged to the profit and loss account in the period.

- (6) A perpetual inventory system is adopted for the calculation of inventory volume.

11. Accounting for Long-term equity Investment

- (1) *Long-term equity investments are recorded at initial investment cost on acquisition*

- 1) For combinations of entities under common control in which a company pays cash, transfers non-cash assets or bear debts as consideration of combinations, the initial investment cost of long-term equity investment is the share with reference to the book value of the shareholders' equity of the party to be combined on the date of combinations. Capital reserve account is adjusted by differences between initial investment cost of long-term equity investment and the book value of the cash paid, non-cash assets transferred as well as liabilities assumed. Amounts that cannot be sufficiently released by capital reserve account serve the purpose of adjusting retained earnings. For companies offering consideration of combinations by issuing equity securities, initial investment cost of long-term equity investment refers to the share with reference to the book value of the shareholders' equity of the party to be combined on the date of combinations, this becomes share capital with reference to the nominal value of shares in issue. Capital reserve account is adjusted by differences between initial investment costs of long-term equity investment and the aggregate nominal value of shares in issue. Amounts that cannot be sufficiently released by capital reserve account serve the purpose of adjusting retained earnings.
- 2) For combinations of entities without common control, initial investment cost of long-term equity investment refers to the assets paid, liabilities incurred or assumed as well as the fair value of equity securities in issue by the company in exchange for control of the acquiree on the date of acquisition. If the fair value of acquisition cost is bigger than the fair value of acquiree's realizable net assets, the differences will be treated as goodwill. If the fair value of acquisition cost is smaller than the fair value of acquiree's realizable net assets, the differences will be included in profit and loss.
- 3) For non combination of entities, long-term equity investment settled in cash, initial investment cost refers to the actual consideration paid. Initial investment cost refers to long-term equity investment acquired through the issue of equity securities in accordance with the fair value of equity securities in issue. Save for unfair agreed values under contract or agreement, initial investment cost are long-term equity investment of investors with reference to the agreed value stipulated under investment contract or agreement. For the long-term equity investment obtained by the exchange of non-monetary assets, the initial investment cost shall be determined by fair value of non-monetary assets plus related tax expense. For the long-term equity investment obtained by debt restructuring, the initial investment cost shall be determined by fair value investment of debt restructuring. The difference of fair value of investment and book value of debt restructuring is stated as profit or loss.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

11. Accounting for Long-term equity Investment *(Continued)*

(2) *Follow-up measurement*

The investment on the subsidiaries without joint control or significant influence, without price quota in the active market, without reliable measure by fair value shall be accounted by the method of cost. The long-term equity investment that the Company co-controls or has significant influences on the unit being invested shall be accounted by the method of equity. Investment revenue is determined by net profit adjustment of invested unit based on fair value of each asset which can be classified in invested unit.

(3) *Provision for the impairment on long-term equity investment*

Goodwill caused by business combination involving entities under non common control should be tested for impairment at the end of the period. Loss of goodwill shall be recognized as profit or loss. According to cost method, without price quota in active market, and reliable fair value, the loss between book value cost of investment and net value from future cash flow shall be stated as profit or loss. If there is impairment in the investment, comparison with net value of initial fair value of investment minus disposal cost and present value from future cash flow by investment, the higher is considered as the amount recoverable. The impairment reserves are accounted by difference between the recoverable amount of the individual investment and the book value. Once the impairment loss for long-term equity investment is confirmed, they shall no longer be reversed in the future accounting period.

12. Fixed assets

- (1) Fixed assets are tangible assets that are held for using the production or supply of goods or services, for rental to others, or for administrative purposes, and have useful lives more than one accounting year such as house, building, machine, equipment, transport vehicle, other tangible assets.
- (2) Fixed assets measure: Fixed assets are initially measured at cost by the ways of purchase, self-construction, and acquisition through business combination under common control. Fixed assets are measured at fair value or carrying cost by non-monetary asset exchange, debt restructure, acquisition through business combination under non common control. If a constructed fixed asset has reached the working condition for its intended use but the final project accounts have not been completed and approved, the asset should be transferred to fixed assets at an estimated value based on project budget and depreciation is based on the estimated value. After completion, the estimated value will be adjusted in accordance with the actual cost. However, the recognized depreciation will not be adjusted.
- (3) Fixed assets are depreciated using the straight-line method to recognize monthly. The estimated useful lives, estimated residual value rates and annual depreciation rates of the fixed assets are as follows:

Fixed assets category	Estimated useful lives	Estimated residual value (%)	Annual depreciation rate (%)
Buildings	40	5	2.38
Machinery equipments	10-14	5	6.79-9.50
Electric equipments, fixture, furniture	10-14	5	6.79-9.50
Transportation equipment	10-14	5	6.79-9.50

The depreciation policy for assets held under finance bases are consistent with that for owned assets. If there is reasonable certainty that the lease will obtain ownership at the end of lease, the asset should be depreciated over the shorter of the lease term and the life of the asset.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

12. Fixed assets *(Continued)*

(4) Provision on impairment loss on fixed assets

At the end of the period, when there is an indication that the fixed asset devalue, estimates its recoverable amount. If the recoverable amounts lower than the book value, decrease the book value of the fixed asset to recoverable amount. The decreased amount is recognized as assets' impairment loss included in profit or loss for the current period and recognizes the provision on impairment loss on fixed assets at the same time. Once the impairment loss on fixed assets recognized, it cannot be reversed in the future per

13. Accounting for Construction in Progress

- (1) The cost of construction-in-progress is determined according to expenditures actually incurred. Construction in progress is transferred to fixed assets at the date of reaching its usable conditions at an estimated amount
- (2) Provision on impairment loss on construction in progress
- (3) At the period end, based on the investigation on each construction in progress, if there exists:
 - a. Construction-in-progress has been (or will be) suspended, terminated construction or disposed ahead of schedule;
 - b. The economic, technological or legal environment in which the enterprise operates, or the market where the assets is situated will have any significant change in the current period or in the near future, which will cause disadvantage impact on the enterprise;
 - c. Internal report shows that the economic benefit generated by the construction-in-progress will be lower than the expectation, e.g. new cash flow or net operating profit (or loss) of the construction-in-progress will much lower (or higher) than the expectation.
 - d. The market interest rate or any other market investment return rate has risen in the current period, and thus the discount rate of the enterprise for calculating the expected future cash flow of the assets will be affected, which will result in great decline of the recoverable amount of the assets;
 - e. Other evidences can prove the existence of the circumstance of the decline in value on construction-in-progress.

Should the above circumstance exists, difference of the recoverable amount and the carrying amount of construction-in-progress can be made as provision on impairment loss on construction-in-progress. The impairment loss is calculated based on the difference between book value and net realizable value. Once the impairment loss on constructure-in-progress recognized, it cannot be reversed in the future period.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

14. Intangible Assets

- (1) Intangible asset refers to the identifiable non-monetary assets possessed or controlled by the Company which have no physical shape, include patents, know how, trade mark, copyright, chartered right, and land use right.
- (2) Measurement: The intangible assets shall be initially measured according to its cost. The cost of outsourcing intangible assets shall include the purchase price, relevant taxes and other necessary expenditures directly attributable to intangible assets for the expected purpose. Where the payment of purchase price for intangible assets is delayed beyond the normal credit conditions, which is of financing intention, the cost of intangible assets shall be determined on the basis of the current value of the purchase price. The difference between the actual payment and the current value of the purchase price shall be recorded into profit or loss for the credit period, unless it shall be capitalized under the relevant regulations.
- (3) Amortization: With regard to intangible assets with limited service life, its amortization amount shall be amortized within its service life systematically and reasonably. Intangible assets with uncertain service life may not be amortized. The intangible assets from contractive rights or other legal rights, the service life is not over the limit period of the contract live right or other legal rights. If there is indefinite contract or legal regulation, it is able to forecast the period to confirm service life when the intangible asset can bring economic benefits to the enterprise.

If it is not able to forecast the period to confirm service life when the intangible asset can bring economic benefits to the enterprise, the intangible asset will be treated as intangible assets with uncertain service life.

- (4) The research expenditures for its internal research and development projects of an enterprise shall be recorded into the profit or loss for the current period. The development expenditures for its internal research and development projects of an enterprise may be confirmed as intangible assets when they satisfy the following conditions simultaneously:
 - a. It is feasible technically to finish intangible assets for use or sale;
 - b. It is intended to finish and use or sell the intangible assets;
 - c. The usefulness of methods for intangible assets to generate economic benefits shall be proved, including being able to prove that there is a potential market for the products manufactured by applying the intangible assets or there is a potential market for the intangible assets itself or the intangible assets will be used internally;
 - d. It is able to finish the development of the intangible assets, and able to use or sell the intangible assets, with the support of sufficient technologies, financial resources and other resources; and
 - e. The development expenditures of the intangible assets can be reliably measured.
- (5) Review the service life of intangible assets: an enterprise shall, at least at the end of each year, check the service life and the amortization method of intangible assets with limited service life. When the service life and the amortization method of intangible assets are different from those before, the years and method of the amortization shall be changed. An enterprise shall check the service life of intangible assets with uncertain service life during each accounting period. Where there are evidences to prove the intangible assets have limited service life, it shall be estimated of its service life, and be treated according to this Standard.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

15. Long-term deferred expenditure

Long-term deferred expenditure are expenditures and other expenses has occurred which will be benefited over 1 year (excluding within 1 year), e.g. expenses for leased fixed assets innovation. Expenses incurred during the incorporation of the Company are recorded in the long term deferred expenditure at first and will be included in the profit and loss account in the first month after commencement of its operation. Other long term deferred expenditure will be amortized evenly over the estimated beneficial period.

16. Accounting for borrowing cost

(1) Where the borrowing costs incurred to an enterprise can be directly attributable to the acquisition and construction or production of assets eligible for capitalization, it shall be capitalized and recorded into the costs of relevant assets. Other borrowing costs shall be recognized as expenses on the basis of the actual amount incurred, and shall be recorded into the current profits and losses. The term "assets eligible for capitalization" shall refer to the fixed assets, investment real estate, inventories and other assets, of which the acquisition and construction or production may take quite a long time to get ready for its intended use or for sale.

(2) The borrowing costs shall not be capitalized unless they simultaneously meet the following requirements:

- a. Expenditures for the asset are being incurred;
- b. Borrowing costs has already incurred; and
- c. Acquisition and construction that are necessary to enable the asset reach its expected usable condition have commenced.

(3) Where the acquisition and construction or production of a qualified asset is interrupted abnormally and the interruption period lasts for more than 3 months, the capitalization of the borrowing costs shall be suspended. The borrowing costs incurred during such period shall be recognized as expenses, and shall be recorded into the profits and losses of the current period, till the acquisition and construction or production of the asset restarts. If the interruption is a necessary step for making the qualified asset under acquisition and construction or production ready for the intended use or sale, the capitalization of the borrowing costs shall continue.

(4) *Recognition of capitalization of borrowing cost and interest:*

The borrowing costs attributable to the acquisition and construction or production of assets eligible for capitalization refer to actual interest expenses during borrowing period, minus interest revenue of borrowing fund deposited on bank or investment revenue from short term investment by borrowing fund. For the general borrowings, the borrowing costs eligible for capitalisation are determined by applying a capitalisation rate to the capital expenditure that accumulated capital expenditures exceed the specific borrowings.

17. Contingency liability:

(1) The obligation pertinent to Contingencies shall be recognized as an estimated debt when the following conditions are satisfied simultaneously:

- a. That obligation is a current obligation of the enterprise;
- b. It is likely to cause any economic benefit to flow out of the enterprise as a result of performance of the obligation; and
- c. The amount of the obligation can be measured in a reliable way.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

17. Contingency liability: *(Continued)*

- (2) The estimated debts shall be initially measured in accordance with the best estimate of the necessary expenses for the performance of the current obligation. If there is a sequent range for the necessary expenses and if all the outcomes within this range are equally likely to occur, the best estimate shall be determined in accordance with the middle estimate within the range. In other cases, the best estimate shall be conducted in accordance with the following situations, respectively:
- a. If the Contingencies concern a single item, it shall be determined in the light of the most likely outcome.
 - b. If the Contingencies concern two or more items, the best estimate should be calculated and determined in accordance with all possible outcomes and the relevant probabilities.

When all or some of the expenses necessary for the liquidation of an estimated debts of an enterprise is expected to be compensated by a third party, the compensation should be separately recognized as an asset only when it is virtually certain that the reimbursement will be obtained. The amount recognized for the reimbursement should not exceed the book value of the estimated debts.

Provision from 1.2% of sales revenue of machine tools business is computed as expenses of after sales service through profits and losses. Actual expenses are kept withing the provision. The reliability of provision ratio shall be reviewed on balance sheet date.

18. Employee benefits

- (1) Employee Benefits refers to monetary salary and benefits not in monetary render by the Company to employees during and after service term of the employees.

(2) *Recognition and Measurement:*

During the accounting period of an employee' providing services to an enterprise, the enterprise shall recognize the compensation payable as liabilities. Except for the compensations for the cancellation of the labor relationship with the employee, the enterprise shall, in accordance with beneficiaries of the services offered by the employee, treat the following circumstances respectively:

- a. The compensation for the employee for producing products or providing services shall be recorded as the product costs and service costs;
- b. The compensation for the employee for any on-going construction project or for any intangible asset shall be recorded as the costs of fixed asset or intangible assets; or
- c. Monthly payments and social insurance charges paid by the Company to early-retirees, laid-off employees, and unemployment people commencing from the date of their early-retirement up until their respective official retirement are recognized as accrued salaries. Payments within one year, salary expenses shall be recorded as profit or loss for the current period. Payments over one year, the future accrued salary should be discounted as profit or loss for the current period. The discount rate is determined by referring to high quality corporate bonds market interest rate. Unrecognized financial fee should be amortised on the actual interest rate.
- d. Other salaries except for the above circumstance should be recognized in profit and loss for the current period.

The enterprise shall calculate the medical and insurance, endowment insurance, unemployment insurance, work injury insurance, maternity insurance and other social insurances, as well as the housing accumulation fund, which are paid by the enterprise to the employee, on the basis of a certain proportion in the total amount of wages.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

19. Share-based payments

- (1) The share-based payments shall consist of equity-settled share-based payments and cash-settled share-based payments. The equity-settled share-based payment in return for employee services shall be measured at the fair value of the equity instruments granted to the employees. As to an equity-settled share-based payment in return for services of employees, if the right may be exercised immediately after the grant, the fair value of the equity instruments shall, on the date of the grant, be included in the relevant cost or expense and the capital reserves shall be increased accordingly. The "grant date" refers to the date on which the share-based payment agreement is approved. As to a equity-settled share-based payment in return for employee services, if the right cannot be exercised until the vesting period comes to an end or until the prescribed performance conditions are met, then on each balance sheet date within the vesting period, the services obtained in the current period shall, based on the best estimate of the number of vested equity instruments, be included in the relevant costs or expenses and the capital reserves at the fair value of the equities instruments on the date of the grant.

A cash-settled share-based payment shall be measured in accordance with the fair value of liability calculated and confirmed based on the shares or other equity instruments undertaken by an enterprise. As to a cash-settled share-based payment instruments, if the right may be exercised immediately after the grant, the fair value of the liability undertaken by the enterprise shall, on the date of the grant, be included in the relevant costs or expenses, and the liabilities shall be increased accordingly. As to a cash-settled share-based payment, if the right may not be exercised until the vesting period comes to an end or until the specified performance conditions are met, on each balance sheet date within the vesting period, the services obtained in the current period shall, based on the best estimate of the information about the exercisable right, be included in the relevant costs or expenses and the corresponding liabilities at the fair value of the liability undertaken by the enterprise.

- (2) Fair value recognition of equity-settled instrument: As for the equity-settled instrument such as for which there is an active market, the quoted prices in the active market shall be used to determine the fair values thereof. If there is no quoted price, the fair value shall be determined by reference of quoted price of similar transaction. Where there is no active market for a equity settled instrument, the enterprise concerned shall adopt value appraisal techniques to determine its fair value.
- (3) *Basis for recognition best estimate of the number of vested equity instruments:*
If, on the balance sheet date, the subsequent information indicates that fair value of the current liability undertaken by the enterprise are different from the previous estimates, an adjustment shall be made, and on the vesting date the estimate shall be adjusted to equal the actually exercisable right.

20. Government grants

Government grants shall be recognized when an enterprise can meet the conditions for the government grants and can obtain the government grants. If a government grant is in the form of a transfer of a monetary asset, the item shall be measured at the amount received or receivable. If a government grant is in the form of a transfer of a non-monetary asset, the item shall be measured at fair value. If fair value is not reliably determinable, the item shall be measured at a nominal amount one dollar and recognized immediately in profit or loss for the current period. If the grant is a compensation for related expenses or losses to be incurred by the enterprise in subsequent periods, the grant shall be recognized as deferred income, and recognized in profit or loss over the periods in which the related costs are recognized. If the grant is a compensation for related expenses or losses already incurred by the enterprise, the grant shall be recognized immediately in profit or loss for the current period.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

III. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATIONS *(Continued)*

21. Recognition of revenue

- (1) Sale of goods: when the major risk and rewards in the ownership of the goods have been transferred to the purchaser, the Company no longer exercises continuing management and actual control over the goods in connection with ownership, economic benefits in connection with transactions can flow in the enterprise and the relevant revenue and costs are reliably measurable, the Company will confirm that revenue from the sale of the goods has been realized.

If the collection of the price as stipulated in the contract or agreement is delayed and if it has the financing nature, the revenue incurred by selling goods shall be ascertained in accordance with the fair value of the receivable price as stipulated in the contract or agreement. The difference between the price stipulated in the contract or agreement and its fair value shall be amortized within the period of the contract or agreement employing the real interest method and shall be included in the current profits and losses.

- (2) Provision of labor services: for labor services which are commenced and completed in the same year, revenue is recognised upon completion of the labor services. If the commencement and completion of a labor service falls in different fiscal years, relevant revenue from the labor service will be recognised on the date of the balance sheet on the basis of the percentage of the completed labor service, provided that the results of the labor service provision transaction is reliably estimated.
- (3) Assignment of asset use rights: the Company will confirm that revenue is realized according to the period and method stipulated under relevant contract or agreement, provided that economic benefits in connection with a transaction can flow in and the revenue amount is reliably estimated.

22. Accounting of Income Tax

The Company applies the balance sheet liability method for accounting of income tax. The tax bases of acquired assets or liabilities are determined upon their acquisition by the Company. Where there is difference between the carrying amount of assets or liabilities and the tax bases, the deferred income tax assets or the deferred income tax liabilities arising from there are recognised.

23. Scope of consolidation and methods of preparing consolidated financial statements

Consolidated financial statements of the Company have been prepared in accordance with ABSEs no.33-Consolidated Financial Statement and relevant supplementary regulations issued by the Ministry of Finance of the PRC. The scope of consolidation for consolidated financial statements is recognized on the basis of control. The consolidated financial statements are prepared on financial statements of parent company and subsidiaries, to adjust long equity investment of subsidiaries according equity method, then offset significant balance and transactions between the Company and its subsidiaries and among subsidiaries.

24. Profit and profit distribution

The obtained net profit of the Company shall be appropriated by the following order:

- (1) offsetting against losses for previous years
- (2) appropriation 10% of net profit to statutory surplus reserve, if the statutory surplus reserve is more than 50% of the registered capital, it may not be appropriated.
- (3) appropriation to discretionary surplus reserve
- (4) payment of dividends to common shares

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IV. TAXATION

1. Value-Added Tax (VAT)

The amount of VAT payable is measured by the difference between the amount of the current amount of tax on sales and the current amount of tax on purchases. The current amount of tax on sales is assessed on the basis of the sales volume of good at the VAT rate 17%.

The Company and its subsidiaries are VAT ordinary taxpayer applicable for 17% VAT rate.

2. Income Tax

Pursuant to the approval reply from taxation authority, the applicable rate of income tax of the Company is 15% due to tax favorable policy for Western Region Development,

The subsidiaries of the Company include Shangxi Hengtong, Siyuan Intelligent, Xian Ser, Winko are High Tech Companies. The applicable rate of income tax is 15%.

The applicable rate of income tax of the other subsidiaries include Kunming GE, Kunming Transportation is 33%.

3. Sales Tax

The Sales tax is paid by 3% or 5% of income taxable.

4. Other Taxes

The amount of tax payable is determined according to the Provision Regulations of Taxation.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

V. SUBSIDIARIES, JOINT VENTURES, AND CONSOLIDATED STATEMENTS

1. Subsidiaries and Joint Ventures

Name of subsidiaries and joint venture	Place of Registration	Scope of Business	Registered Capital (RMB'000)	Investment Proportion (%)	Economic Nature	Time of Investment	Relationship with the Company
Xi'an Ser Turbo Machinery Company Limited (Xi'an Ser)	Xi'an City	Design, develop and sales of turbo machinery	50,000	45.00%	Limited liabilities	2001.12	Subsidiary
Shaanxi Hengtong Intelligent Company Limited ("Shaanxi Hengtong")	Xi'an City	Develop and sales of machines, develop and sales of machine manufacturing mould, machinery, equipment, electronic products, software and hardware	27,960	65.34%	Limited liabilities	2001.12	Subsidiary
Kunming Kunji General Machine Co., Ltd.	Kunming City	Development, design and sale of machine tool products and accessories	3,000	100.00%	Limited liabilities (legal person sole proprietorship)	2007.10	Subsidiary
Xi'an Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Siyuan")	Xi'an City	Develop manufacture and sale of electronic products, electronic machine and products of electronic power, provide technology services	35,000	78.03%	Limited liabilities	2002.12	Subsidiary
Winko Machines Company Limited ("Winko")	Kunming City	Develop, apply and integrate hardware and software; retail, whole sale, purchase on behalf of others and consign electronic products, machinery and electronic machine	20,230	96.74%	Limited liabilities	2002.11	Subsidiary
Tos Kunming Machine Tool Company Limited ("TOS Kunming")	Kunming City	Develop, design, manufacture and sales of machine tool products, and high-tech products and repairs of machine	5 million Euros	50.00%	Limited liabilities	2005.4	Joint venture
Changsha Ser Turbo Machinery Equipment Company Limited ("Changsha Ser")	Changsha City	Design, develop, sales of turbo machinery	10,000	95.00%	Limited liabilities	2004.01	Subsidiary of Xi'an Ser
Hangzhou Ser Turbo Machinery Equipment Company Limited ("Changsha Ser")	Hangzhou City	Design, develop and sales of turbo machinery, technology development, retail, whole sale of construction materials, and import and export business	1,200	51.00%	Limited liabilities	2004.04	Subsidiary of Xi'an Ser
Kunji Transportation Company Limited	Kunming City	General cargo transportation	500	100%	Limited liabilities	2006.10	Subsidiary
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite")	Xi'an City	Manufacture fast prototyping series equipments	60,000	23.34%	Limited liabilities	2006	Associated Company

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

V. SUBSIDIARIES, JOINT VENTURES, AND CONSOLIDATED STATEMENTS *(Continued)*

2. Changes in consolidated statements during the reporting period

- (1) the Company established a new subsidiary in October 2007 – Kunming Kunji General Machine Co., Ltd.
- (2) Shaanxi Hengtong has been sold in March 2007. The financial statements consolidated Shaanxi Hengtong's income statement and cash flow statement of January to March, 2007.

Except TOS Kunming and Xi'an Ruite, financial statements of above enterprises are consolidated in the financial statements of the Company.

Even though the Company holds 45% of the total share capital of Xi'an Ser, most of the directors of Xi'an Ser are sent by the Company. Therefore, the Company consolidated statements of Xi'an Ser and its subsidiaries Changsha Ser and Hangzhou Ser.

On April 7, 2005, the joint venture TOS Kunming was established by the Company and Czech Tos Company Limited with registered capital 5 million Euros. Even though the Company holds 50% of the registered capital of TOS Kunming, it does not have the controlling power. Thus, the statements of TOS Kunming have not been consolidated in the Company's statements. The Company invested RMB500,000 to establish Kunji Transportation Company Limited, which is a wholly owned subsidiary of the Company. The statements of Kunji Transportation have been consolidated in the statements of the Company from the date of its establishment.

On 23rd March, 2007, a resolution was passed at the 20th meeting of the 5th term board of directors which approved the Company used its shareholding of Shaanxi Hengtong as consideration of RMB14,000,000.00 to acquire equity interest in the Xi'an Ruite.

VI. CHANGE OF ACCOUNTING POLICIES

1. According to the notice issued by the Ministry of Finance regarding printing the 38 accounting standards for business enterprises (file no.: 財政部財會[2006]3號), the Company adopted the Accounting Standards for Business Enterprises on 1 January 2007 at the first time. And according to the No. 1 Interpretation for Accounting Standards for Business Enterprises, issued by the Ministry of Finance on 16 November 2007, the Company has retrospectively adjusted the relevant data of the beginning of the reporting and the last period in respect of the above change in accounting policies. The Company has made the reconciliation statement for net profit differences for the year 2006 and reconciliation statement for shareholders' equity difference as at 31 December 2006. Details can refer to the notes 十五.4及十五.5.
2. On May 15, 2007, the Ministry of Finance of the PRC announced "Opinions of Professionals Working Group on Implementation of the Accounting Standards for Business Enterprises" ("Opinions"). According to the Rule 2.2 of the Opinions, The Company has accounted for the accrued early-retirement benefits for 252 early-retirement employees, 45 laid-off workers and 5 unemployments commencing from the date of their early-retirement up until their respective official retirement. Since the retirement benefits will pay for about 5 years, the Company refers to high quality corporate bonds market interest rate to determine the discount rate of the salaries for early retirees. Presently, the discount rate is 5.2% annually. As at 30 June 2007, the Group has properly accounted for these early-retirement benefits and retrospective adjustments were made for the recognition of such accruals for prior years.
 - (1) Retrospective adjustment of Opening Accounts on 1 January 2006: increased accrued salary of RMB31,061,067.08; increased unrecognized finance cost of RMB5,863,554.28; increased deferred tax assets of RMB5,756,394.65; decreased unappropriated profit of RMB19,441,118.15.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

VI. CHANGE OF ACCOUNTING POLICIES *(Continued)*

- (2) For the year 2006, decreased administrative expenses of RMB3,341,901.32; decreased accrued salary of RMB3,341,901.32; decreased unrecognized finance cost of RMB1,232,537.95; increased financial expense of RMB1,232,537.95; decreased deferred tax assets of RMB316,404.50; increased income tax of RMB316,404.50; increased net profit of RMB1,792,958.86; accumulatively decreased undistributed profit of RMB17,648,159.29.
 - (3) Retrospective adjustment on 1 January 2007, increased accrued salary of RMB27,719,165.76, increased unrecognized finance cost of RMB4,631,016.32, increased deferred tax assets of RMB5,439,990.14, accumulatively decreased undistributed profit of RMB17,648,159.29
 - (4) Accrued salary for early-retirement for the year 2007 was RMB4,388,251.74, retrospective adjustment: increased interest payment of RMB1,098,808.97, decreased deferred tax assets of RMB493,416.42, increased income tax of RMB493,416.42. This change of accounting policy lead to increase profit of RMB2,796,026.36 for the year 2007.
3. In recently years, the sales revenue increased rapidly. In order to ensure matching the revenue and the expenses, fairly reflect the profits, liabilities and net assets of the Group, the Group decided to change the existing accounting practice (which recognised the after-sales service expenses by actually occurred cost as profit or loss for the current period) to recognise provision for warranty with a experienced rate for after-sales expenses. The actual after-sales expenses will be recognised under the provision for warranty. The experienced rate will be reviewed and confirmed whether it needs to be changed at the date of balance sheet. According to experienced statistic information before 31 December 2007, the experienced rate of after-sales expenses is about 1.2% of the sales revenue. As at 31 December 2007, the Group has properly accounted for the provision for warranty and retrospective adjustments were made for the recognition of such provisions for prior years.
 - (1) Retrospective adjustment of Opening Accounts on 1 January 2006: increased contingent liability of RMB1,243,836.54; increased deferred tax assets of RMB186,575.48, decreased undistributed profit of RMB1,057,261.06.
 - (2) Retrospective adjustment for the year 2006: increased contingent liability of RMB2,310,723.59; increased selling expense of RMB2,310,723.59; increased deferred tax assets of RMB346,608.54; increased income tax of RMB346,608.54; decreased net profit of RMB1,964,115.05; accumulatively decreased undistributed profit of RMB3,021,376.11.
 - (3) Retrospective adjustment on 1 January 2007: increased contingent liability of RMB3,554,560.13; increased deferred tax assets of RMB533,184.02; accumulatively decreased undistributed profit of RMB3,021,376.11.
 - (4) At the beginning of the year 2007, provision for contingent liability of RMB11,303,410.41 was made, actual payment for the year was RMB5,742,975.97, retrospective adjustment of increasing deferred tax assets of RMB834,065.17, this change of accounting policy lead to decrease profit of RMB4,726,369.27 for the year 2007.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

VII. CHANGE IN ACCOUNTING ESTIMATES

In recent years, sales and production have increased largely; the structure of products has changed significantly. Under the benefit of scale, the cost of products had not changed in time. In order to strengthen the control of inventories cost, improve the management quality for cost, accurately calculate the cost of inventories, the Company has reviewed and changed the standard cost of the existing products at the end of year 2007. The after-changed standard cost for products has been used to re-calculate cost of goods in progress and inventories for the year 2006 and at the end of 2007. According to the results of re-calculation, inventories at the end of 2006 has overestimated RMB7,527,145.32, and goods of progress has underestimated RMB30,661,133.38. After balance out, the inventories at the end of 2006 was underestimated RMB23,133,988.06. Due to the effect of this change in accounting estimates for the year 2006 can be accurately calculated, the Company retrospective adjusted the relevant data for the year 2006: increased goods in progress of RMB30,661,133.38, decreased inventories of RMB7,527,145.32, decreased sales expensed of RMB23,133,988.06, increased profit of RMB23,133,988.06, increased income tax of RMB3,470,098.21, increased tax payable of RMB3,470,098.21 and increased net profit of RMB19,663,889.85.

VIII. CORRECTION ERRORS

1. Problems of construction in progress in Xi'an

Adjustment for the balance sheet of Siyuan at 31 December 2006:

Items	At 31 December	Adjustment	1 January 2007
Construction in progress	30,391,613.23	(28,640,211.23)	1,751,402.00
Other accounts payable	6,305,199.82	28,728,073.97	35,033,273.79
Other accounts receivable	616,276.46	(250,000.00)	366,276.46
Intangible assets	2,261,100.01	57,618,285.20	59,879,385.21

Construction in progress was adjusted at 1 January 2007 because it subject to the project between Siyuan and Xi'an Jiaotong University in respect of development of Science & Technology Street with northern no. 2 and northern no. 3 buildings (the "Buildings"). Siyuan has the operation and management rights for Buildings for 23 years, this belongs to intangible assets. Therefore, the construction in progress is adjusted as intangible assets at 1 January 2007. The adjustment was based on the Auditing Report for Capital Construction Project Settlement (file no. 陝西西造價字(2007)第009號) and Auditing Report for Capital Construction Project Financial Final Accounts (file no. 希會審字(2007)0648號), Agreement, Payment Agreement between Siyuan and Shaanxi Hangtian Construction Company. Because the issue was happened before 1 January 2007, thus adjusted the amount at 1 January 2007 was needed, involved other accounts receivable and other accounts payable were adjusted at the same time.

2. Deferred gain/income: During December 2001, the Company implemented capital restructuring and sold several buildings and land use rights to Yunnan Provincial Government then leased back for 20 years. The recognized initial deferred gain was RMB12,310,986.00. The opening balance of deferred gain on 1 January, 2005 was RMB9,714,394.95. Due to problems producing from deductions and exemptions of Land Appreciation Tax ("LAT") approved by Yunnan Government, the estimated LAT for the year RMB10,984,000 was offset the deferred income of RMB9,714,394.95 at the beginning of 2005, the remaining balance of RMB1,269,605.05 was considered as non-operating expenses through profit or loss for 2005. According to settlement result with the government tax department in 2006, the actual LAT payment of the Company for the year would be RMB5,048,680.52. The difference of RMB5,935,319.48 between actual payment and recognized amount made by the government would be transferred to deferred income amortizing within the rest leasing period. The above accounting transactions have mistakes and have been corrected as follows:

- (1) Retrospective adjustment on 1 January 2006: decreased taxes payable-taxes payable for LAT of RMB5,935,319.48, increased taxes payable-income tax payable of RMB231,608.83, increased deferred gain RMB4,391,260.64 and increased accumulative undistributed profit of RMB1,312,450.01.
- (2) Retrospective adjustment on 1 January 2006: increased taxes payable-taxes payable for LAT of RMB5,935,319.48; decreased deferred gain of RMB5,935,319.48; increased administrative expenses of RMB423,819.09, increased deferred gain of RMB423,819.09; decreased taxes payable-income tax payable of RMB11,202.40, decreased income tax of RMB11,202.40; decreased net profit of RMB412,616.69 and accumulatively increased undistributed profit of RMB899,833.32.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Cash and Cash Equivalents

Items	At 31 December 2007		At 31 December 2006	
	Foreign Currency	RMB	Foreign Currency	RMB
Cash:	–	1,059,311.52	–	601,786.29
RMB	–	964,072.57	–	390,030.21
HKD	36,167.64	33,866.65	37,717.64	37,894.91
USD	2,814.15	20,556.24	17,680.15	138,058.99
IRD	390,000.00	390.00	390,000	332.86
EUR	3,789.86	40,426.06	3,454.86	35,469.32
Bank deposit:	–	363,391,576.90	–	164,004,046.31
RMB	–	326,340,014.24	–	136,722,811.17
HKD	30,773,494.90	28,815,685.28	24,662,913.23	24,778,828.92
USD	1,097,358.84	8,015,767.38	320,463.87	2,502,406.22
EUR	20,634.86	220,110.00	–	–
Other currencies:	–	5,899,900.00	–	2,188,430.03
RMB	–	5,899,900.00	–	2,188,430.03
Total	–	<u>370,350,788.42</u>	–	<u>166,794,262.63</u>

Compared with the beginning of the reporting period, the cash and cash equivalents increased 122.04% due to sales increase significantly.

2. Bills receivable

Types of receivable bills

Items	At 31 December 2007	At 31 December 2006
Bank acceptance notes	134,784,345.56	50,360,390.23
Commercial acceptance notes	–	1,771,000.00
Total	<u>134,784,345.56</u>	<u>52,131,390.23</u>

Note: bills receivable increased 158.55% due to sales revenue increased largely during the period.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

3. Accounts receivable

(1) Account aged analysis

Account aged analysis	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Within one year	147,679,052.75	64	7,341,005.32	120,848,831.28	63.24	4,360,776.01
1-2 years	30,801,988.03	13	15,239,618.97	28,023,833.06	14.66	11,859,964.65
2-3 years	18,630,583.51	8	18,502,888.51	19,406,818.76	10.16	17,530,793.76
Over 3 years	35,407,907.14	15	35,407,907.14	22,823,804.29	11.94	22,568,804.29
Total	<u>232,519,531.43</u>	<u>100</u>	<u>76,491,419.93</u>	<u>191,103,287.39</u>	<u>100</u>	<u>56,320,338.71</u>

(2) Accounts receivable by customer type

Item	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Individual significant amount accounts receivable	-	-	-	-	-	-
Individual not significant amount accounts receivable with similar credit risk characteristics	-	-	-	-	-	-
Other not significant accounts receivable	232,519,531.43	100.00	76,491,419.93	191,103,287.39	100.00	56,320,338.71
Total	<u>232,519,531.43</u>	<u>100.00</u>	<u>76,491,419.93</u>	<u>191,103,287.39</u>	<u>100.00</u>	<u>56,320,338.71</u>

Total amount of top five accounts receivables is RMB21,840,182.20, representing 9.36% of the total amount of accounts receivables of the year.

There is no individual significant amount of accounts receivable due from shareholders whose shares exceed 5% (or 5%) of the total shares of the Company during the reporting period.

4. Other receivables

(1) Account aged analysis

Account aged analysis	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Within one year	17,778,832.19	38.68	3,627,594.25	13,030,180.86	44.28	1,014,499.24
1-2 years	16,588,575.07	36.09	9,305,512.28	4,965,296.51	16.87	2,440,014.79
2-3 years	7,721,275.37	16.80	7,721,275.37	7,727,086.60	26.26	7,727,086.60
Over 3 years	3,875,046.72	8.43	3,875,046.71	3,704,097.27	12.59	3,704,097.27
Total	<u>45,963,729.35</u>	<u>100</u>	<u>24,529,428.61</u>	<u>29,426,661.24</u>	<u>100</u>	<u>14,885,697.90</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Other receivables (Continued)

Item	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Individual significant amount accounts receivable	11,460,955.08	24.93	2,795,752.51	5,915,072.66	20.10	1,239,784.16
Individual not significant amount accounts receivable with similar credit risk characteristics	-	-	-	-	-	-
Other not significant accounts receivable	34,502,774.27	75.07	21,733,676.10	23,511,588.58	79.90	13,645,913.74
Total	45,963,729.35	100.00	24,529,428.61	29,426,661.24	100.00	14,885,697.90

Total amount of top five other receivables is RMB8,076,178.04, representing 17.57% of the total amount of other receivables of the year.

Other receivables increased 47.41% as compared with the beginning of the period due to sales revenue increased largely.

There is other receivables due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company during the reporting period.

5. Prepayments

Aged analysis	At 31 December 2007		At 31 December 2006	
	Amount	Proportion (%)	Amount	Proportion (%)
Within one year	33,733,536.48	81	35,161,401.17	81
1-2 years	5,257,836.36	13	7,726,604.31	18
2-3 years	2,323,971.10	6	40,794.50	-
Over 3 years	121,279.78	-	469,132.39	1
Total	41,436,623.72	100	43,397,932.37	100

There is prepayment due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company during the reporting period.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Inventories

(1) Category of inventories

Items	At 31 December 2007			At 31 December 2006		
	Account Balance	Provision	Net realizable value	Account Balance	Provision	Net realizable value
Raw materials	93,233,602.90	5,674,852.93	87,558,749.97	64,574,957.94	6,410,009.63	58,164,948.31
Turnover materials	5,697,635.02	82,781.00	5,614,854.02	3,874,635.15	82,781.00	3,791,854.15
Work in progress	261,332,170.65	6,461,004.32	254,871,166.33	175,710,877.13	6,277,441.75	169,433,435.38
Finished goods	78,215,906.27	7,935,274.62	70,280,631.65	61,514,282.26	10,450,070.36	51,064,211.90
Good sold	243,838.80	40,080.83	203,757.97	2,080,733.83	2,080,733.83	-
Consigned processing materials	8,893,351.63	-	8,893,351.63	1,464,306.93	-	1,464,306.93
Total	<u>447,616,505.27</u>	<u>20,193,993.70</u>	<u>427,422,511.57</u>	<u>309,219,793.24</u>	<u>25,301,036.57</u>	<u>283,918,756.67</u>

Inventories increased 44.76% as compared with the beginning of the year due to the production increased.

7. Available-for-sale financial assets

Items	Unit: RMB	
	Fair value at 31 December 2007	Fair value at 31 December 2006
Available-for-sale equity instruments	-	11,902,402.80
Total	<u>-</u>	<u>11,902,402.80</u>

On February 23, 2004, the Company entered into an agreement with China Fortune Securities ("China Fortune") for the trusteeship of the management of investment in state bonds ("the Trusteeship Agreement") pursuant to which the Company entrusted China Fortune to conduct investment on state bonds with RMB50,000,000.00 (the "Fund") for one year. However, China Fortune failed to comply with the Trusteeship Agreement to invest in state bonds but using the Fund to invest in stocks and incurred huge losses. In August 2006, China Fortune was performed the liquidation work in accordance with the decision made by China Securities Regulation Commission. As at 31st December, 2006, the Company has recognized an impairment loss of RMB38,100,000.00 for the Fund. At the beginning of August, 2007, the Company applied to unfreeze the Company's capital account in China Fortune Beijing Operating Department. On August 13, 2007, the Company took back RMB32,030,000.00 of the Fund (The Company has received the Fund proceeds of RMB4,250,000.00 from China Fortune on March 1, 2004. Thus, the Company totally took back RMB36,280,000.00 of the Fund.). This issue increased the profit of RMB20,725,500 for the year.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Long-term equity investment

(1) Proportion of investment and voting rights

Name of invested company	Investment proportion (%)	Proportion of voting rights in invested company (%)	Remark
TOS Kunming	50.00%	50.00%	–
Xi'an Ruite	23.34%	23.34%	–
Yunnan Cheng Jiang Copper Products Plant	40.00%	40.00%	–

(2) In accordance with cost method

Invested company	Initial investment cost	Opening balance	Increase/decrease	Closing balance	Unit: RMB Provision for diminution in value of long-term investment
Yunnan Cheng Jiang Copper Products Plant	2,000,000.00	2,000,000.00	–	2,000,000.00	2,000,000.00
Total	<u>2,000,000.00</u>	<u>2,000,000.00</u>	<u>–</u>	<u>2,000,000.00</u>	<u>2,000,000.00</u>

(3) In accordance with equity method

Invested company	Initial investment cost	Opening balance	Increase/decrease	Closing balance	Provision for diminution in value of long-term investment
TOS Kunming	24,739,533.99	25,341,128.79	4,967,612.74	30,308,741.53	–
Xi'an Ruite	10,000,000.00	10,000,000.00	4,011,818.76	14,011,818.76	–
Total	<u>34,739,533.99</u>	<u>35,341,128.79</u>	<u>8,979,431.50</u>	<u>44,320,560.29</u>	<u>–</u>

Note:

- (1) Full provision for impairment loss on long-term investment of Yunnan Cheng Jiang Copper Products Plant was made because the plant has lost of the ability of sustainable operation.
- (2) There is no significant difference between the accounting policies used by the invested companies and that used by the Company. There is no significant restriction to realization of investment and investment income outflow as foreign currency.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Fixed assets

Items	At 31 December 2006	Increase in the period	Decrease in the period	At 31 December 2007
1. Fixed assets at cost	571,146,028.54	87,880,242.17	27,919,284.54	631,106,986.17
Including: building and constructions	228,567,553.26	33,884,310.98	414,747.79	262,037,116.45
Machinery equipments	279,947,646.28	41,270,555.37	14,109,434.27	307,108,767.38
Transportation equipments	22,497,491.01	6,768,655.98	3,402,377.73	25,863,769.26
Electronic equipments	40,133,337.99	5,956,719.84	9,992,724.75	36,097,333.08
2. Accumulate depreciation	211,099,118.62	28,787,646.29	19,330,781.73	220,555,983.18
Including: building and constructions	40,405,219.87	7,364,626.34	53,694.60	47,716,151.61
Machinery equipments	134,986,465.30	16,321,218.40	8,231,368.23	143,076,315.47
Transportation equipments	9,068,322.54	2,304,200.65	2,140,723.28	9,231,799.91
Electronic equipments	26,639,110.91	2,797,600.90	8,904,995.62	20,531,716.19
3. Net book value	360,046,909.92	59,092,595.88	8,588,502.81	410,551,002.99
Including: building and constructions	188,162,333.39	26,519,684.64	361,053.19	214,320,964.84
Machinery equipments	144,961,180.98	24,949,336.97	5,878,066.04	164,032,451.91
Transportation equipments	13,429,168.47	4,464,455.33	1,261,654.45	16,631,969.35
Electronic equipments	13,494,227.08	3,159,118.94	1,087,729.13	15,565,616.89
4. Provision for impairment	8,345,232.87	1,203,326.94	738,297.63	8,810,262.18
Including: building and constructions	-	-	-	-
Machinery equipments	7,937,239.57	421,563.39	519,929.31	7,838,873.65
Transportation equipments	-	-	-	-
Electronic equipments	407,993.30	781,763.55	218,368.32	971,388.53
5. Net realizable value	351,701,677.05	57,889,268.94	7,850,205.18	401,740,740.81
Including: building and constructions	188,162,333.39	26,519,684.64	361,053.19	214,320,964.84
Machinery equipments	137,023,941.41	24,527,773.58	5,358,136.73	156,193,578.26
Transportation equipments	13,429,168.47	4,464,455.33	1,261,654.45	16,631,969.35
Electronic equipments	13,086,233.78	2,377,355.39	869,360.81	14,594,228.36

Of the fixed assets, the evaluation of buildings and constructions for charge was RMB132,046,800.

10. Construction in progress

Item	Provision for impairment		Increase this year	Transfer to fixed assets	Amount of interests capitalization	Unit: RMB Provision for impairment	
	At 31 December 2006	at 31 December 2006				At 31 December 2007	at 31 December 2007
"Nine.Five" technology improvement projects	41,422.00	-	-	1,422.00	-	40,000.00	-
Canteen	-	-	899,500.00	-	-	899,500.00	-
New plant building	10,654,130.99	-	19,004,280.66	16,626,738.12	1,456,233.68	14,487,907.21	-
Cool workshop	1,301,677.00	-	1,321,479.00	2,623,156.00	-	-	-
Baobei city	1,751,402.00	-	-	-	-	1,751,402.00	-
Others	18,295,657.04	2,132,152.98	30,274,128.31	19,103,130.02	1,584,191.32	30,975,625.04	2,056,931.37
Total	32,044,289.03	2,132,152.98	51,499,387.97	38,354,446.14	3,040,425.00	48,154,434.25	2,056,931.37

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Intangible assets

Item	At 31 December 2006	Provision for impairment		Increase this year	Decrease this year	At 31 December 2007	Provision for impairment	
		at 31 December 2006					at 31 December 2007	
Use rights for Siyuan building-no.2	49,306,068.80	-		13,589.72	-	49,319,658.52	-	
Land use right	13,516,000.40	-		-	283,057.56	13,232,942.84	-	
Land use right	11,772,682.02	-		-	320,345.04	11,452,336.98	-	
Use rights for Siyuan building-no.3	8,312,216.40	-		-	-	8,312,216.40	-	
The all over vortex technology	5,814,999.80	-		-	1,163,000.04	4,651,999.76	-	
Intelligent electric appliance know-how	4,974,420.02	2,713,320.01		-	813,996.00	4,160,424.02	4,160,424.02	
Usage right to staff quarter	3,457,949.93	-		-	93,458.04	3,364,491.89	-	
Technical know-how of embroidery	2,323,453.26	2,323,453.26		-	-	2,323,453.26	2,323,453.26	
IMAG software	755,779.72	-		-	251,926.56	503,853.16	-	
Kingdee production management software	404,579.93	-		-	49,040.04	355,539.89	-	
Service for Kingdee production management software	-	-		280,000.00	11,666.65	268,333.35	-	
Kingdee software permit fee	288,331.99	-		-	38,688.60	249,643.39	-	
Office software	236,835.00	-		-	24,930.00	211,905.00	-	
Kingdee logistic software	200,400.08	-		-	27,783.00	172,617.08	-	
Mail system software	148,999.88	-		0.12	14,899.98	134,100.02	-	
ORACLE software	156,442.69	-		-	49,403.04	107,039.65	-	
Kingdee instrument for accounting standards for business enterprises	-	-		40,000.00	4,000.02	35,999.98	-	
Financial software	-	-		5,000.00	916.63	4,083.37	-	
Website development	6,333.50	-		-	6,333.50	-	-	
Technical know-how of fast moulding	7,777,213.79	3,561,499.50		-	7,777,213.79	-	-	
Total	109,452,707.21	8,598,272.77		338,589.84	10,930,658.49	98,860,638.56	6,483,877.28	

12. Deferred tax assets

Reasons for coursing deferred tax assets	Unit: RMB	
	31 December 2007	31 December 2006
Bad debt provision	17,202,496.60	12,519,685.93
Impairment of available-for-sale financial assets	-	5,714,639.58
Provision for impairment of inventories	4,052,851.23	4,759,868.89
Provision for impairment of fixed assets	578,502.55	670,370.47
Provision for impairment of construction in progress	514,232.84	533,038.25
Provision for diminution in value of long term equity investment	500,000.00	1,146,448.36
Contingent liabilities	1,367,858.22	533,184.02
Depreciation of fixed assets	35,619.80	-
Long term deferred expenses	2,375.70	-
Unrealized internal profit	1,740,934.63	2,358,539.61
Income tax on early retirement salaries	4,942,324.47	5,439,990.14
Issue VAT invoice in advance	4,341,338.47	-
Government grants	277,500.00	-
Total	35,556,034.52	33,675,765.24

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Short-term loans

Item	At 31 December 2007	At 31 December 2006
Secured loans	–	40,000,000.00
Total	–	40,000,000.00

14. Accounts payable

Item	At 31 December 2007	At 31 December 2006
Accounts payable	130,879,524.76	113,675,973.10

Shareholders whose shares exceed 5% (including 5%) of the total shares of the Company have not owed any amount in accounts payable during the period.

15. Advances from customers

Item	At 31 December 2007	At 31 December 2006
Advances from customers	432,062,138.47	218,325,953.57

Advances from customers increased 97.90% as compared with the beginning of the year due to the order increased.

Shareholders whose shares exceed 5% (including 5%) of the total shares of the Company have not owed any amount in advances from customers during the period.

16. Accrued salary

Items	At 31 December 2006	Increase this period	Decrease this period	At 31 December 2007
1. Salary, bonus, subsidy and grants	6,885,445.27	127,675,731.19	117,818,101.32	16,743,075.14
2. Employees benefits	3,977,824.89	8,265,598.99	12,243,423.88	–
3. Social insurance	–	19,624,771.70	20,291,984.02	(667,212.32)
Of which: Medical insurance	–	6,294,900.76	6,342,918.07	(48,017.31)
Defined contribution	–	12,298,470.40	12,710,159.61	(411,689.21)
Annuity	–	–	–	–
Unemployment insurance	–	1,291,447.68	1,498,953.48	(207,505.80)
Industrial injury insurance	–	512,613.77	512,613.77	–
Birth insurance	–	564,971.17	564,971.17	–
4. Housing fund	–	8,606,891.00	7,195,787.00	1,411,104.00
5. Union expenses and employees education expenses	–	6,283,515.42	1,497,552.33	4,785,963.09
6. non-monetary benefit	–	–	–	–
7. Compensation for releasing labouring service contract	23,088,149.43	–	3,289,442.77	19,798,706.66
8. Others	–	–	–	–
Total	33,951,419.59	169,997,596.29	161,877,379.31	42,071,636.57

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

17. Taxes payable

Items	At 31 December 2007	At 31 December 2006
Value-add tax	32,156,920.07	12,500,830.04
Resource tax	–	–
Sales tax	144,229.74	190,735.38
Consumption tax	–	–
City construction tax	966,000.93	239,034.78
House taxes	1,701,323.56	671,108.51
Vehicle and vessel usage tax	–	–
Land use tax	32,827.48	32,827.48
Personal income tax	603,078.11	158,590.57
Income tax	31,758,318.22	14,602,753.93
Others	578,479.32	–
Total	<u>67,941,177.43</u>	<u>28,395,880.69</u>

18. Other payables

Items	At 31 December 2007	At 31 December 2006
Other payables	<u>64,694,849.97</u>	<u>77,852,888.95</u>

Other payables of this period has no amount need to pay to shareholders who hold more than 5% (including 5%) shares of total share capital or associate parties.

19. Contingent liabilities

Items	At 31 December 2007	At 31 December 2006
Products' quality warrant fee	<u>9,117,430.70</u>	<u>3,554,560.13</u>
Total	<u>9,117,430.70</u>	<u>3,554,560.13</u>

20. Long-term loans

Items	At 31 December 2007	At 31 December 2006
Secured loan	<u>50,000,000.00</u>	<u>20,000,000.00</u>
Total	<u>50,000,000.00</u>	<u>20,000,000.00</u>

Note: Long-term loans have increased 150% during the period due to the fund invested in the technological renovation of the Company. The evaluation of the builds for charge was RMB132,046,800.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

21. Long-term payables

Items	At 31 December 2007	At 31 December 2006
1. obligation under finance lease	4,790,364.60	4,790,364.60
2. Appropriation for intelligent electronic machine industrialization exemplary project technology and equipment technology	7,000,000.00	7,000,000.00
3. Infrastructure construction Appropriation from the office of Finance of Shaanxi province	200,000.00	200,000.00
Total	<u>11,990,364.60</u>	<u>11,990,364.60</u>
Less: future finance expenses	<u>1,805,438.20</u>	<u>1,934,398.00</u>
Total	<u>10,184,926.40</u>	<u>10,055,966.60</u>

22. Specific Project Payables

Items	At 31 December 2006	Transfer in/out this period	Unit: RMB At 31 December 2007
Specific project appropriation from the Science and Technology Committee of Yunnan Province	3,211,680.50	3,211,680.50	–
Specific project appreciation for industrial automation from Shaanxi Provincial Development and Reform Commission	8,000,000.00	–	8,000,000.00
Specific project appreciation from Shaanxi Intellectual Property Office	<u>100,000.00</u>	<u>–</u>	<u>100,000.00</u>
Total	<u>11,311,680.50</u>	<u>–</u>	<u>8,100,000.00</u>

Specific project appropriation from the Science and Technology Committee of Yunnan Province was transferred to non-operating income during the year.

23. Deferred tax liabilities

Reasons for coursing deferred tax liabilities	At 31 December 2006	At 31 December 2007
Long term equity investment	<u>241,191.93</u>	<u>–</u>
Total	<u>241,191.93</u>	<u>–</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

24. Share capital

Item	At 31 December 2006	Increase of the year	Decrease of the year	At 31 December 2007
Unlisted circular shares	120,007,400.00	60,003,700.00	–	180,011,100.00
Promoter's shares	31,345,554.00	15,672,777.00	–	47,018,331.00
Of which: state-owned shares	31,345,554.00	15,672,777.00	–	47,018,331.00
Collected legal person shares	88,661,846.00	44,330,923.00	–	132,992,769.00
Listed circulating shares	125,000,000.00	119,853,783.00	–	244,853,783.00
Of which: Renminbi ordinary shares	60,000,000.00	72,137,883.00	–	132,137,883.00
Oversea listed foreign shares	65,000,000.00	47,715,900.00	–	112,715,900.00
Total shares	<u>245,007,400.00</u>	<u>179,857,483.00</u>	<u>–</u>	<u>424,864,883.00</u>

For details of the shares increase, please refer to the introduction of the Company.

25. Capital reserve

Item	At 31 December 2006	Increase this period	Decrease this period	At 31 December 2007
Share premium	305,280,480.12	–	179,857,483.00	125,422,997.12
Others	8,096,544.60	–	–	8,096,544.60
Total	<u>313,377,024.72</u>	<u>–</u>	<u>179,857,483.00</u>	<u>133,519,541.72</u>

Unit: RMB

Capital reserve decreased 57.40% as compared with the beginning of the period due to increase shares by transferring capital reserves. For details, please refer to the introduction of the Company.

26. Surplus reserve

Item	At 31 December 2006	Increase this period	Decrease this period	At 31 December 2007
Statutory surplus reserve	20,773,925.55	21,129,363.92	–	41,903,289.47
Total	<u>20,773,925.55</u>	<u>21,129,363.92</u>	<u>–</u>	<u>41,903,289.47</u>

Unit: RMB

27. Unappropriated profit

Item	Amount of the year 2007	Amount of the year 2006
Net profit	242,957,688.27	98,058,774.72
Add: unappropriated profit at the beginning of this year	57,263,089.40	(36,834,417.61)
Gain or loss directly record in shareholders' equity	–	–
Less: statutory surplus reserve	21,129,363.92	3,961,267.71
Unappropriated profit	<u>279,091,413.76</u>	<u>57,263,089.40</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

28. Operation revenue

Item	Amount of the year 2007	Amount of the year 2006
Principal operation revenue	1,295,795,259.46	848,419,448.35
Other operation revenue	6,590,368.21	3,619,317.68
Total	<u>1,302,385,627.67</u>	<u>852,038,766.03</u>

Item	Amount of the year 2007	Amount of the year 2006
Sales of machine tool products	941,730,649.52	570,474,372.61
Sales of high-effective energy-saving compressors	233,544,300.54	177,025,679.48
Sales of new products	33,682,054.95	20,962,248.42
Processing services	42,309,122.48	51,074,384.96
Sales of embroidery machines	–	3,418,165.68
Sales of intelligent electric appliance	6,900,247.99	7,110,202.83
Sales of laser prototyping system	–	7,951,709.42
Sales of sensor equipment	17,564,111.42	2,202,783.67
Revenue of transportation	20,432,695.86	–
Sales of materials	2,961,549.29	2,854,034.14
Leasing	456,285.10	37,200.00
Technology service	10,600.00	2,386,379.43
Other sales	2,794,010.52	6,541,605.39
Total	<u>1,302,385,627.67</u>	<u>852,038,766.03</u>

Operation revenue of the Company increased 52.86% as compared with last year due to production increase and market share increase in the year 2007.

Total sales revenue due from the 5 largest customers was up to RMB126,488,162.20 which constitutes 9.71% of total sales of the Group.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

29. Operation cost

Item	Amount of the year 2007	Amount of the year 2006
Principal business cost	830,310,475.57	581,679,813.21
Other business cost	4,125,808.38	1,962,845.80
Total	<u>834,436,283.95</u>	<u>583,642,659.01</u>

Item	Amount of the year 2007	Amount of the year 2006
Cost of sales of machine tool products	595,028,492.93	411,455,290.07
Cost of sales of high-effective energy-saving compressors	178,575,276.43	129,956,619.35
Cost of sales of new products	–	–
Processing services	20,101,832.67	23,669,903.30
Cost of sales of embroidery machines	–	3,254,712.79
Cost of sales of intelligent electric appliance	3,931,614.14	3,163,951.11
Cost of sales of laser prototyping system	–	6,417,756.36
Cost of sales of sensor equipment	15,255,650.07	2,297,922.81
Cost of revenue of transportation	17,921,870.16	–
Cost of sales of materials	3,154,760.15	1,640,269.61
Cost of leasing	275,571.78	226,601.19
Cost of technology service	–	95,975.00
Cost of other sales	191,215.62	1,463,657.42
Total cost	<u>834,436,283.95</u>	<u>583,642,659.01</u>

30. Operation Tax and Addition

Item	Amount of the year 2007	Amount of the year 2006
Sales tax	556,241.90	46,976.53
City construction tax	1,485,864.89	947,472.71
Education fee addition	774,731.84	475,424.66
Total	<u>2,816,838.63</u>	<u>1,469,873.90</u>

31. loss on assets impairment

Item	Amount of the year 2007	Amount of the year 2006
Bad debt provision	30,947,548.23	16,500,333.47
Provision on impairment loss on inventories	(5,107,042.87)	(5,730,887.66)
Provision on impairment loss on investment held-to-maturity	–	–
Provision on diminution on long term equity investment	–	580,623.63
Provision on impairment loss on fixed assets	465,029.31	1,119,904.93
Provision on impairment loss on construction-in-progress	–	313,663.88
Provision on impairment loss on intangible assets	1,447,104.01	1,733,371.75
Total	<u>27,752,638.68</u>	<u>14,517,010.00</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

32. Finance Expenses

Item	Amount of the year 2007	Amount of the year 2006
Interest expense	1,617,993.66	6,095,994.69
Less: interest income	2,632,845.36	1,601,495.67
Exchange loss/gain	4,029,856.03	1,208,549.73
Unrecognized finance expenses	1,227,768.77	–
Bank charges	449,055.33	171,548.98
Others	–	128,959.80
Total	<u>4,691,828.43</u>	<u>6,003,557.53</u>

33. Investment Income

Invested companies	Amount of the year 2007	Amount of the year 2006
TOS Kunming	4,967,017.01	(353,043.85)
Xi'an Ruite	11,818.81	–
Available-for-sale financial assets (wealth management)	24,382,945.80	–
Gain from wealth management	69,041.10	–
Debenture	–	261,277.66
Investment fund	–	234,516.02
Loss on sale of Hengtong	(1,388,083.31)	–
Total	<u>28,042,739.41</u>	<u>142,749.83</u>

34. Non-operating Income

Item	Amount of the year 2007	Amount of the year 2006
Total gain on disposal of non-current assets	603,031.85	169,121.32
Of which: gain on disposal of fixed assets	603,031.85	169,121.32
Return of value-add tax	16,130,092.56	3,000,762.73
Land use fees reduction or exemption	3,197,608.00	2,484,285.00
Transfer special fund from science & technology commission	3,211,680.50	755,637.00
Others	2,222,274.78	–
Total	<u>25,364,687.69</u>	<u>6,409,806.05</u>

Return of value-add tax included: in accordance with the "Notice of "Pay first, refund later" method for value added tax for numerical control machine products" by the Ministry of Finance & State Administration of Taxation (No. [2006] 149), from January 1, 2006 to December 31, 2008, for numerical control machines products, the value added tax should be paid first in accordance with the regulations, and then 50% of the paid value added tax will be refunded. The Company has enjoyed this preferential policy from year 2006 to year 2008 (The Company had got this preferential policy from year 2003 to year 2005, and had valued added tax refund of RMB2 million per year.) The tax refund is used for the specified purpose for technology innovation, environment protection, developing energysaving products and numerical control machine products. According to this policy and relevant regulations, the value-add tax refund will be determined by the actual paid value-add tax. This policy has the positive effect to the results of the year 2007, to increase the total profit of RMB15,722,278.14.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

35. Non-operating Expenses

Item	Amount of the year 2007	Amount of the year 2006
Total loss on disposal non-current assets	1,874,551.53	2,239,996.49
Of which: loss on disposal fixed assets	1,829,186.07	2,239,996.49
Donation	20,522.70	20,300.00
Fines	167,200.00	–
Others	8,842,351.31	71,309.10
Total	<u>10,904,625.54</u>	<u>2,331,605.59</u>

36. Income tax expenses

Item	Amount of the year 2007	Amount of the year 2006
Income tax expenses for the period	47,825,410.60	15,068,558.77
Deferred income tax	(2,121,461.20)	1,853,744.29
Total	<u>45,703,949.40</u>	<u>16,922,303.06</u>

37. Gain (loss) on non-recurring items

Item	Effected after-tax amount
Insurance indemnities	128,502.28
Return of value-add tax	16,041,596.83
Government grants	4,018,217.41
Gain on disposal fixed assets	508,422.03
Written back provision on impairment loss of inventories	546,119.16
Gain on investment from wealth management	20,725,503.96
Other income	66,815.46
Fines	(165,630.68)
Loss on disposal non-current assets	(1,580,069.73)
Donation	(20,522.70)
Late fee	(553,319.45)
Loss on stand-down by the builder during the progress in construction	(6,448,675.15)
Total	<u>33,266,959.42</u>
Net profit attributable to equity shareholders of the Company	242,957,688.27
Net profit excluding non-recurring items attributable to equity shareholders of the Company	<u>209,690,728.85</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

IX. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

38. Cash and cash equivalent

Item	Amount of the year 2007	Amount of the year 2006
Cash	370,350,788.42	143,507,132.60
Of which: cash on hand	1,059,311.52	601,786.29
Bank deposit available to withdraw at any time	363,391,576.90	142,905,346.31
Other currency available to withdraw at any time	5,899,900.00	–
Cash equivalents	553,623.03	–
Of which: bonds investment mature within 3 months	–	–
Cash and cash equivalents	370,904,411.45	143,507,132.60

39. Other Cash Paid Relating to Operating Activities:

Item	Amount of the year 2007
Installation fee	1,274,964.56
Warrant fee	1,013,978.99
Office expense	7,762,357.38
Package fee	64,664.77
Insurance fee	1,171,844.94
Business traveling expense	12,294,677.27
Telephone expense	406,326.04
Board of directors and supervisory committee expense	311,165.82
Leasing expense	2,747,627.40
Listing management fee	2,280,390.29
Advertising and exhibition fee	1,784,983.94
Conference fee	189,285.50
Labor protection fee	53,811.99
Labor insurance fee	178,819.23
Pollutant discharge fee	175,762.00
Vehicles maintenance fee	1,107,666.21
Repair and maintenance fee	325,693.91
Research & development fee	2,742,022.32
Design fee	–
Communication fee	739,448.37
Compensation fee for Land loss	1,192,507.10
Entertainment fee	2,680,743.82
Service fee due to acceptance of a bid	6,300,376.00
Human resource administration fee	158,667.71
Auditing and evaluation fee	2,775,649.40
Consultation fee	268,536.12
Total amounts of Quanzhou branch	1,985,512.10
Others	9,723,822.93
Total	61,711,306.11

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

X. NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY

1. Bills receivable

Items	At 31 December 2007	At 31 December 2006
Bank acceptance notes	88,342,942.50	30,149,988.21
Commercial acceptance notes	–	–
Total	<u>88,342,942.50</u>	<u>30,149,988.21</u>

Note: Bills receivable has increased 193.02% as compared with the beginning of the year due to sales revenue increased significantly.

2. Accounts receivable

(1) Account aged analysis

Account aged analysis	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Within one year	110,201,209.19	69.86	5,510,060.46	82,007,539.236	68.86	2,600,087.25
1-2 years	20,659,851.95	13.10	10,329,925.98	12,854,514.11	10.79	4,952,655.17
2-3 years	7,171,514.21	4.55	7,171,514.21	7,232,469.05	6.07	6,740,844.05
Over 3 years	19,709,632.61	12.49	19,709,632.61	17,002,579.40	14.28	16,752,579.40
Total	<u>157,742,207.96</u>	<u>100.00</u>	<u>42,721,133.25</u>	<u>119,097,101.79</u>	<u>100.00</u>	<u>31,046,165.87</u>

(2) Accounts receivable by customer type

Item	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Individual significant amount accounts receivable	–	–	–	–	–	–
Individual not significant amount accounts receivable with similar credit risk characteristics	–	–	–	–	–	–
Other not significant accounts receivable	157,742,207.96	100.00	42,721,133.25	119,097,101.79	100.00	31,046,165.87
Total	<u>157,742,207.96</u>	<u>100.00</u>	<u>42,721,133.25</u>	<u>119,097,101.79</u>	<u>100.00</u>	<u>31,046,165.87</u>

There is no accounts receivable due from shareholders whose shares exceed 5% (or 5%) of the total shares of the Company during the reporting period.

The total amount of accounts receivable increased 32.45% as compared with the beginning of the year due to sales revenue increased significantly during the year.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

X. NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (Continued)

3. Other receivables

(1) Account aged analysis

Account aged analysis	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Within one year	19,847,005.27	49.29	992,350.26	10,662,989.77	36.52	507,899.70
1-2 years	19,967,514.55	49.59	17,061,698.03	18,162,783.12	62.21	7,326,925.50
2-3 years	93,078.29	0.23	93,078.29	279,464.40	0.96	279,464.40
Over 3 years	355,715.75	0.88	355,715.75	92,211.55	0.32	92,211.55
Total	<u>40,263,313.86</u>	<u>100.00</u>	<u>18,502,842.33</u>	<u>29,197,448.84</u>	<u>100.00</u>	<u>8,206,501.15</u>

(2) Other receivables by customer type

Item	At 31 December 2007			At 31 December 2006		
	Book value Amount	Proportion (%)	Bad debt provision	Book value Amount	Proportion (%)	Bad debt provision
Individual significant amount of accounts receivable	9,092,730.99	22.58	850,032.93	3,831,769.11	13.12	191,588.46
Individual not significant amount of accounts receivable with similar credit risk characteristics	-	-	-	-	-	-
Other not significant accounts receivable	31,170,582.87	77.42	17,652,809.40	25,365,679.73	86.88	8,014,912.69
Total	<u>40,263,313.86</u>	<u>100.00</u>	<u>18,502,842.33</u>	<u>29,197,448.84</u>	<u>100.00</u>	<u>8,206,501.15</u>

There is no other receivables due from shareholders whose shares exceed 5% (or 5%) of the total shares of the Company during the reporting period.

The total amount of other receivables increased 30.63% as compared with the beginning of the year due to impress cash increased by sales revenue increase significantly during the year.

4. Prepayments

Account aged analysis	At 31 December 2007		At 31 December 2006	
	Amount	Proportion (%)	Amount	Proportion (%)
Within one year	8,521,867.47	89.28	1,129,000.47	12.24
1-2 years	905,817.86	9.49	7,632,324.31	82.71
2-3 years	-	-	-	-
Over 3 years	117,179.78	1.23	466,032.39	5.05
Total	<u>9,544,865.11</u>	<u>100.00</u>	<u>9,227,357.17</u>	<u>100.00</u>

There is no prepayment due from shareholders whose shares exceed 5% (or 5%) of the total shares of the Company during the reporting period.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

X. NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (Continued)

5. Available-for-sale financial assets

Items	Fair value at 31 December 2007	Fair value at 31 December 2006
Available-for-sale equity instruments	–	11,902,402.80
Total	–	11,902,402.80

6. Long term investment

(1) Information regarding the shareholding proportion and voting right in the invested company

Invested Company	Shareholding proportion in the invested company	Voting rights proportion in the invested company	Explanation of shareholding proportioning and voting rights proportion inconsistent in the invested company
Si'an Ser	45.00%	45.00%	
Siyuan	78.03%	78.03%	
TOS Kunming	50.00%	50.00%	
Kunji Transportation Co.	100.00%	100.00%	
Xi'an Ruite	23.34%	23.34%	
Yunnan Cheng Jiang Copper Products Plant	40.00%	40.00%	
Winko	96.74%	96.74%	
Kunji General-purpose equipment Co.	100.00%	100.00%	

(2) In accordance with cost method

Invested company	Initial investment cost	Opening balance	Increase/ decrease	Closing balance	Provision for diminution in value of long-term investment
Xi'an Ser	21,693,265.85	21,693,265.85	–	21,693,265.85	–
Siyuan	27,310,000.00	27,310,000.00	–	27,310,000.00	19,330,000.00
Kunji Transportation Co.	500,000.00	500,000.00	–	500,000.00	–
Winko	19,341,544.85	19,341,544.85	–	19,341,544.85	19,341,544.85
Yunnan Cheng Jiang Copper Products Plant	2,000,000.00	2,000,000.00	–	2,000,000.00	2,000,000.00
Kunji General-purpose Equipment Co.	3,000,000.00	–	3,000,000.00	3,000,000.00	–
Shaanxi Hengtong	24,442,315.79	24,442,315.79	(24,442,315.79)	–	–
Total	98,287,126.49	95,287,126.49	(21,442,315.79)	73,844,810.70	40,671,544.85

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

X. NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (Continued)

6. Long term investment (Continued)

(3) In accordance with equity method

Invested company	Initial investment cost	Opening balance	Increase/decrease	Closing balance	Provision for diminution in value of long-term investment
TOS Kunming	24,739,533.99	25,341,128.79	4,967,612.74	30,308,741.53	-
Xi'an Ruite	10,000,000.00	10,000,000.00	4,011,818.76	14,011,818.76	-
Total	<u>34,739,533.99</u>	<u>35,341,128.79</u>	<u>8,979,431.50</u>	<u>44,320,560.29</u>	<u>-</u>

Long term equity investment increased due to recognize investment gain based on equity method.

7. Deferred tax assets

Reasons for coursing deferred tax assets	Unit: RMB	
	At 31 December 2007	At 31 December 2006
Bad debt provision	13,890,405.76	9,628,429.81
Impairment of available-for-sale financial assets	-	5,714,639.58
Impairment of inventories	3,345,775.79	4,227,912.09
Provision for impairment of fixed assets	578,502.55	670,370.47
Provision for impairment of construction-in-progress	514,232.84	533,038.25
Provision for diminution of long term equity investment	8,234,886.21	8,367,163.52
Contingent liabilities	1,367,249.19	533,184.02
Early retirement	4,942,324.47	5,439,990.14
Issued VAT invoice in advance	4,341,338.47	-
Government Grands (defferred gain)	277,500.00	-
Total	<u>37,492,215.28</u>	<u>35,114,727.87</u>

8. Operation revenue

Item	Amount of the year 2007	Amount of the year 2006
Principal operation revenue	935,728,422.35	644,001,780.51
Other operation revenue	6,222,444.91	3,621,547.55
Total	<u>941,950,867.26</u>	<u>647,623,328.06</u>

Total sales revenue due from the 5 largest customers was up to RMB126,488,162.20 which constitutes 13.43% of total sales of the Company.

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

X. NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (Continued)

9. Operation cost

Item	<i>Unit: RMB</i>	
	Amount of the year 2007	Amount of the year 2006
Cost of principal operation	565,186,503.25	436,875,592.93
Cost of other operation	3,536,657.02	–
Total	<u>568,723,160.27</u>	<u>436,875,592.93</u>

XI. RELATED PARTIES AND TRANSACTIONS

1. Details of Related Parties with Control Relationship

(1) Related Parties with Control Relationship

Name	Relationship with the Company	Nature	Place of registration	Scope of business	Legal representative
Shenyang Machine Tool (Group) Company Limited ("Shenyang Group")	the largest substantial shareholder	Limited liability	Shenyang City	Production of metal-cutting machines, digital controlled software and machine accessories; General business trading and technology trading within PRC.	Chen Hui Ren
Xi'an Ser	Subsidiary	Limited liability	Xi'an City	Design, develop and sales of turbo-machinery	Wang Shangjin
Shaanxi Hengtong	Subsidiary	Limited liability	Xi'an City	Develop and sales of manufacturing moulds, machinery, equipment, electronic products, software and hardware.	Lu Bingheng
Siyuan	Subsidiary	Limited liability	Xi'an City	Develop, manufacture and sales of electronic products, electric machinery and products of electronic power; Provide technology services.	Zhang Hanrong
Winko	Subsidiary	Limited liability	Kunming City	Develop, apply and integrate hardware and software; retail, wholesale, purchase on behalf of others and consign electronic products, machinery and electronic machinery.	Zhang Hanrong
Kunji Transportation	Subsidiary	Limited liability	Kunming City	General cargo Transportation	Zhang Xiaoyi
Kunni General-purpose Equipment Co.	Subsidiary	Limited liability	Kunming City	Development, design, and sale of machine tool products and accessories	Gao Minghui

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XI. RELATED PARTIES AND TRANSACTIONS (Continued)

1. Details of Related Parties with Control Relationship (Continued)

(2) Registered Capital of Related Parties with Controlling Relationship

Company name	At 31 December 2006	Increase in this year	Decrease in this year	At 31 December 2007
Shenyang Group	1,556,480,000.00	-	-	1,556,480,000.00
Xi'an Ser	50,000,000.00	-	-	50,000,000.00
Siyuan	35,000,000.00	-	-	35,000,000.00
Winko	20,230,000.00	-	-	20,230,000.00
Kunji Transportation	500,000.00	-	-	500,000.00
Kunji General-Purpose Equipment Co.	-	3,000,000.00	-	3,000,000.00

(3) Shares and Equity held by Related Parties with Controlled Relationship

Company name	At 31 December 2006			At 31 December 2007		
	Amount	Proportion (%)	Increase in this year	Decrease in this year	Amount	Proportion (%)
Shenyang Group	71,052,146.00	29.00	35,526,073.00	-	106,578,219.00	25.09
Xi'an Ser	22,500,000.00	45.00	-	-	22,500,000.00	45.00
Heng Tong	18,270,000.00	65.34	-	18,270,000.00	-	-
Siyuan	27,310,000.00	78.03	-	-	27,310,000.00	78.03
Winko	19,570,000.00	96.74	-	-	19,570,000.00	96.74
Kunji Transportation	500,000.00	100.00	-	-	500,000.00	100.00
Kunji General-Purpose Equipment Co.	-	-	3,000,000.00	-	3,000,000.00	100.00

2. Related Parties without Controlling Relationship

Company name	Relationship with the Company
TOS Kunming	Joint Venture
Xi'an Ruite	Associated company
Yunnan CY Group Company Ltd. Products Trading Center ("CY Group Products Trading Center")	Subsidiary of the first substantial shareholder of the Company
Yunnan Yunji Group Import and Export Co. Ltd.	Subsidiary of the first substantial shareholder of the Company
Kunji Group Co. Ltd.	Subsidiary of the second substantial shareholder of the Company

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XI. RELATED PARTIES AND TRANSACTIONS (Continued)

3. Information of Joint Venture and Associated Company

Invested Company	Registered Place	Nature of Business	Registered Capital	Shareholding proportion of the Company	Voting rights in the invested company
Joint Venture TOS Kunming	Yunnan, Kunming	Producing and sales of machine tool products	5 million Euros	50	50
Associated Company Xi'an Ruite	Xi'an City	Producing and sales of Laser Prototyping products	60,000,000	23.34	23.34

Invested company	Total assets at 31 December 2007	Total liabilities at 31 December 2007	Operation revenue of the year	Net profit of the year
Joint venture TOS Kunming	101,322,943.12	40,727,506.08	74,995,151.14	9,934,034.04

4. Transactions

(1) Sales of Goods

The Company sold goods at market value amount of RMB3,794.88 and RMB355,810.26 to related party Kunji Group in 2006.

The Company sold goods at market value amount of RMB9,804,937.62 and RMB3,938,628.50 to related party Tos Kunming in 2007 and 2006 respectively.

The Company sold goods at market value amount of RMB2,083,517.12 to related party Yunnan CY Group Products Trading Center in 2006.

The Company sold goods at market value amount of RMB2,397,435.89 to related party Yunnan CY Group Import and Export Co. in 2007.

(2) Provision and Receipt of Services

1) On 15th November, 1993, the Company entered into an agreement with Kunji Group Company relating to the provision of certain services to each other after the reorganization. Pursuant to this agreement, the Company agreed to provide certain public utility services available to the Company such as water and electricity to Kunji group Company, while Kunji Group agreed to provide certain services to the Company including property management, employee's medical services, education and administration of retired staff. Service fee is reviewed by both parties on an annual basis and is determined by reference first to the standards set by the relevant government department for that particular service. If there are no applicable State standards, the Company and Kunji Group Company will determine the service fee based on market price or transaction price at arm's length negotiation. The above transactions between Kunji Group and the Company in 2007 and 2006 are as follows:

Item	Year 2007	Year 2006
Property management fee paid to Kunji Group	739,661.44	956,461.15
Staff medical service fee paid to Kunji Group	75,000.00	75,000.00
Social and education service fee paid to Kunji Group	-	-
Administrative fee for retired staff	80,236.80	75,384.00
Total	894,898.24	1,106,845.15

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XI. RELATED PARTIES AND TRANSACTIONS (Continued)

4. Transactions (Continued)

(2) Provision and Receipt of Services (Continued)

- 2) the Company received consultation fee of RMB2,254,900.00 and RMB10,600.00 from the related party Tos Kunming in 2006,2007 respectively. Because of the consultation fee has included in the sales revenue (receive by 5% of the sales revenue) this year, thus, there is a big difference regarding the consultation fee between year 2006 and year 2007.

(3) Purchase of Goods

The Company purchased goods of RMB38,923,315.85 and RMB53,689,130.74 from related party TOS Kunming Machine in 2006 and 2007 respectively.

(4) Leases

The 16th meeting of the 4th term of board of directors held on 18th April, 2004 approved that "The Premise Rental Agreement" and "The Land Use Rental Agreement" signed in 2001 between the Company and Kunji Group Company and would be continued. According to the result passed at 26th session meeting of 4th term of board of directors, on August 17, 2005, the Company and Kunji Group entered into the agreements "The Rent Amendment Agreement of the Premises" and "The Rent Amendment Agreement of the Land Use Right", which stated that Kunji Group was authorized by Yunnan government to succeed the rights and obligations of the "The Premise Rental Agreement" and "The Land Use Rental Agreement" signed by Yunnan government in 2001 with the Company. The rental of premises and the rental of land use right would be adjusted to RMB850,080.00 and RMB1,320,000.00 respectively for each year during 2005 to 2007. The assets mentioned in the above agreements involved the leaseback of part of the premises and land use right from the Yunnan Government after the capital restructuring in 2001.

In 2006, the Company paid the rental of the premises and land use right at annual rent of RMB507,911.09 and RMB1,320,000.00 respectively.

In the year 2007, the Company paid the rental of the premises and land use right at annual rent of RMB490,059.10 and RMB1,320,000.00 respectively.

5. Accounts receivables and payables from related parties

Related parties	Item	At 31 December	At 31 December	Nature
		2007	2007	
TOS Kunming	Accounts payables	13,871,668.75	17,213,254.55	payment for goods
	Accounts receivables	5,653,902.25	4,960,475.33	payment for goods
	Other receivables	61,109.40	140,205.88	current account
Shenyang Group Shen Yi Co., Ltd. Electric Branch Co.	Accounts payables	5,994.00	-	payment for goods
CY Group Products Trading Center	Accounts payables	4,300.00	-	payment for goods
	Prepayment	-	81,700.00	payment for goods
	Advances from customers	286,000.00	(8,200.00)	payment for goods
Yunnan CY Group Jinhui Painting Factory	Accounts payables	10,929.00	-	payment for goods
Kunji Group	Other payables	894,898.23	1,349,716.22	unpay property administration fee
Xi'an Ruite	Other payables	-	10,000,000	payment for sale of Hengtong Equity

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XII. CONTINGENT EVENTS

There are no contingent events required to be disclosed in this year.

XIII. COMMITMENTS

1. Lease commitments:

1) Fixed assets by financial leases

Premises	At 31 December 2006	At 31 December 2007
Original cost	4,264,181.00	4,264,181.00
Accumulated depreciations	3,179,926.68	3,815,912.02
Provision on impairment	-	-
	<u> </u>	<u> </u>

2) The minimum lease payment in the future years

Remaining leasehold	Minimum lease payment
Within 1 year (including 1 year)	342,168.90
1-2 years (including 2 years)	342,168.90
2-3 years (including 3 years)	342,168.90
Over 3 years	<u>3,763,857.90</u>
Total	<u>4,790,364.60</u>

2. By 31st December, 2007, the unsettled L/C amount was RMB20,497,493.86, which the L/C was opened by the Company.

XIV. POST BALANCE SHEET EVENT

The 38th board meeting held on 3 April 2008 considered and passed the resolution: referred to the assets evaluation (total net assets evaluation of Siyuan at the basis date on 31 December 2007 was RMB10,950,000), the Company would sale its 78.02% equity interest of Siyuan by Yunnan Provincial Equity Exchange.

As at the date of the auditing report of the Company made, the assets evaluation report of Siyuan was approved by Shenyang State-owned Assets Supervision and Administration Commission. The 78.02% equity interest of Siyuan held by the Company has not been listed on the Yunnan Provincial Equity Exchange.

XV. SUPPLEMENTARY INFORMATION

1. Return on Net Assets and Earning Per Share

Profit during reporting period	Return on Net Assets(%)		Earning Per Share (RMB)	
	Fully diluted	Weighted average	Basic earning per share	Dulited earning per share
Net Profit attributable to equity shareholders of the Company	27.63	32.06	0.57	0.57
Net profit deducted extraordinary gain and loss attributable to the Company ordinary shareholders	<u>23.85</u>	<u>27.67</u>	<u>0.49</u>	<u>0.49</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION (Continued)

2. Details of Provision on Impairment Assets

Details of Provision on Impairment Assets (Consolidation)

Items	Balance at beginning of the period	Provision for this period	Decrease during the period			Balance at end of the period
			Recoverable	Other (derecognized)	Sub total	
一. Provision for bad debts	71,206,036.61	30,562,456.80	-	747,644.87	747,644.87	101,020,848.54
Include: receivable	56,320,338.71	23,411,460.80	-	3,240,379.58	3,240,379.58	76,491,419.93
Other receivable	14,885,697.90	7,150,996.00	-	(2,492,734.71)	(2,492,734.71)	24,529,428.61
二. Provision on impairment inventory	25,301,036.57	2,128,237.07	-	7,235,279.94	7,235,279.94	20,193,993.70
Include: Stock Merchandise	10,450,070.36	-	-	2,514,795.74	2,514,795.74	7,935,274.62
Raw material	6,410,009.63	-	-	735,156.90	735,156.90	5,674,852.73
三. Provision on impairment available for sale financial assets	38,097,597.20	-	-	38,097,597.20	38,097,597.20	-
四. Provision on impairment held-to-maturity	-	-	-	-	-	-
五. Provision on impairment long-term equity investment	2,000,000.00	-	-	-	-	2,000,000.00
六. Provision on impairment investment property	-	-	-	-	-	-
七. Provision on impairment fixed assets	8,345,232.87	1,203,326.94	-	738,297.63	738,297.63	8,810,262.18
Include: house, building	-	-	-	-	-	-
Machine equipment	7,937,239.57	1,392,951.92	-	519,929.31	519,929.31	8,810,262.18
Property	-	-	-	-	-	-
八. Provision on impairment engineering material	-	-	-	-	-	-
九. Provision on impairment construction in progress	2,132,152.98	-	-	75,221.61	75,221.61	2,056,931.37
十. Provision on impairment of production biological assets	-	-	-	-	-	-
incl: provision on impairment of maternity production biological assets	-	-	-	-	-	-
十一. Provision on impairment of an assets	-	-	-	-	-	-
十二. Provision on impairment intangible assets	8,598,272.77	1,447,104.01	-	3,561,499.50	3,561,499.50	6,483,877.28
Include: patent	2,713,320.01	1,447,104.01	-	-	-	4,160,424.02
Trademark	-	-	-	-	-	-
十三. Provision on impairment of goodwill	2,714,267.78	-	-	-	-	2,714,267.78
十四. Others	-	-	-	-	-	-
Total	158,394,596.78	35,341,124.82	-	50,455,540.75	50,455,540.75	143,280,180.85

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION (Continued)

2. Details of Provision on Impairment Assets (Continued)

Details of Provision on Impairment Assets (the Company)

Items	Balance at beginning of the period	Provision for this period	Decrease during the period			Balance at end of the period
			Recoverable	Other (derecognized)	Sub total	
一. Provision for bad debts	39,252,667.02	21,971,308.56	-	-	-	61,223,975.58
Include: receivable	31,046,165.87	11,674,967.38	-	-	-	42,721,133.25
Other receivable	8,206,501.15	10,296,341.18	-	-	-	18,502,842.33
二. Provision on impairment inventory	16,911,640.46	-	-	3,528,537.29	3,528,537.29	13,383,103.17
Include: Stock Merchandise	9,977,845.53	-	-	3,528,537.29	3,528,537.29	6,449,308.24
Raw material	3,058,111.54	-	-	-	-	3,058,111.54
三. Provision on impairment available for sale financial assets	38,097,597.20	-	-	38,097,597.20	38,097,597.20	-
四. Provision on impairment held-to-maturity	-	-	-	-	-	-
五. Provision on impairment long-term equity investment	37,743,492.34	13,370,376.11	-	10,442,323.60	10,442,323.60	40,671,544.85
六. Provision on impairment investment property	-	-	-	-	-	-
七. Provision on impairment fixed assets	2,681,481.88	75,221.62	-	442,693.29	442,693.29	2,314,010.21
Include: house, building	-	-	-	-	-	-
Machine equipment	2,554,144.60	75,221.62	-	224,324.97	224,324.97	2,405,041.25
Property	-	-	-	-	-	-
八. Provision on impairment engineering material	-	-	-	-	-	-
九. Provision on impairment construction in progress	2,132,152.98	-	-	75,221.61	75,221.61	2,056,931.37
十. Provision on impairment of production biological assets incl: provision on impairment of maternity production biological assets	-	-	-	-	-	-
十一. Provision on impairment of an assets	-	-	-	-	-	-
十二. Provision on impairment intangible assets	-	-	-	-	-	-
Include: patent	-	-	-	-	-	-
Trademark	-	-	-	-	-	-
十三. Provision on impairment goodwill	-	-	-	-	-	-
十四. Others	-	-	-	-	-	-
Total	136,819,031.88	35,416,906.29	-	52,586,372.99	52,586,372.99	119,649,565.18

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION (Continued)

3. Cash Flow Statement SUPPLEMENTARY

Cash Flow Statement SUPPLEMENTARY (Consolidation)

Items	Balance at the end of year 2007	Balance at the end of year 2006
1. Net Profit	242,957,688.27	98,058,774.72
Add: gain or loss from minor shareholder	8,520,798.05	9,482,874.07
Provision on impairment assets	27,752,638.68	14,517,010.00
Depreciation of fixed assets	29,177,104.49	29,050,089.26
Amortisation of intangible assets	3,308,116.51	4,620,131.59
Amortisation of long term deferred expenditure	197,494.83	(249,128.90)
Loss of disposal of fixed assets, intangible assets, long term assets	822,630.51	1,510,275.55
Loss of derecognition of fixed assets	396,508.93	398,074.69
Fair value loss	-	-
Financial expense	6,830,990.51	7,026,911.63
Loss from investment	(28,042,739.41)	586,923.83
Decrease in deferred income tax assets	(1,880,269.28)	(33,675,765.24)
Decrease in deferred income tax liabilities	(241,191.93)	2,466,784.81
Decrease in inventory	(151,953,685.63)	(558,421,442.56)
Decrease in receivable from operating activities	(176,244,474.96)	464,951,248.69
Increase in payables from operating activities	293,933,713.63	57,346,722.72
Other	9,514,976.72	-
Net cash flows from operating activities	265,050,299.92	97,669,484.86
2. Significant investment and financing activities without involved in cash receive and pay	-	-
Debt into Capital	-	-
Convertible debenture due within one year	-	-
Leasing fixed assets in finance	4,264,181.00	4,264,181.00
3. Net increase in cash and cash equivalents	-	-
Cash and bank balance at the end of year	370,350,788.42	143,507,132.60
Less: cash and bank balance at the beginning of year	143,507,132.60	157,726,606.62
Add: Cash Equivalent at the end of the year	553,623.03	-
Less: Cash Equivalent at the end of the year	-	-
Net Cash flow from finance activities	<u>227,397,278.85</u>	<u>(14,219,474.02)</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION (Continued)

3. Cash Flow Statement SUPPLEMENTARY (Continued)

Cash Flow Statement SUPPLEMENTARY (the Company)

Items	Balance at the end of year 2007	Balance at the end of year 2006
1. Net Profit	211,293,639.21	91,348,518.31
Add: gain or loss from minor shareholder	-	-
Provision on impairment assets	31,812,543.85	4,505,489.37
Depreciation of fixed assets	21,823,460.35	22,558,641.94
Amortisation of intangible assets	2,055,474.51	2,026,303.33
Amortisation of long term deferred expenditure	-	-
Loss of disposal of fixed assets, intangible assets, long term assets	731,223.33	841,685.26
Loss of derecognition of fixed assets	386,254.93	-
Fair value loss	-	-
Financial expense	5,333,623.76	4,091,097.11
Loss from investment	(27,410,028.42)	7,728,348.15
Decrease in deferred income tax assets	(2,377,487.41)	(35,114,727.87)
Decrease in deferred income tax liabilities	(241,191.93)	2,466,784.81
Decrease in inventory	(90,636,360.98)	(18,757,064.21)
Decrease in receivable from operating activities	(112,140,695.36)	(68,180,094.70)
Increase in payables from operating activities	203,494,238.68	87,069,966.86
Other	311,795.07	(2,365,589.71)
Net cash flows from operating activities	244,436,489.59	98,219,358.65
2. Significant investment and financing activities without involved in cash receive and pay	-	-
Debt into Capital	-	-
Convertible debenture due within one year	-	-
Leasing fixed assets in finance	-	-
3. Net increase in cash and cash equivalents	-	-
Cash and bank balance at the end of year	322,698,506.89	90,597,289.14
Less: cash and bank balance at the beginning of year	90,597,289.14	112,111,009.79
Add: Cash Equivalent at the end of the year	-	-
Less: Cash Equivalent at the end of the year	-	-
Net Cash flow from finance activities	<u>232,101,217.75</u>	<u>(21,513,720.65)</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION *(Continued)*

4. Reconciliation of difference in net profit of the year 2006

Pursuant to the relevant regulations on comparative accounts between new and old accounting standard issued by CSRC. The Company prepared the reconciliation of difference in net profit of the year 2006, shown retrospective matters in income statement for the year 2006. The new accounting standard was supposed to be implemented in 2006 without retrospection. The significant differences in net profit prepared simulatingly in between new and previous accounting standards are analyzed shown following.

Reconciliation of difference in net profit of year 2006

Unit: RMB'000

ITEM	AMOUNT
Net profit for year 2006 under previous accounting standards	86,156.91
Total of retrospective accounts	21,384.74
Include: income tax expense	16,922.30
Net profit for 2006 attributable to ordinary shareholders of the Company under new accounting standards	98,058.77
Add: minor shareholder gain	9,482.87
Net profit for the year 2006 under new accounting standards	107,541.65
Pro-forma data assuming full implementation of new accounting standards	–
Total of pro forma	–
Include: income tax expense	–
Simulated net profit for the year 2006	<u>107,541.65</u>

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION (Continued)

5. Reconciliation of difference of shareholder equity at 31st Dec 2006 under new and previous accounting standards

Reconciliation of difference of shareholder equity at 31st Dec 2006

Unit: RMB'000

No	Notes	Items	The Company	The Group
		Shareholder equity at 31st Dec 2006 under previous accounting standards	611,473.2	610,752.4
		Add: effect of correction of accounting errors on deferred gain	899.8	899.8
		Adjustment of inventory at the beginning of the year 2006	19,663.9	19,663.9
		Adjusted shareholders' equity under previous accounting standards at 31st Dec 2006	632,036.9	631,316.1
1		Adjustment of gain/loss on long-term equity investment	(24,127.1)	–
2		Investment property accounting in fair value	–	–
3		Additional provision of depreciation for preceding year	–	–
4		Salary for Early retired qualified as accrued liabilities	(23,088.1)	(23,088.1)
5		Share-base payment	–	–
6		After-service obligations qualified as accrued liabilities	(3,554.6)	(3,554.6)
7		Merge of Enterprises	–	–
		Including: book value of consolidated good will under uncommon control	–	–
		Provision on impairment good will under new accounting standards	–	–
8		Finance assets at fair value thorough profit or loss and available-for-sale finance assets	–	–
9		Financial liabilities at fair value thorough profit or loss	–	–
10		Equity addition by splitting financial instruments	–	–
11		Derivative financial instrument	–	–
12		Income tax directly record in items related the owner's equity	(1,330.3)	(1,330.3)
13		Income tax	34,873.5	33,434.6
		Including: deferred income tax asset of the Company	35,114.7	26,484.2
		Deferred income tax liabilities of the Company	(241.2)	(241.2)
		Deferred income tax assets of the subsidiaries	–	7,191.6
		Deferred income tax liabilities of the subsidiaries	–	–
14		Minority interest	–	(4,003.8)
15		Good will	–	3,648.1
16		Others	(0.5)	(0.6)
		Shareholders equity under new accounting standards on 1st Jan 2007	614,809.8	636,421.4

FINANCIAL STATEMENT NOTE

For the year ended 31 December 2007 (Expressed in Renminbi)

XV. SUPPLEMENTARY INFORMATION *(Continued)*

6. Information of acquisition or disposal of subsidiaries and other operating units during reporting period.

Items	Amounts (RMB)
一. Information of acquisition of subsidiaries and other operating units	
1. Consideration of acquisition of subsidiaries and other operating units	–
2. Cash and Cash equivalents paid on acquisition of subsidiaries and other operating units	–
less: Cash and Cash equivalents held acquired subsidiaries and other operating units	–
3. cash flow of acquisition of subsidiaries and other operating units	–
4. net asset of acquisition of subsidiaries	–
Current assets	–
non current assets	–
current liabilities	–
non-current liabilities	–
二. Information of disposal of subsidiaries and other operating units	
1. Consideration of disposal of subsidiaries and other operating units	14,000,000.00
2. Cash and Cash equivalents gain on disposal of subsidiaries and other operating units	–
less: Cash and Cash equivalents held by disposal subsidiaries and other operating units	1,367,894.02
3. cash flow of acquisition of subsidiaries and other operating units	(1,367,894.02)
4. net asset of disposal of subsidiaries	17,790,208.11
Current assets	13,669,826.86
non current assets	6,703,521.60
current liabilities	2,583,140.35
non-current liabilities	–

XVI. DIFFERENCE BETWEEN THE PRC GAAP AND HK GAAP

The financial statements are prepared in accordance with the PRC GAAP, which are different from those prepared in accordance with HK GAAP.

The consolidated net profit for year 2007 and the consolidated net asset as at 31st Dec 2007 are RMB242,957,688.27 and RMB879,379,127.95, the major adjustments to consolidated net profit and the consolidated net asset are as follows

Unit: RMB'000

Items	Net profit	Net assets
Consolidated results in accordance with PRC GAAP	242,957.69	879,379.13
Add: investment income from subsidiaries	(1,330.00)	(8,869.00)
Adjusted deferred income	(894.73)	57.00
Amortization of good will	–	(1,427.63)
Adjusted bad debt	939.44	–
Others	(220.00)	220.00
Consolidated results in accordance with HK GAAP	<u>241,452.40</u>	<u>869,359.50</u>

The figures above were audited by KPMG in accordance to HK GAAP

XVII. OTHER EVENTS

The Company's 2007 annual report was approved at 40th sessions meeting of 5th term of Board of Directors.

AUDITOR'S REPORT



Independent auditor's report to the shareholders of Shenji Group Kunming Machine Tool Company Limited (formerly known as Jiaoda Kunji High-Tech Company Limited) *(Established in the People's Republic of China with limited liability)*

We have audited the consolidated financial statements of Shenji Group Kunming Machine Tool Company Limited (the "Company") set out on pages 127 to 198, which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2007 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

24 April 2008

FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH HONG KONG FINANCIAL REPORTING STANDARDS

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
Continuing operations			
Turnover	6	1,266,707	818,085
Cost of sales		(830,944)	(571,916)
Gross profit		435,763	246,169
Other revenue	7	54,976	33,146
Other net income/(expenses)	7	25,694	(1,451)
Selling expenses		(61,732)	(39,792)
Administrative expenses		(147,172)	(96,990)
Other operating expenses		(10,078)	(1,279)
Profit from operations		297,451	139,803
Finance costs	8(a)	(3,064)	(6,236)
Share of profits of associate		12	–
Share of profits of jointly controlled entity		4,967	1,523
Profit before taxation	8	299,366	135,090
Income tax	9(a)	(47,248)	(16,660)
Profit from continuing operations		252,118	118,430
Discontinued operation			
Loss from discontinued operation (net of income tax)	5	(1,980)	(6,610)
Profit for the year		250,138	111,820
Attributable to:			
Equity shareholders of the Company	39(a)	241,452	102,529
Minority interests	39(a)	8,686	9,291
Profit for the year	39(a)	250,138	111,820
Earnings per share			
– Basic earnings per share	14	RMB0.568	RMB0.241
– Basic earnings per share from continuing operations		RMB0.572	RMB0.251

The notes on pages 135 to 198 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

At 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
Non-current assets			
Property, plant and equipment	15(a)	403,708	353,785
Construction in progress	16	26,984	14,390
Lease prepayments	17	24,685	25,289
Prepaid property lease rights	18	60,996	61,076
Intangible assets	19(a)	4,562	12,100
Goodwill	20	5,844	11,490
Interest in an associate	22	14,217	10,000
Interest in a jointly controlled entity	23	21,440	16,473
Deferred tax assets	37	31,209	33,638
		593,717	538,241
Current assets			
Inventories	24	427,423	283,919
Trade and bills receivable	25	285,089	181,387
Deposits, other receivables and prepayments	26	82,423	73,261
Amounts due from related parties	41(b)	5,715	6,094
Available-for-sale investments	27	–	7,652
Cash at bank and in hand	28	370,351	165,806
		1,171,001	718,119
Current liabilities			
Bank loans – due within one year	29	–	40,000
Trade and bills payable	30	120,798	96,480
Other payables	31	557,466	309,840
Amounts due to related parties	41(b)	13,872	29,639
Obligations under finance leases due within one year	32	213	213
Early retirement benefits obligation due within one year	33	3,642	3,289
Deferred income	34	9,950	8,107
Income tax payable		27,364	12,896
Provisions	38	9,117	3,555
		742,422	504,019
Net current assets		428,579	214,100
Total assets less current liabilities		1,022,296	752,341
Non-current liabilities			
Bank loans – due after one year	29	50,000	20,000
Obligations under finance leases	32	2,772	2,985
Early retirement benefits obligation	33	16,157	19,799
Deferred gain	35	2,817	3,018
Long-term payables	36	7,200	7,200
Deferred tax liabilities	37	–	241
		78,946	53,243
NET ASSETS		943,350	699,098

The notes on pages 135 to 198 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

At 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
CAPITAL AND RESERVES	39(a)		
Share capital		424,865	245,007
Reserves		444,494	382,900
Total equity attributable to equity shareholders of the Company		869,359	627,907
Minority interests		73,991	71,191
TOTAL EQUITY		943,350	699,098

Approved and authorised for issue by the board of directors on 24 April 2008.

Gao Minghui
Director

Pi Jianguo
Director

The notes on pages 135 to 198 form part of these financial statements.

BALANCE SHEET

At 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
Non-current assets			
Property, plant and equipment	15(b)	336,902	287,440
Construction in progress	16	25,233	13,088
Lease prepayments	17	11,452	11,772
Prepaid property lease rights	18	3,364	3,458
Intangible assets	19(b)	4,562	5,623
Investments in subsidiaries	21	33,172	57,543
Interest in an associate	22	14,000	10,000
Interest in a jointly controlled entity	23	15,871	15,871
Deferred tax assets	37	33,150	33,542
		477,706	438,337
Current assets			
Inventories	24	285,716	195,079
Trade and bills receivable	25	188,531	113,880
Deposits, other receivables and prepayments	26	39,624	35,239
Amounts due from subsidiaries	41(c)	22,003	16,403
Amounts due from related parties	41(b)	5,715	6,094
Available-for-sale investments	27	–	7,652
Cash at bank and in hand	28	322,699	113,885
		864,288	488,232
Current liabilities			
Bank loans – due within one year	29	–	20,000
Trade and bills payables	30	45,775	54,688
Other payables	31	314,715	143,714
Amounts due to subsidiaries	41(c)	52,827	778
Amounts due to related parties	41(b)	13,872	29,639
Obligations under finance leases due within one year	32	213	213
Early retirement benefits obligation due within one year	33	3,642	3,289
Deferred income	34	1,849	4
Income tax payable		16,542	11,911
Provisions	38	9,115	3,555
		458,550	267,791
Net current assets		405,738	220,441
Total assets less current liabilities		883,444	658,778

The notes on pages 135 to 198 form part of these financial statements.

BALANCE SHEET

At 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
Non-current liabilities			
Bank loans – due after one year	29	50,000	20,000
Obligations under finance leases	32	2,772	2,985
Early retirement benefits obligation	33	16,157	19,799
Deferred gain	35	2,817	3,018
Deferred tax liabilities	37	–	241
		71,746	46,043
NET ASSETS			
		811,698	612,735
CAPITAL AND RESERVES			
	39(b)		
Share capital		424,865	245,007
Reserves		386,833	367,728
TOTAL EQUITY			
		811,698	612,735

Approved and authorised for issue by the board of directors on 24 April 2008.

Gao Minghui
Director

Pi Jianguo
Director

The notes on pages 135 to 198 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

At 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
Total equity at 1 January:	39(a)		
Attributable to:			
Equity shareholders of the Company (as previously reported at 31 December)		605,622	523,141
Minority interests (as previously presented separately from liabilities and equity at 31 December)		67,058	59,098
		672,680	582,239
Prior period adjustments arising from retrospective restatements	4	26,418	5,082
Total equity at 1 January, after prior period adjustments		699,098	587,321
Net profit for the year:			
Attributable to:			
Equity shareholders of the Company (2006: as previously reported)		241,452	82,481
Minority interests (2006: as previously presented separately in the income statement)		8,686	8,003
Prior period adjustments arising from retrospective restatements	4	–	21,336
Net profit for the year (2006: as restated)		250,138	111,820
Attributable to:			
Equity shareholders of the Company	39(a)	241,452	102,529
Minority interests	39(a)	8,686	9,291
		250,138	111,820
Disposal/acquisition of interests in subsidiaries: Minority interests		(5,886)	(43)
Total equity at 31 December		943,350	699,098
Retrospective restatements of net profit for the year are attributable to:			
Equity shareholders of the Company			20,048
Minority interests			1,288
			21,336

The notes on pages 135 to 198 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2007 (Expressed in Renminbi)

Note	2007 RMB'000	2006 (Restated) RMB'000
Operating activities		
Profit before taxation	297,386	128,486
Adjustments for:		
Depreciation of property, plant and equipment	28,401	28,157
Impairment loss of property, plant and equipment and construction in progress	771	2,182
Amortisation of lease prepayments	604	604
Amortisation of prepaid property lease rights	94	94
Amortisation of intangible assets	2,037	3,141
Impairment of intangible assets	1,447	3,561
Impairment of goodwill	3,270	4,475
Finance costs	3,064	6,236
Interest income	(2,844)	(1,601)
Share of profits of an associate	(12)	–
Share of profits of a jointly controlled entity	(4,967)	(1,523)
Net loss on disposal of property, plant and equipment	1,272	2,344
Gain on disposal of available-for-sale investments	(24,383)	(234)
Amortisation of deferred gain	(201)	(201)
Loss on disposal of discontinued operation	1,027	–
Discount on acquisition of additional interest in a subsidiary	–	(43)
Deemed income from transfer of shares from minority interests	(1,906)	–
Foreign exchange loss	2,446	1,069
Operating profit before changes in working capital	307,506	176,747
Increase in inventories	(161,969)	(9,416)
Increase in trade and bills receivable	(107,070)	(91,469)
Increase in deposits, other receivables and prepayments	(3,274)	(25,957)
Increase/(decrease) in trade and bills payable	26,612	(1,847)
Increase in other payables	244,061	26,352
Increase in provision for product warranties	5,562	3,555
Increase in restricted bank deposits	(4,256)	(1,668)
Increase/(decrease) in amounts due to jointly controlled entity	12,184	(3,966)
Decrease in early retirement benefits obligation	(3,289)	(2,109)
Cash generated from operations	316,067	70,222
Income tax paid	(30,591)	(8,987)
Net cash from operating activities	285,476	61,235

The notes on pages 135 to 198 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2007 (Expressed in Renminbi)

	Note	2007 RMB'000	2006 (Restated) RMB'000
Investing activities			
Payments for acquisition of property, plant and equipment and construction in progress		(92,706)	(53,936)
Investments in an associate		(4,000)	(10,000)
Proceeds from disposal of property, plant and equipment		4,041	1,840
Prepayments for property lease rights		(14)	–
Additions of deferred income		1,843	4,100
Proceeds from disposal of available-for-sale investments		32,035	1,105
Interest received		2,844	1,601
Net proceeds from disposal of discontinued operation		12,633	–
Repayments of cash advances from other parties		–	9,600
Net cash used in investing activities		(43,324)	(45,690)
Financing activities			
Proceeds from new bank loans		50,000	40,000
Repayments of bank loans		(60,000)	(80,000)
Interest paid		(3,064)	(6,236)
Repayments of obligations under finance leases		(213)	(213)
(Repayments to)/advances from an associate		(10,000)	10,000
(Repayments to)/advances from a jointly controlled entity		(16,140)	16,079
Repayments of cash advances to other parties		–	(856)
Net cash used in financing activities		(39,417)	(21,226)
Net increase/(decrease) in cash and cash equivalents		202,735	(5,681)
Cash and cash equivalents at 1 January		163,017	169,767
Effect of foreign exchange rate changes		(2,446)	(1,069)
Cash and cash equivalents at 31 December	28	363,306	163,017

The notes on pages 135 to 198 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

1. GENERAL

Shenji Group Kunming Machine Tool Company Limited (formerly known as Jiaoda Kunji High-Tech Company Limited) (the "Company") was established in the People's Republic of China (the "PRC") as a Sino-foreign joint stock limited company, and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") and the Shanghai Stock Exchange. With effect from 10 September 2007, the Company changed its name from Jiaoda Kunji High-Tech Company Limited to Shenji Group Kunming Machine Tool Company Limited.

The place of registration of the Company is 23 Ciba Road, Kunming City, Yunnan Province. The business registration number is Qi Gu Dian Zong Zi No. 000682.

The Company acts as an investment holding company and it is also engaged in the design, development, manufacture and sale of machine tools, precision measuring equipment and precision transducers. The principal activities of its subsidiaries are set out in note 21.

The consolidated financial statements are presented in Renminbi ("RMB"), which is the functional currency of the Company.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Company. Note 3 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2007 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in an associate and a jointly controlled entity.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that financial instruments classified as available-for-sale are stated at their fair values as explained in the accounting policies set out in note 2(f) below.

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(b) Basis of preparation of the financial statements *(Continued)*

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised 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.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 47.

(c) Subsidiaries and minority interests

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Company, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

Loans from holders of minority interests and other contractual obligations towards these holders are presented as financial liabilities in the consolidated balance sheet in accordance with notes 2(n) or (o) depending on the nature of the liability.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 2(k)), unless the investment is classified as held for sale (or included in a disposal group that is classified as held for sale (see note 2(w))).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(d) Associates and jointly controlled entities

An associate is an entity in which the Group or Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or Company and other parties, where the contractual arrangement establishes that the Group or Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a jointly controlled entity is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates and jointly controlled entities for the year, including any impairment loss on goodwill relating to the investment in associates and jointly controlled entities recognised for the year (see notes 2(e) and (k)).

When the Group's share of losses exceeds its interest in the associate or the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or the jointly controlled entity. For this purpose, the Group's interest in the associate or the jointly controlled entity is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate or the jointly controlled entity.

Unrealised profits and losses resulting from transactions between the Group and its associates and jointly controlled entities are eliminated to the extent of the Group's interest in the associate or jointly controlled entity, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

In the Company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 2(k)).

(e) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate or a jointly controlled entity over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(k)). In respect of associates or jointly controlled entities, the carrying amount of goodwill is included in the carrying amount of the interest in the associate or jointly controlled entity.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate or a jointly controlled entity is recognised immediately in profit or loss.

On disposal of a cash generating unit, an associate or a jointly controlled entity during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Investments in equity securities

The Group's and the Company's policies for investments in equity securities, other than investments in subsidiaries, associates and jointly controlled entities, are as follows:

Investments in equity securities are initially stated at cost, which is their transaction price unless fair value can be more reliably estimated using valuation techniques whose variables include only data from observable markets. Cost includes attributable transaction costs. These investments are subsequently accounted for as follows, depending on their classification:

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the balance sheet at cost less impairment losses (see note 2(k)).

For investments in securities that are classified as available-for-sale securities, at each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except foreign exchange gains and losses resulting from changes in the amortised cost of monetary items such as debt securities which are recognised directly in profit or loss. Dividend income from these investments is recognised in profit or loss in accordance with the policy set out in note 2(t)(iv) and, where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss in accordance with the policy set out in note 2(t)(v). When these investments are derecognised or impaired (see note 2(k)), the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss.

Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.

(g) Property, plant and equipment

- (i) Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 2(k)).

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs (see note 2(v)).

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

- (ii) Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight-line method over their estimated useful lives as follows:

Buildings	40 years
Plant and machinery	5 to 20 years
Furniture, fixtures and equipment	5 to 14 years
Motor vehicles	5 to 14 years

Both the useful life of an asset and its residual value, if any, are reviewed annually.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(g) Property, plant and equipment *(Continued)*

(iii) Construction in progress represents items of property, plant and equipment under construction and pending installation and is stated at cost less impairment losses *(see note 2(k))*. Cost comprises direct and indirect costs, related to acquisition and installation of the property, plant and equipment, incurred before the asset is substantially ready for its intended use.

Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided for construction in progress.

(h) Intangible assets (other than goodwill)

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources and the intention to complete development. The expenditure capitalised includes the costs of materials, direct labour and an appropriate proportion of overheads and borrowing costs, where applicable *(see note 2(v))*. Capitalised development costs are stated at cost less accumulated amortisation and impairment losses *(see note 2(k))*. Other development expenditure is recognised as an expense in the period in which it is incurred. During the year, all expenditures incurred on research and development activities by the Group have been recognised as expenses.

Other intangible assets that are acquired by the Group are stated in the balance sheet at cost less accumulated amortisation (where the estimated useful life is finite) and impairment losses *(see note 2(k))*.

Amortisation of intangible assets with finite useful lives is charged to profit or loss on a straight-line basis over the assets' estimated useful lives of 10 years.

Both the period and method of amortisation are reviewed annually.

(i) Lease prepayments

Lease prepayments represent payments for land use rights to the PRC authorities. Land use rights are stated in the balance sheet at cost less accumulated amortisation and impairment losses *(see note 2(k))*. Amortisation is charged to profit or loss on a straight-line basis over the respective periods of the rights.

(j) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

(i) Classification of assets leased to the Group

Assets that are held by the Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(j) **Leased assets** *(Continued)*

(ii) *Assets acquired under finance leases*

Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments, of such assets are included in property, plant and equipment and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in note 2(g). Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(k). Finance charges implicit in the lease payments are charged to profit or loss over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

(iii) *Operating lease charges*

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

(k) **Impairment of assets**

(i) *Impairment of investments in equity securities and other receivables*

Investments in equity securities (other than investments in subsidiaries, associates and jointly controlled entities: see note 2(k)(ii)) and other current and non-current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

- significant financial difficulty of the debtor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- it becoming probable that the debtor will enter bankruptcy or other financial reorganisation;
- significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and
- a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

If any such evidence exists, any impairment loss is determined and recognised as follows:

- For unquoted equity securities carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for equity securities are not reversed.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(k) Impairment of assets *(Continued)*

(i) *Impairment of investments in equity securities and other receivables (Continued)*

- For trade and other current receivables and other financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material. This assessment is made collectively where financial assets carried at amortised cost share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective Group.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

- For available-for-sale securities, the cumulative loss that has been recognised directly in equity is removed from equity and is recognised in profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

Impairment losses recognised in profit or loss in respect of available-for-sale equity securities are not reversed through profit or loss. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

Impairment losses are written off against the corresponding assets directly, except for impairment losses recognised in respect of trade and bills receivable included within trade and other receivables, whose recovery is considered doubtful but not remote. In this case, the impairment losses for doubtful debts are recorded using an allowance account. When the Group is satisfied that recovery is remote, the amount considered irrecoverable is written off against trade and bills receivable directly and any amounts held in the allowance account relating to that debt are reversed. Subsequent recoveries of amounts previously charged to the allowance account are reversed against the allowance account. Other changes in the allowance account and subsequent recoveries of amounts previously written off directly are recognised in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(k) Impairment of assets *(Continued)*

(ii) *Impairment of other assets*

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment;
- construction in progress;
- lease prepayments;
- prepaid property lease rights;
- intangible assets;
- investments in subsidiaries, associates and joint ventures; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price 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 time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

– Recognition of impairment losses

An impairment loss is recognised in profit or loss whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Impairment of assets (Continued)

(iii) Interim financial reporting and impairment

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS 34, Interim Financial Reporting, in respect of the first six months of the financial year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the financial year (see notes 2(k)(i) and (ii)).

Impairment losses recognised in an interim period in respect of goodwill and unquoted equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the financial year to which the interim period relates.

(l) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

(m) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less allowance for impairment of doubtful debts (see note 2(k)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less allowance for impairment of doubtful debts.

(n) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in profit or loss over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

(o) Trade and other payables

Trade and other payables are initially recognised at fair value, and subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(p) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(q) Employee benefits

(i) *Short term employee benefits and contribution to defined contribution retirement plans*

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) *Early retirement benefits*

Early retirement benefits are recognised when, and only when, the Group demonstrably commits itself to provide benefits as a result of the voluntary early retirement of the employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(r) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(r) Income tax *(Continued)*

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(s) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(t) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) *Sale of goods*

Revenue is recognised when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

(ii) *Services*

Revenue from services is recognised in profit or loss at the time when services are rendered.

(iii) *Rental income from operating leases*

Rental income receivable under operating leases is recognised in profit or loss in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognised in profit or loss as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

(iv) *Dividends*

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

(v) *Interest income*

Interest income is recognised as it accrues using the effective interest method.

(vi) *Government grants*

Government grants are recognised in the balance sheet initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in profit or loss on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

(u) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Renminbi using the foreign exchange rates ruling at the transaction dates.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(v) Borrowing costs

Borrowing costs are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

(w) Non-current assets held for sale and discontinued operations

(i) *Non-current assets held for sale*

A non-current asset (or disposal group) is classified as held for sale if it is highly probable that its carrying amount will be recovered through a sale transaction rather than through continuing use and the asset (or disposal group) is available for sale in its present condition. A disposal group is a group of assets to be disposed of together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

Immediately before classification as held for sale, the measurement of the non-current assets (and all individual assets and liabilities in a disposal group) is brought up-to-date in accordance with the accounting policies before the classification. Then, on initial classification as held for sale and until disposal, the non-current assets (except for certain assets as explained below), or disposal groups, are recognised at the lower of their carrying amount and fair value less costs to sell. The principal exceptions to this measurement policy so far as the financial statements of the group and the company are concerned are deferred tax assets, assets arising from employee benefits, financial assets (other than investments in subsidiaries, associates and joint ventures) and investment properties. These assets, even if held for sale, would continue to be measured in accordance with the policies set out elsewhere in note 2.

Impairment losses on initial classification as held for sale, and on subsequent remeasurement while held for sale, are recognised in profit or loss. As long as a non-current asset is classified as held for sale, or is included in a disposal group that is classified as held for sale, the non-current asset is not depreciated or amortised.

(ii) *Discontinued operations*

A discontinued operation is a component of the Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Group and which represents a separate major line of business or geographical area of operations, or is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or is a subsidiary acquired exclusively with a view to resale.

Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale (see (i) above), if earlier. It also occurs when the operation is abandoned.

Where an operation is classified as discontinued, a single amount is presented on the face of the income statement, which comprises:

- the post-tax profit or loss of the discontinued operation; and
- the post-tax gain or loss recognised on the measurement to fair value less costs to sell, or on the disposal, of the assets or disposal group(s) constituting the discontinued operation.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

2. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(x) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- (ii) the Group and the party are subject to common control;
- (iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;
- (iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(y) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format for the purposes of these financial statements. As the Group's operations are predominantly in the PRC, no geographical segment information is presented.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade receivables and property, plant and equipment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

3. CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued a number of new and revised HKFRSs and Interpretations that are first effective or available for early adoption for the current accounting period of the Group and the Company.

There have been no significant changes to the accounting policies applied in these financial statements for the years presented as a result of these developments. However, as a result of the adoption of HKFRS 7, *Financial Instruments: Disclosures* and the amendment to HKAS 1, *Presentation of Financial Statements: Capital Disclosures*, there have been some additional disclosures provided as follows:

As a result of the adoption of HKFRS 7, the financial statements include expanded disclosure about the significance of the Group's financial instruments and the nature and extent of risks arising from those instruments, compared with the information previously required to be disclosed by HKAS 32, *Financial Instruments: Disclosure and Presentation*. These disclosures are provided throughout these financial statements, in particular in note 42.

The amendment to HKAS 1 introduces additional disclosure requirements to provide information about the level of capital and the Group's and the Company's objectives, policies and processes for managing capital. These new disclosures are set out in note 39(f).

Both HKFRS 7 and the amendment to HKAS 1 do not have any material impact on the classification, recognition and measurement of the amounts recognised in the financial instruments.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 48).

4. RETROSPECTIVE RESTATEMENTS

The following tables disclose the adjustments that have been made as a result of retrospective restatements to the consolidated income statement and consolidated balance sheet, the Company's balance sheet, and other significant related disclosure items as previously reported for the year ended 31 December 2006. The effects of the retrospective restatements on the balances at 1 January 2006 and 2007 are disclosed in note 39.

(a) Effect on the consolidated financial statements

Consolidated income statement for the year ended 31 December 2006

	Note	Year ended 31 December 2006		
		Equity shareholders of the Company RMB'000	Minority interests RMB'000	Total equity RMB'000
Profit after taxation (as previously reported)		82,481	8,003	90,484
Adjustments of inventories	4(c)(i)	19,664	–	19,664
Adjustments of deferred taxation	4(c)(ii)	586	1,288	1,874
Adjustments of provisions	4(c)(ii)	(2,311)	–	(2,311)
Adjustments of early-retirement benefits obligation	4(c)(iii)	2,109	–	2,109
Total effect for the year		20,048	1,288	21,336
Profit after taxation (as restated)		102,529	9,291	111,820
Effect on earnings per share		0.047		

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

4. RETROSPECTIVE RESTATEMENTS *(Continued)*

(a) Effect on the consolidated financial statements

Consolidated balance sheet at 31 December 2006

	Note	2006 (As previously reported) RMB'000	Adjustments RMB'000	2006 (As restated) RMB'000
Inventories	4(c)(i)	260,785	23,134	283,919
Income tax payable	4(c)(i)	(9,426)	(3,470)	(12,896)
Deferred taxation	4(c)(ii)	–	33,397	33,397
Provisions	4(c)(ii)	–	(3,555)	(3,555)
Early-retirement benefits obligation	4(c)(ii)	–	(23,088)	(23,088)
Prepaid property lease rights	4(c)(ii)	32,347	28,729	61,076
Other payables	4(c)(ii)	(281,111)	(28,729)	(309,840)
Statutory surplus reserve	4(c)(iii)	(21,338)	(472)	(21,810)
Retained profits	4(c)(iii)	(35,307)	(21,813)	(57,120)
Minority interests	4(c)(iii)	(67,058)	(4,133)	(71,191)

(b) Effect on the Company's balance sheet

Balance sheet at 31 December 2006

	Note	2006 (As previously reported) RMB'000	Adjustments RMB'000	2006 (As restated) RMB'000
Inventories	4(c)(i)	171,945	23,134	195,079
Income tax payable	4(c)(i)	(8,441)	(3,470)	(11,911)
Deferred taxation	4(c)(ii)	–	33,301	33,301
Provisions	4(c)(ii)	–	(3,555)	(3,555)
Early-retirement benefits obligation	4(c)(ii)	–	(23,088)	(23,088)
Statutory surplus reserve	4(c)(iii)	(20,297)	(472)	(20,769)
Retained profits	4(c)(iii)	(17,139)	(25,850)	(42,989)

(c) Summary of the retrospective restatements

(i) Inventories

During the year, the Group updated the costing of its inventory to enable a more accurate calculation of the actual costs of inventory items, and retrospective adjustments have been made to inventories and income tax payable as at 31 December 2006 and the cost of sales and income tax expenses for the year ended 31 December 2006 accordingly.

(ii) Accruals and recognition of items

In prior years, certain items were not accrued for and/or recognised by the Group. Retrospective adjustments have been made to these financial statement line items accordingly.

(iii) Consequential adjustments

These adjustments have been made as a result of the retrospective restatements outlined above.

(iv) Reclassification

Certain comparative figures have been reclassified to conform with current financial year's presentation.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

5. DISCONTINUED OPERATION

In March 2007, the Group disposed of a subsidiary, Shanxi Hengtong Intelligent Machine Company Limited ("Hengtong"), which represented its entire laser prototyping machines segment (see note 43), to Xi'an Ruite Laser Prototyping Manufacturing and Engineering Research Company Limited ("Xi'an Ruite"), an associate of the Group. The segment was not a discontinued operation or classified as held for sale as at 31 December 2006, and the comparative consolidated income statement and consolidated cash flow statement have been re-presented to show the discontinued operation separately from continuing operations. The effect of the disposal was a decrease in the net assets of the Group of RMB15,232,000, excluding cash consideration of RMB14,000,000.

Losses attributable to the discontinued operation for the years ended 31 December 2007 and 2006 are as follows:

	2007 RMB'000	2006 RMB'000
Results of discontinued operation		
Revenue	45	9,001
Expenses	(998)	(15,605)
Results from operations	(953)	(6,604)
Income tax	–	(6)
Loss after tax but before loss on sale of discontinued operation	(953)	(6,610)
Loss on sale of discontinued operation	(1,027)	–
Loss for the year	(1,980)	(6,610)
Attributable to:		
Equity shareholders of the Company	(1,650)	(4,329)
Minority interests	(330)	(2,281)
	(1,980)	(6,610)
Basic loss per share	(0.004)	(0.010)
Cash flows (used in)/from discontinued operation		
Net cash (used in)/from operating activities	(2,095)	1,522
Net cash from/(used in) investing activities	12,633	(16)
Net cash from discontinued operation	10,538	1,506

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

5. DISCONTINUED OPERATION *(Continued)*

The effect of the disposal on the financial position of Group is as follows:

	2007 RMB'000
Property, plant and equipment	(2,333)
Intangible assets	(4,054)
Inventories	(6,217)
Trade and bills receivable	(3,368)
Deposits, other receivables and prepayments	(1,791)
Cash and cash equivalents	(1,367)
Trade and bills payable	2,294
	<hr style="border-top: 1px dashed black;"/>
Net identifiable assets and liabilities	(16,836)
	<hr style="border-top: 1px solid black;"/>
Goodwill	(2,376)
Minority interests	3,980
	<hr style="border-top: 1px dashed black;"/>
Effect on net assets of the Group	(15,232)
	<hr style="border-top: 1px solid black;"/>

6. TURNOVER

Turnover represents the sales value of goods and services supplied to customers, excludes value added or other sales taxes, and is after the deduction of any trade discounts. The amount of each significant category of revenue recognised in turnover during the year is as follows:

	Continuing operations		Discontinued operation (see note 5)		Consolidated	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Sales of goods	1,216,074	775,479	17	8,611	1,216,091	784,090
Rendering of services	50,633	42,606	28	390	50,661	42,996
	<hr style="border-top: 1px solid black;"/>		<hr style="border-top: 1px solid black;"/>		<hr style="border-top: 1px solid black;"/>	
	1,266,707	818,085	45	9,001	1,266,752	827,086
	<hr style="border-top: 1px solid black;"/>		<hr style="border-top: 1px solid black;"/>		<hr style="border-top: 1px solid black;"/>	

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

7. OTHER REVENUE AND NET INCOME/(EXPENSES)

	Continuing operations		Discontinued operation (see note 5)		Consolidated	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Other revenue						
Government grants (i)	22,550	5,485	–	–	22,550	5,485
Sales of prototype machines and raw materials	28,133	22,351	–	124	28,133	22,475
Interest income	2,840	1,569	4	32	2,844	1,601
Others	1,453	3,741	–	980	1,453	4,721
	54,976	33,146	4	1,136	54,980	34,282

Notes:

- (i) Government grants represent various forms of incentives and subsidies given to the Group by the local PRC government.

	Continuing operations		Discontinued operation (see note 5)		Consolidated	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Other net income/ (expenses)						
Gain on disposal of available-for-sale investments (note 27)	24,383	234	–	–	24,383	234
Net loss on sale of property, plant and equipment	(1,272)	(1,946)	–	(398)	(1,272)	(2,344)
Deemed income from transfer of shares from minority interests (note 21)	1,906	–	–	–	1,906	–
Others	677	261	–	–	677	261
	25,694	(1,451)	–	(398)	25,694	(1,849)

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

8. PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging/(crediting):

(a) Finance costs

	2007	2006
	RMB'000	(Restated) RMB'000
Interest on bank loans	4,658	4,852
Less: borrowing costs capitalised*	(3,040)	–
	1,618	4,852
Finance charges on obligations under finance leases	129	129
Finance charges in respect of early retirement benefits	1,099	1,232
Other interest expenses	218	23
	3,064	6,236

* The borrowing costs have been capitalised at annual rates of interest ranging from 6.30% to 6.57% for the year ended 31 December 2007.

(b) Staff costs

	2007	2006
	RMB'000	(Restated) RMB'000
Salaries, wages and allowances	134,516	92,948
Contributions to retirement schemes (note 33)	8,907	7,129
	143,423	100,077

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

8. PROFIT BEFORE TAXATION (Continued)

(c) Other items

	Continuing operations		Discontinued operation (see note 5)		Consolidated	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Amortisation [#]						
– lease prepayments	604	604	–	–	604	604
– intangible assets	1,875	2,080	162	1,061	2,037	3,141
– prepaid property lease rights	94	94	–	–	94	94
Depreciation of property, plant and equipment	28,246	27,588	155	569	28,401	28,157
Impairment losses						
– trade and other receivables	20,746	13,413	158	219	20,904	13,632
– property, plant and equipment	771	1,573	–	295	771	1,868
– construction in progress	–	314	–	–	–	314
– goodwill	3,270	4,475	–	–	3,270	4,475
– intangible assets	1,447	–	–	3,561	1,447	3,561
Research and development costs	28,855	16,547	–	129	28,855	16,676
Provision for product warranties	11,305	7,728	–	–	11,305	7,728
Net foreign exchange loss	3,974	1,214	–	–	3,974	1,214
Auditors' remuneration	1,836	1,882	6	–	1,842	1,882
Operating lease charges:						
minimum lease payments for land and buildings	2,548	1,881	–	103	2,548	1,984
Cost of inventories [#] (note 24(b))	800,181	549,657	156	6,813	800,337	556,470

Cost of inventories includes RMB95,441,000 (2006: RMB80,253,000, as restated) relating to staff costs and depreciation expenses, amount of which is also included in the respective total amounts disclosed separately above or in note 8(b) for each of these types of expenses.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

9. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

(a) Taxation in the consolidated income statement represents:

	2007	2006
	RMB'000	(Restated) RMB'000
Current tax		
Provision for the year	45,060	18,539
Deferred tax		
Origination and reversal of temporary differences	4,094	(1,597)
Change in tax rate	(1,906)	(276)
	47,248	16,666
Income tax expense from continuing operations	47,248	16,660
Income tax expense from discontinued operation	-	6
	47,248	16,666

No provision has been made for Hong Kong Profits Tax as the Group did not have assessable profits subject to Hong Kong Profits Tax during the year. Profits of the Company and the Company's subsidiaries in the PRC are subject to PRC income taxes at rates ranging from 15% to 33% (2006: 0% to 33%).

Based on Notice 2007 No.183 dated 25 December 2007 issued by the Kunming State Tax Bureau, the Company is entitled to a state income tax rate of 15% commencing from 2004 under the Preferential Tax Policies for the Extensive Development of the Western Regions because the proportion of the Company's sales of digital machine tools exceed 70% of its total revenue. This preferential tax policy is subject to annual assessment and renewal, and the policy will officially expire in 2011.

Pursuant to the relevant laws and regulations in the PRC, certain subsidiaries of the Company are entitled to a state income tax rate of 15% under the preferential tax policies for Advanced and New Technology Enterprises.

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China ("new tax law") which takes effect on 1 January 2008. As a result of the new tax law, the statutory income tax rate currently adopted by the Group changes to 25% from 1 January 2008.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

9. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

- (a) Taxation in the consolidated income statement represents: *(Continued)*

In order to qualify for the preferential tax rate of 15% for Advanced and New Technology Enterprises, the subsidiaries of the Company have to be re-recognised as such according to the qualifying measures under the new tax law. As yet, these qualifying measures have not yet been promulgated and therefore, the re-recognition process has not commenced.

The change in the carrying amount of the deferred tax assets and liabilities, as a result of the change in tax rate, is reflected in the financial statements of the Group for the year ended 31 December 2007.

- (b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2007	2006 (Restated)
	RMB'000	RMB'000
Profit for the year	250,138	111,820
Total income tax expense	47,248	16,666
Profit before taxation	297,386	128,486
Notional tax on profit before taxation, calculated at the applicable rates	92,855	41,884
Tax effect of tax holiday granted	(45,743)	(27,898)
Tax benefits	(2,027)	–
Tax effect of non-deductible expenses	2,467	1,601
Tax effect of non-taxable income	(3,554)	(832)
Change in tax rate	(1,906)	(276)
Current year losses for which no deferred tax asset was recognised	4,991	2,299
Others	165	(112)
Actual tax expense	47,248	16,666

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

10. DIRECTORS' REMUNERATION

Details of directors' remuneration for the year ended 31 December 2007 are as follows:

	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Retirement scheme contributions RMB'000	Discretionary bonuses RMB'000	Total RMB'000
Executive directors:					
Gao Minghui (Chairman) ^{&}	73	60	–	–	133
Pi Jianguo [*]	38	203	9	–	250
Cheng Yunchuan [#]	15	206	11	250	482
Wu Ketian [#]	11	166	11	125	313
Lei Jinlu [#]	10	–	–	–	10
Non-executive directors:					
Song Xingju [*]	45	–	–	–	45
Wang Xing [*]	33	–	–	–	33
Sun Kai	42	–	–	–	42
Wang Sheng	42	–	–	–	42
Guo Shangwu [#]	14	–	–	–	14
Shen Guorong ⁺	39	–	–	–	39
Zhang Hanrong [@]	112	276	11	760	1,159
Independent non-executive directors:					
Yu Weifeng Wayne	177	–	–	–	177
Chen Ying [*]	90	–	–	–	90
Li Dongru [^]	57	–	–	–	57
Liu Minghui [*]	90	–	–	–	90
Tong Yunhuan [#]	28	–	–	–	28
Yu Chengting [#]	28	–	–	–	28
	944	911	42	1,135	3,032

& This director had been appointed as chairman on 23 October 2007.

These directors had resigned on 23 March 2007.

* These directors had been appointed on 23 March 2007.

^ This director had been appointed on 29 June 2007.

+ This director had been appointed on 23 March 2007 and had resigned on 28 February 2008.

@ This director had been reassigned from executive director to non-executive director on 23 October 2007.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

10. DIRECTORS' REMUNERATION

Details of directors' remuneration for the year ended 31 December 2006 are as follows:

	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Retirement scheme contributions RMB'000	Discretionary bonuses RMB'000	Total RMB'000
Executive directors:					
Zhang Hanrong (Chairman)	24	267	10	380	681
Cheng Yunchuan	24	163	10	130	327
Wu Ketian	24	121	10	90	245
Lei Jinlu	36	–	–	–	36
Non-executive directors:					
Wang Shangjin [#]	18	180	–	–	198
Guo Shangwu	24	–	–	–	24
Luo Guowei [#]	18	–	–	–	18
Wen Peixiong [#]	18	–	–	–	18
Gao Minghui	6	–	–	–	6
Sun Kai	6	–	–	–	6
Wang Sheng	6	–	–	–	6
Independent non-executive directors:					
Tong Yunhuan	36	–	–	–	36
Yu Chengting	36	–	–	–	36
Yu Weifeng Wayne	36	–	–	–	36
Dong Juan [*]	24	–	–	–	24
	<u>336</u>	<u>731</u>	<u>30</u>	<u>600</u>	<u>1,697</u>

[#] These directors had resigned on 30 September 2006.

^{*} This director had resigned on 15 August 2006.

11. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments, one (2006: five) is a director whose emolument is disclosed in note 10. The aggregate of the emoluments in respect of the remaining individuals is as follows:

	2007 RMB'000	2006 RMB'000
Salaries and other emoluments	1,006	–
Discretionary bonuses	1,350	–
Retirement scheme contributions	34	–
	<u>2,390</u>	<u>–</u>

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

11. INDIVIDUALS WITH HIGHEST EMOLUMENTS *(Continued)*

The emoluments of the four individuals (2006: Nil) with the highest emoluments is within the following band:

	2007 Number of individuals	2006 Number of individuals
HKD Nil – HKD1,000,000	4	–

12. PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The profit attributable to equity shareholders of the Company includes a profit of RMB198,963,000 (2006: RMB100,777,000, as restated), which has been dealt with in the financial statements of the Company.

13. DIVIDENDS

No dividend has been paid or declared by the Company during the year ended 31 December 2007 (2006: Nil).

Notwithstanding the above, during the Annual General Meeting held on 29 June 2007, the shareholders have approved a resolution to distribute no less than 50% of accumulated profits as at 31 December 2007 in the form of cash to the shareholders provided that the requirements for profits distribution are met.

14. EARNINGS PER SHARE

(a) Basic earnings per share

The calculation of basic earnings per share for the year ended 31 December 2007 is based on the profit attributable to ordinary equity shareholders of the Company of RMB241,452,000 (2006: RMB102,529,000, as restated) and the weighted average number of ordinary shares of 424,864,883 (2006: 424,864,883 shares after adjusting for the capitalisation issues in 2007) in issue during the year, calculated as follows:

	2007 RMB'000	2006 RMB'000
Issued ordinary shares at 1 January	245,007	245,007
Effect of capitalisation issues <i>(note 39(c)(ii))</i>	179,858	179,858
Weighted average number of ordinary shares at 31 December	424,865	424,865

(b) Diluted earnings per share

No diluted earnings per share information has been presented because the Company does not have any potential dilutive shares in issue during the years ended 31 December 2007 and 2006.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

15. PROPERTY, PLANT AND EQUIPMENT

(a) The Group

	Buildings RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Total RMB'000
Cost					
Balance at 1 January 2006	205,282	258,463	47,283	18,746	529,774
Additions	–	7,090	1,789	1,192	10,071
Disposals	(1,904)	(5,008)	(769)	(305)	(7,986)
Transfers from construction in progress	28,353	17,685	–	–	46,038
Balance at 31 December 2006	231,731	278,230	48,303	19,633	577,897
Balance at 1 January 2007	231,731	278,230	48,303	19,633	577,897
Additions	3,378	32,321	4,973	7,776	48,448
Disposals	(372)	(13,966)	(12,022)	(3,727)	(30,087)
Transfers from construction in progress	33,166	4,688	479	32	38,365
Balance at 31 December 2007	267,903	301,273	41,733	23,714	634,623
Accumulated depreciation and impairment					
Balance at 1 January 2006	33,182	133,143	25,991	6,156	198,472
Charge for the year	7,242	14,636	3,781	2,498	28,157
Impairment loss	–	1,664	24	180	1,868
Written back on disposal	(393)	(2,999)	(748)	(245)	(4,385)
Balance at 31 December 2006	40,031	146,444	29,048	8,589	224,112
Balance at 1 January 2007	40,031	146,444	29,048	8,589	224,112
Charge for the year	9,116	11,575	5,155	2,555	28,401
Impairment loss	–	–	770	1	771
Written back on disposal	(54)	(8,740)	(11,161)	(2,486)	(22,441)
Balance at 31 December 2007	49,093	149,279	23,812	8,659	230,843
Net book value					
At 31 December 2007	218,810	151,994	17,921	15,055	403,780
At 31 December 2006	191,700	131,786	19,255	11,044	353,785

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

15. PROPERTY, PLANT AND EQUIPMENT (Continued)

(b) The Company

	Buildings RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Total RMB'000
Cost					
Balance at 1 January 2006	165,746	217,045	38,740	11,322	432,853
Additions	–	878	798	3,172	4,848
Disposals	(1,904)	(3,002)	(26)	(305)	(5,237)
Transfers from construction in progress	25,887	17,685	–	–	43,572
Balance at 31 December 2006	189,729	232,606	39,512	14,189	476,036
Balance at 1 January 2007	189,729	232,606	39,512	14,189	476,036
Additions	3,283	26,215	4,463	6,889	40,850
Disposals	(372)	(11,117)	(10,517)	(1,471)	(23,477)
Transfers from construction in progress	30,543	4,689	479	32	35,743
Balance at 31 December 2007	223,183	252,393	33,937	19,639	529,152
Accumulated depreciation and impairment					
Balance at 1 January 2006	30,190	114,042	22,380	3,572	170,184
Charge for the year	4,890	11,859	2,296	1,961	21,006
Written back on disposal	(393)	(1,931)	(25)	(245)	(2,594)
Balance at 31 December 2006	34,687	123,970	24,651	5,288	188,596
Balance at 1 January 2007	34,687	123,970	24,651	5,288	188,596
Charge for the year	6,898	8,434	4,503	2,224	22,059
Impairment loss	–	3	72	–	75
Written back on disposal	(54)	(7,333)	(9,930)	(1,163)	(18,480)
Balance at 31 December 2007	41,531	125,074	19,296	6,349	192,250
Net book value					
At 31 December 2007	181,652	127,319	14,641	13,290	336,902
At 31 December 2006	155,042	108,636	14,861	8,901	287,440

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

15. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

(c) Impairment loss

In 2007, a number of items of property, plant and equipment were physically damaged or technically obsolete and the Group plans to dispose of these items, although no active programme to locate a buyer has been initiated. As a result, the Group had assessed the recoverable amounts of these items. Based on this assessment, the carrying amount of the assets was written down by RMB771,000 and RMB75,000 (2006: RMB1,868,000 and Nil) (included in "Other operating expenses"), respectively, by the Group and the Company. The estimates of the recoverable amounts were based on the assets' fair values less costs to sell, determined by reference to recent observable market prices for similar assets within the same industry.

(d) Property, plant and equipment held under finance leases

The Group leases certain buildings under finance leases with a remaining term of 14 years. At the balance sheet date, the net book value of buildings held under finance leases of the Group was RMB153,000 (2006: RMB877,000).

(e) Property, plant and equipment pledged for bank loans

As at 31 December 2007, buildings of the Group and the Company with carrying amounts of RMB47,977,000 and RMB47,977,000 (2006: RMB54,061,000 and RMB49,575,000), respectively, were pledged to banks to secure bank loans (see note 29).

(f) As at 31 December 2007, the Group was in the progress of registering the titles of buildings with net book values of RMB1,415,000 (2006: RMB1,682,000).

16. CONSTRUCTION IN PROGRESS

	The Group		The Company	
	2007 RMB'000	2006 (Restated) RMB'000	2007 RMB'000	2006 RMB'000
Cost				
At 1 January	17,274	19,447	15,220	17,045
Additions	50,884	43,865	47,813	41,747
Transfers to property, plant and equipment	(38,365)	(46,038)	(35,743)	(43,572)
At 31 December	29,793	17,274	27,290	15,220
Impairment				
At 1 January	2,884	2,570	2,132	1,818
Impairment loss	-	314	-	314
Transfers to property, plant and equipment	(75)	-	(75)	-
At 31 December	2,809	2,884	2,057	2,132
Net book value				
At 31 December	26,984	14,390	25,233	13,088

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

17. LEASE PREPAYMENTS

	The Group		The Company	
	2007 RMB'000	2006 (Restated) RMB'000	2007 RMB'000	2006 RMB'000
Cost				
At 1 January and 31 December	30,141	30,141	15,989	15,989
Accumulated amortisation				
At 1 January	4,852	4,248	4,217	3,897
Charge for the year	604	604	320	320
At 31 December	5,456	4,852	4,537	4,217
Net book value				
At 31 December	24,685	25,289	11,452	11,772

Lease prepayments represent payments for land use rights paid to the PRC authorities. The Group's land use rights have remaining terms ranging from 36 to 47 years as at 31 December 2007.

As at 31 December 2007, lease prepayments with a carrying amount of RMB11,452,000 (2006: RMB11,772,000) were pledged to banks to secure bank loans (see note 29).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

18. PREPAID PROPERTY LEASE RIGHTS

	The Group			The Company
	Prepaid rental for staff quarters RMB'000	Prepaid leasing rights (Restated) RMB'000	Total (Restated) RMB'000	Prepaid rental for staff quarters RMB'000
Cost				
At 1 January 2006	4,486	57,002	61,488	4,486
Additions	–	616	616	–
At 31 December 2006	4,486	57,618	62,104	4,486
At 1 January 2007	4,486	57,618	62,104	4,486
Additions	–	14	14	–
At 31 December 2007	4,486	57,632	62,118	4,486
Accumulated amortisation				
At 1 January 2006	934	–	934	934
Charge for the year	94	–	94	94
At 31 December 2006	1,028	–	1,028	1,028
At 1 January 2007	1,028	–	1,028	1,028
Charge for the year	94	–	94	94
At 31 December 2007	1,122	–	1,122	1,122
Net book value				
At 31 December 2007	3,364	57,632	60,996	3,364
At 31 December 2006	3,458	57,618	61,076	3,458

(i) Prepaid leasing rights

Pursuant to an agreement entered into between Xi'an Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Siyuan"), a subsidiary of the Company, and Xi'an Jiaotong University (the "University") on 26 March 2003 for the purpose of the joint construction of office buildings, the University contributed the land use rights and Siyuan paid for the construction costs of the project.

Siyuan is entitled to the rental income derived from the leasing of the office space of the buildings for a period of 23 years after the completion of the project. However, ownership of the properties continues to remain with the University.

The construction works have been substantially suspended since 2005. However, the directors believe that no provision for impairment of these prepaid costs is necessary because the Group may eventually dispose of Siyuan in the future. As at 31 December 2007, the directors estimate that the fair value less costs to sell the assets exceed the carrying amounts.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

19. INTANGIBLE ASSETS

(a) The Group

Intangible assets of the Group represent the following technical know-how purchased as part of business combinations in prior years:

	Turbo machines RMB'000	Computerised embroidery machines RMB'000	Intelligent electrical appliances RMB'000	Laser prototyping machines RMB'000	Total RMB'000
Cost					
At 1 January 2006 and 31 December 2006	11,630	3,745	9,118	12,521	37,014
Disposals	–	–	–	(12,521)	(12,521)
At 31 December 2007	11,630	3,745	9,118	–	24,493
Accumulated amortisation and impairment					
At 1 January 2006	4,844	3,280	6,405	3,683	18,212
Charge for the year	1,163	465	452	1,061	3,141
Impairment loss	–	–	–	3,561	3,561
At 31 December 2006	6,007	3,745	6,857	8,305	24,914
At 1 January 2007	6,007	3,745	6,857	8,305	24,914
Charge for the year	1,061	–	814	162	2,037
Impairment loss	–	–	1,447	–	1,447
Write back on disposal	–	–	–	(8,467)	(8,467)
At 31 December 2007	7,068	3,745	9,118	–	19,931
Net book value					
At 31 December 2007	4,562	–	–	–	4,562
At 31 December 2006	5,623	–	2,261	4,216	12,100

The amortisation charge for the year is included in "administrative expenses" in the financial statements.

During the year, the technical know-how for laser prototyping machines has been disposed of as part of the disposal of Hengtong (see note 5).

Impairment loss

During the year, the directors conducted a review of the Group's intangible assets and determined that certain assets were impaired due to technical obsolescence. Accordingly, an aggregate impairment loss of RMB1,447,000 (2006: RMB3,561,000) in respect of intangible assets was recognised in the consolidated income statement, based on their existing condition and shortfall of their recoverable amounts to their carrying amounts. The recoverable amounts of the relevant assets have been determined on the basis of their value in use.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

19. INTANGIBLE ASSETS (Continued)

(b) The Company

Intangible assets of the Company represent technical know-how relating to turbo machines as follows:

	2007 RMB'000	2006 RMB'000
Cost		
At 1 January and 31 December	11,630	11,630
Accumulated amortisation		
At 1 January	6,007	4,844
Charge for the year	1,061	1,163
At 31 December	7,068	6,007
Net book value		
At 31 December	4,562	5,623

20. GOODWILL

	The Group	
	2007 RMB'000	2006 RMB'000
Cost		
At 1 January	17,334	17,334
Disposals	(4,815)	-
At 31 December	12,519	17,334
Accumulated impairment losses		
At 1 January	5,844	1,369
Impairment loss	3,270	4,475
Write back on disposal	(2,439)	-
At 31 December	6,675	5,844
Carrying amount		
At 31 December	5,844	11,490

Goodwill is allocated to the Group's cash-generating units ("CGU") identified according to business segments as follows:

	2007 RMB'000	2006 RMB'000
Turbo machines	5,844	5,844
Intelligent electrical appliances	-	3,270
Laser prototyping machines	-	2,376
	5,844	11,490

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

20. GOODWILL (Continued)

During the year, goodwill relating to laser prototyping machines has been disposed of as part of the disposal of Hengtong (see note 5).

The recoverable amounts of the turbo machines unit and the intelligent electrical appliances unit are determined based on value in use calculations. The key assumptions for these calculations are those regarding the discount rates, growth rates and expected changes in selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to these CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next year and extrapolates cash flows for the following four years based on estimated steady growth rates of 20% and 1% for the turbo machines unit and the intelligent electrical appliances unit, respectively. These rates do not exceed the average long-term growth rates for the relevant markets. The rates used to discount the forecast cash flow for these CGUs range from 8.0% to 8.5% (2006: 8.1% to 10.1%) per annum.

21. INVESTMENTS IN SUBSIDIARIES

	The Company	
	2007 RMB'000	2006 RMB'000
Unlisted shares, at cost		
At 1 January	92,912	92,912
Additions	3,000	–
Disposals	(23,839)	–
At 31 December	<u>72,073</u>	<u>92,912</u>
Accumulated impairment losses		
At 1 January	35,369	29,409
Impairment loss	13,371	5,960
Write back on disposal	(9,839)	–
At 31 December	<u>38,901</u>	<u>35,369</u>
Carrying amount		
At 31 December	<u>33,172</u>	<u>57,543</u>

During the year, a minority shareholder transferred his entire interest of 11.02% in Hengtong at nil consideration to the Company. Accordingly, the interest in Hengtong held by the Company was increased from 65.34% to 76.36%. On 22 March 2007, Xi'an Ruite acquired the Company's entire 76.36% equity interests in Hengtong for RMB14,000,000. Details of the disposal are disclosed in note 5.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

21. INVESTMENTS IN SUBSIDIARIES (Continued)

Details of the subsidiaries as at 31 December 2007 are set out below. The class of shares held is ordinary unless otherwise stated.

Name of subsidiary	Place and date of establishment and operation	Registered capital (RMB'000)	Proportion of ownership interest			Principal activity
			Group's effective interest	Held by the Company	Held by a subsidiary	
Xi'an Ser Turbo Machinery Equipment Company Limited	PRC 3 July 2000	50,000	45% (Note (i))	45%		Design, development and sale of turbo-machinery
Changsha Ser Turbo Machinery Equipment Company Limited	PRC 16 January 2004	10,000	43% (Note (i))		95%	Design, development and sale of turbo-machinery
Hangzhou Ser Gas Engineering Company Limited	PRC 29 April 2004	1,200	23% (Note (i))		51%	Design, development and sale of turbo-machinery
Siyuan	PRC 14 August 1997	35,000	78.03%	78.03%		Research, development, manufacture and sale of automatic electrical machines for industries such as water utilities, civil engineering and construction
Winko Machine Company Limited ("Winko")	PRC 18 November 2002	20,230	96.74%	96.74%		Research, development, manufacture and sale of sensors, turbo tables and computerised embroidery machines
Kunming Machine Shipping Company Limited	PRC 13 October 2006	500	100%	100%		Provision of transportation services
Kunming Kunji General Machine Company Limited ("General Machine")	PRC 16 October 2007	3,000	100%	100%		Manufacture and sale of boring machines

Note:

- (i) The Company has the power to appoint over 50% of the number of directors of the entities and has retained the Company's controlling power over the entities. Accordingly, these entities are accounted for as subsidiaries of the Company.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

22. INTEREST IN AN ASSOCIATE

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Unlisted shares, at cost	–	–	14,000	10,000
Share of net assets	14,012	10,000	–	–
Unrealised loss on disposal of subsidiary to an associate	205	–	–	–
	14,217	10,000	14,000	10,000

As at 31 December 2007, details of the Group's interest in the associate are as follows:

Name of associate	Form of business structure	Place of establishment and operation	Registered capital (RMB'000)	Proportion of ownership interest		Principal activity
				Group's effective interest	Held by the Company	
Xi'an Ruite	Limited liability corporation	PRC	60,000	23.34%	23.34%	Design, development, and sale of prototyping machine tools, car moulds and manufacturing moulds

The summarised consolidated financial information of the associate is as follows:

	Assets RMB'000	Liabilities RMB'000	Equity RMB'000	Revenue RMB'000	Profit RMB'000
2007					
100 per cent	80,455	(20,421)	60,034	–	34
Group's effective interest	18,778	(4,766)	14,012	–	12
2006					
100 per cent	60,000	–	60,000	–	–
Group's effective interest	10,000	–	10,000	–	–

During the year, the Company's equity interest in Xi'an Ruite was increased from 16.67% to 23.34%.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

23. INTEREST IN A JOINTLY CONTROLLED ENTITY

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Unlisted shares, at cost	–	–	15,871	15,871
Share of net assets	21,440	16,473	–	–
	21,440	16,473	15,871	15,871

As at 31st December 2007, details of the Group's interest in the jointly controlled entity are as follows:

Name of joint venture	Form of business structure	Place of establishment and operation	Registered capital (RMB'000)	Proportion of ownership interest		Principal activity
				Group's effective interest	Held by the Company	
TOS Kunming Machine Tool Company Limited ("TOS")	Sino-foreign joint venture	PRC	49,457	50%	50%	Design, development, manufacture and sale of machine tools

The summarised financial information, after elimination of the effect of unrealised fair value adjustment of property, plant and equipment contributed to the jointly controlled entity, in respect of the Group's jointly controlled entity which is accounted for using the equity method is as follows:

	2007 RMB'000	2006 RMB'000
Non-current assets	7,603	9,178
Current assets	34,201	18,220
Current liabilities	(20,364)	(10,925)
Net assets	21,440	16,473
Income	35,755	19,478
Expenses	(30,788)	(17,955)
Profit for the year	4,967	1,523

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

24. INVENTORIES

(a) Inventories in the balance sheet comprise:

	The Group		The Company	
	2007 RMB'000	2006 (Restated) RMB'000	2007 RMB'000	2006 (Restated) RMB'000
Raw materials	97,984	61,018	78,947	49,712
Work in progress	259,268	171,729	141,991	101,855
Finished goods	70,171	51,172	64,778	43,512
	427,423	283,919	285,716	195,079

(b) The analysis of the amount of inventories recognised as an expense is as follows:

	The Group	
	2007 RMB'000	2006 (Restated) RMB'000
Carrying amount of inventories sold	805,960	562,363
Write-down of inventories	2,128	3,175
Reversal of write-down of inventories	(7,751)	(9,068)
	800,337	556,470

The reversal of write-down of inventories arose as a result of the subsequent usage of long-aged raw materials for which a write-down was made in prior years.

25. TRADE AND BILLS RECEIVABLE

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Trade and bills receivable	361,580	238,845	231,252	144,926
Less: Allowance for doubtful debts (note 25(b))	(76,491)	(57,458)	(42,721)	(31,046)
	285,089	181,387	188,531	113,880

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

25. TRADE AND BILLS RECEIVABLE (Continued)

(a) Ageing analysis

An ageing analysis of trade and bills receivable (net of impairment losses for bad and doubtful debts) is as follows:

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Current	273,047	155,020	184,418	108,496
Less than 1 month past due	2,965	9,751	1,807	3,478
1 to 3 months past due	4,239	12,299	1,318	1,906
More than 3 months but less than 12 months past due	3,934	2,007	988	–
More than 12 months past due	904	2,310	–	–
Amounts past due	12,042	26,367	4,113	5,384
	285,089	181,387	188,531	113,880

Trade and bills receivable are expected to be recovered within one year. In general, debts other than amounts relating to quality guarantee deposits are due for payment upon billing. Subject to negotiation, credit terms within a range of one to three months are available for certain customers with well-established trading and payment records on a case-by-case basis. The quality deposits are due for payment upon one year from date of billing. Further details on the Group's credit policy are set out in note 42(a).

(b) Impairment of trade and bills receivable

Impairment losses in respect of trade and bills receivable are recorded using an allowance account unless the Group is satisfied that recovery of the amount is remote, in which case the impairment loss is written-off against trade and bills receivable directly (see note 2(k)(i)).

The movement in the allowance for doubtful debts during the year, including both specific and collective loss components, is as follows:

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
At 1 January	57,458	44,192	31,046	25,104
Impairment loss recognised	20,439	13,266	11,675	5,942
Write back on disposal	(1,406)	–	–	–
At 31 December	76,491	57,458	42,721	31,046

At 31 December 2007, the Group's and the Company's trade and bills receivable of RMB102,229,000 (2006: RMB67,130,000) and RMB48,312,000 (2006: RMB31,263,000), respectively, were individually determined to be impaired. The individually impaired receivables related to customers that were in financial difficulties and management assessed that only a portion of the receivables is expected to be recovered. Consequently, specific allowances for doubtful debts of RMB76,491,000 (2006: RMB57,458,000) and RMB42,721,000 (2006: RMB31,046,000) were recognised. The Group does not hold any collateral over these balances.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

25. TRADE AND BILLS RECEIVABLE *(Continued)*

(c) Trade and bills receivable that are not impaired

The ageing analysis of trade and bills receivable that are neither individually nor collectively considered to be impaired are as follows:

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Neither past due nor impaired	254,339	155,020	180,000	108,496
Less than 1 month past due	1,611	9,660	1,060	3,478
1 to 3 months past due	1,967	4,691	1,142	1,689
More than 3 months but less than 12 months past due	1,322	1,947	738	–
More than 12 months past due	112	397	–	–
	5,012	16,695	2,940	5,167
	259,351	171,715	182,940	113,663

Receivables that were neither past due nor impaired relate to a wide range of customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Group. Based on past experience, management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral over these balances.

26. DEPOSITS, OTHER RECEIVABLES AND PREPAYMENTS

	The Group		The Company	
	2007 RMB'000	2006 (Restated) RMB'000	2007 RMB'000	2006 RMB'000
Advances to suppliers	37,530	42,619	8,558	9,139
Deposits for bidding, construction work and equipment purchase	28,465	20,787	26,243	18,499
Staff advances	4,110	3,824	2,368	1,821
Taxes recoverable	4,142	62	–	–
Others	8,176	5,969	2,455	5,780
	82,423	73,261	39,624	35,239

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

27. AVAILABLE-FOR-SALE INVESTMENTS

	The Group and the Company	
	2007 RMB'000	2006 RMB'000
Available-for-sale investments		
– Listed shares in the PRC	–	7,652
	–	7,652

In 2004, the Company entered into an agreement with China Fortune Securities Company Limited (“China Fortune”) for the trusteeship of the management of investment in state bonds (the “Trusteeship Agreement”), pursuant to which the Company entrusted China Fortune to conduct investments in state bonds with RMB50,000,000 (the “Funds”) for one year. However, China Fortune failed to comply with the Trusteeship Agreement by using the Funds to invest in stocks, and significant losses were subsequently incurred.

As at 31 December 2006, the directors considered that the range of reasonable fair value estimates of these investments was so significant that their fair values could not be determined reliably and accordingly, these investments were stated at a carrying value of RMB7,652,000 after taking into account the provision for impairment losses amounting to RMB38,098,000 and an amount of RMB4,250,000 that has previously been received by the Company.

During the year ended 31 December 2007, the Company liquidated the investments and received RMB32,035,000. Accordingly, a gain on disposal of RMB24,383,000 has been recognised in the income statement for the year ended 31 December 2007. The net gain after tax was RMB20,726,000.

28. CASH AT BANK AND IN HAND

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Cash in hand and demand deposits	363,306	163,017	322,299	111,697
	363,306	163,017	322,299	111,697
Restricted bank deposits for performance guarantees and bills payable with maturity of more than three months	7,045	2,789	400	2,188
	370,351	165,806	322,699	113,885

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

29. BANK LOANS

The bank loans were repayable as follows:

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Within 1 year or on demand	–	40,000	–	20,000
After 1 year but within 2 years	–	20,000	–	20,000
After 2 years but within 5 years	50,000	–	50,000	–
	50,000	20,000	50,000	20,000
	50,000	60,000	50,000	40,000

The bank loans were secured as follows:

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Bank loans				
– secured	50,000	40,000	50,000	20,000
– unsecured	–	20,000	–	20,000
	50,000	60,000	50,000	40,000

At 31 December 2007, the bank loans of the Group were secured by mortgages over land and buildings with an aggregate carrying value of RMB11,452,000 (2006: RMB11,772,000) and RMB47,977,000 (2006: RMB54,061,000), respectively.

The annual rate of interest charged on the bank loans was 6.57% for year ended 31 December 2007 (2006: 5.85% to 6.30%).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

30. TRADE AND BILLS PAYABLE

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Trade creditors	116,128	96,480	45,775	54,688
Bills payable	4,670	–	–	–
	120,798	96,480	45,775	54,688

An ageing analysis of trade and bills payable of the Group is as follows:

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Due within 1 month or on demand	58,370	20,602	12,898	13,892
Due after 1 month but within 3 months	49,229	64,206	29,862	39,097
Due after 3 months but within 6 months	13,199	11,672	3,015	1,699
	120,798	96,480	45,775	54,688

All the trade and bills payable are expected to be settled within one year.

31. OTHER PAYABLES

	The Group		The Company	
	2007 RMB'000	2006 RMB'000	2007 RMB'000	2006 RMB'000
Advances from customers	434,605	229,214	258,985	116,209
Payables for construction work	37,765	35,635	677	3,212
Other taxes payable	38,609	14,259	24,829	10,673
Employees' bonus and welfare	24,323	12,490	20,308	7,966
Land use fees payable	5,284	6,449	–	–
Others	16,880	11,793	9,916	5,654
	557,466	309,840	314,715	143,714

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

32. OBLIGATIONS UNDER FINANCE LEASES

At 31 December 2007, the Group and the Company had obligations under finance leases repayable as follows:

	The Group and the Company			
	2007		2006	
	Present value of the minimum lease payments RMB'000	Total minimum lease payments RMB'000	Present value of the minimum lease payments RMB'000	Total minimum lease payments RMB'000
Within 1 year	213	342	213	342
After 1 year but within 2 years	213	342	213	342
After 2 years but within 5 years	640	1,026	640	1,026
After 5 years	1,919	3,080	2,132	3,422
	2,772	4,448	2,985	4,790
	2,985	4,790	3,198	5,132
Less: total future interest expenses		(1,805)		(1,934)
Present value of lease obligations		2,985		3,198

33. RETIREMENT BENEFITS

(i) The Group participates in government pension schemes whereby it is required to pay annual contributions at the rates of 20% of the basic salaries of its employees. Under these schemes, retirement benefits of the existing and retired employees are payable by the relevant authorities and the Group has no further obligations beyond the annual contributions.

(ii) Early retirement benefits obligation

The Group has a number of employees who were made to retire from employment of the Group prior to their official retirement dates. However, the Group is obligated to continue to make monthly payments to these employees commencing from the date of their early-retirement up until their respective official retirement dates. The payments are calculated based on a certain percentage of their last drawn salaries. The amounts recognised as at year end represent the Group's obligation discounted to present value determined by reference to market yields at the balance sheet date on high quality corporate bonds of similar maturities.

The Group does not operate any other retirement benefits schemes for its employees.

34. DEFERRED INCOME

Deferred income mainly represents research and development funds obtained from the government for the purpose of developing control systems used in compressors. The funds will be recognised as income over the useful lives of the relevant assets when the development project has been completed and put into use.

35. DEFERRED GAIN

Deferred gain represents the gain on disposal of certain buildings that were subsequently leased back by the Group in 2001. Such leases qualify as finance leases (see note 32) and the gain is deferred and amortised to profit or loss over the lease term of 20 years.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

36. LONG-TERM PAYABLES

The amount, which represents a government grant to Siyuan for working capital for a construction project (see note 18(i)), is unsecured, non-interest bearing and will not be repayable until the project is completed. As the project has been substantially suspended, the directors believe it is probable the Group may have to repay the amount. However, no fixed date of repayment has been set by the government. In the opinion of the directors, the amount will not be repaid within the next twelve months.

37. DEFERRED TAXATION

(a) Deferred tax assets and liabilities recognised

	The Group					The Company				
	At 1	Credited/	At 31	Credited/	At 31	At 1	Credited/	At 31	Credited/	At 31
	January	(charged) to	December	(charged) to	December	January	(charged) to	December	(charged) to	December
	(Restated)	2006 profit or loss	(Restated)	2006 profit or loss	2007	(Restated)	2006 profit or loss	(Restated)	2006 profit or loss	2007
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Impairment losses for trade and other receivables	10,237	2,518	12,755	4,456	17,211	6,630	1,425	8,055	5,834	13,889
Write-down of inventories	6,899	(2,139)	4,760	(707)	4,053	6,367	(2,139)	4,228	(882)	3,346
Provision for product warranties	187	346	533	835	1,368	187	346	533	834	1,367
Early retirement benefits obligation	5,756	(316)	5,440	(498)	4,942	5,756	(316)	5,440	(498)	4,942
Impairment of property, plant and equipment and construction in progress	1,129	74	1,203	(75)	1,128	1,130	73	1,203	(110)	1,093
Impairment of available-for-sale investments	5,734	(19)	5,715	(5,715)	-	5,734	(19)	5,715	(5,715)	-
Deferred income	-	-	-	278	278	-	-	-	278	278
Intra-group unrealised profits	852	1,735	2,587	(858)	1,729	-	-	-	-	-
Impairment of investments in subsidiaries	-	-	-	-	-	6,830	1,538	8,368	(133)	8,235
Others	730	(326)	404	96	500	230	(471)	(241)	241	-
Net deferred tax assets/(liabilities)	31,524	1,873	33,397	(2,188)	31,209	32,864	437	33,301	(151)	33,150

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

37. DEFERRED TAXATION (Continued)

(a) Deferred tax assets and liabilities recognised (Continued)

	The Group		The Company	
	2007	2006	2007	2006
	RMB'000	(Restated) RMB'000	RMB'000	(Restated) RMB'000
Net deferred tax asset recognised on the balance sheet	31,209	33,638	33,150	33,542
Net deferred tax liability recognised on the balance sheet	–	(241)	–	(241)
	<u>31,209</u>	<u>33,397</u>	<u>33,150</u>	<u>33,301</u>

(b) Deferred tax assets not recognised

Deferred tax assets of the Group have not been recognised in respect of the following items:

	The Group	
	2007	2006
	RMB'000	RMB'000
Tax losses	<u>58,079</u>	<u>44,658</u>

The tax losses will expire by 2012. Deferred tax assets have not been recognised in respect of the above tax losses because it is not probable that future taxable profits will be available against which the Group can utilise the benefits therefrom.

38. PROVISION FOR PRODUCT WARRANTIES

	The Group		The Company	
	2007	2006	2007	2006
	RMB'000	(Restated) RMB'000	RMB'000	(Restated) RMB'000
At 1 January	3,555	1,244	3,555	1,244
Additional provisions made	11,305	7,728	11,303	7,728
Provisions utilised	(5,743)	(5,417)	(5,743)	(5,417)
At 31 December	<u>9,117</u>	<u>3,555</u>	<u>9,115</u>	<u>3,555</u>

Under the normal terms of the Group's sales agreements, the Group will rectify any product defects arising within one year of the date of sale. Provision is therefore made for the best estimate of the expected settlement under these agreements in respect of sales made within the one year prior to the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

39. CAPITAL AND RESERVES

(a) The Group

	Attributable to equity shareholders of the Company						Total	Minority interests	Total equity
	Share capital	Share premium	Capital reserve	Statutory surplus reserve	Statutory public welfare fund	Statutory (Accumulated losses)/ retained profits			
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
At 1 January 2006:									
– as previously reported	245,007	293,745	10,225	9,292	8,561	(43,689)	523,141	59,098	
– retrospective restatements in respect of:									
– Deferred taxation	–	–	–	–	–	28,678	28,678	2,845	
– Warranty provision	–	–	–	–	–	(1,244)	(1,244)	–	
– Early-retirement benefits obligation	–	–	–	–	–	(25,197)	(25,197)	–	
– as restated	245,007	293,745	10,225	9,292	8,561	(41,452)	525,378	61,943	
Profit for the year:									
– as previously reported	–	–	–	–	–	82,481	82,481	8,003	
– retrospective restatements	–	–	–	–	–	20,048	20,048	1,288	
– restated	–	–	–	–	–	102,529	102,529	9,291	
Acquisition of additional interests in a subsidiary	–	–	–	–	–	–	–	(43)	
Transfers between reserves	–	–	–	8,561	(8,561)	–	–	–	
Appropriations	–	–	–	–	–	–	–	–	
– as previously reported	–	–	–	3,485	–	(3,485)	–	–	
– retrospective restatements	–	–	–	472	–	(472)	–	–	
– as restated	–	–	–	3,957	–	(3,957)	–	–	
At 31 December 2006:									
– as previously reported	245,007	293,745	10,225	21,338	–	35,307	605,622	67,058	
– retrospective restatements	–	–	–	472	–	21,813	22,285	4,133	
– as restated	245,007	293,745	10,225	21,810	–	57,120	627,907	71,191	
At 1 January 2007:									
– as previously reported	245,007	293,745	10,225	21,338	–	35,307	605,622	67,058	
– retrospective restatements in respect of:									
– Deferred taxation	–	–	–	–	–	29,264	29,264	4,133	
– Warranty provision	–	–	–	–	–	(3,555)	(3,555)	–	
– Early-retirement benefits obligation	–	–	–	–	–	(23,088)	(23,088)	–	
– Inventories	–	–	–	–	–	19,664	19,664	–	
– Appropriations	–	–	–	472	–	(472)	–	–	
– as restated	245,007	293,745	10,225	21,810	–	57,120	627,907	71,191	
Changes in share capital (note 39(c)(ii))	179,858	(179,858)	–	–	–	–	–	–	
Disposal of a subsidiary	–	–	–	–	–	–	–	(5,886)	
Profit for the year	–	–	–	–	–	241,452	241,452	8,686	
Appropriations	–	–	–	21,129	–	(21,129)	–	–	
At 31 December 2007	424,865	113,887	10,225	42,939	–	277,443	869,359	73,991	

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

39. CAPITAL AND RESERVES (Continued)

(b) The Company

	Attributable to equity shareholders of the Company						
	Share capital RMB'000	Share premium RMB'000	Capital reserve RMB'000	Statutory surplus reserve RMB'000	Statutory public welfare fund RMB'000	(Accumulated losses)/ retained profits RMB'000	Total RMB'000
At 1 January 2006:							
– as previously reported	245,007	293,745	10,225	8,406	8,406	(60,254)	505,535
– retrospective restatements in respect of:							
– Deferred taxation	–	–	–	–	–	32,864	32,864
– Warranty provision	–	–	–	–	–	(1,244)	(1,244)
– Early-retirement benefits obligation	–	–	–	–	–	(25,197)	(25,197)
– as restated	245,007	293,745	10,225	8,406	8,406	(53,831)	511,958
Profit for the year:							
– as previously reported	–	–	–	–	–	80,878	80,878
– retrospective restatements	–	–	–	–	–	19,899	19,899
– as restated	–	–	–	–	–	100,777	100,777
Transfers between reserves	–	–	–	8,406	(8,406)	–	–
Appropriations							
– as previously reported	–	–	–	3,485	–	(3,485)	–
– retrospective restatements	–	–	–	472	–	(472)	–
– as restated	–	–	–	3,957	–	(3,957)	–
At 31 December 2006:							
– as previously reported	245,007	293,745	10,225	20,297	–	17,139	586,413
– retrospective restatements	–	–	–	472	–	25,850	26,322
– as restated	<u>245,007</u>	<u>293,745</u>	<u>10,225</u>	<u>20,769</u>	<u>–</u>	<u>42,989</u>	<u>612,735</u>
At 1 January 2007:							
– as previously reported	245,007	293,745	10,225	20,297	–	17,139	586,413
– retrospective restatements in respect of:							
– Deferred taxation	–	–	–	–	–	33,301	33,301
– Warranty provision	–	–	–	–	–	(3,555)	(3,555)
– Early-retirement benefits obligation	–	–	–	–	–	(23,088)	(23,088)
– Inventories	–	–	–	–	–	19,664	19,664
– Appropriations	–	–	–	472	–	(472)	–
– as restated	245,007	293,745	10,225	20,769	–	42,989	612,735
Changes in share capital (note 39(c)(iii))	179,858	(179,858)	–	–	–	–	–
Profit for the year	–	–	–	–	–	198,963	198,963
Appropriations	–	–	–	21,129	–	(21,129)	–
At 31 December 2007 (as restated)	<u>424,865</u>	<u>113,887</u>	<u>10,225</u>	<u>41,898</u>	<u>–</u>	<u>220,823</u>	<u>811,698</u>

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

39. CAPITAL AND RESERVES (Continued)

(c) Share capital

(i) Issued share capital

	2007 RMB'000	2006 RMB'000
Registered, issued and fully paid:		
– 312,148,000 domestic listed A-shares of RMB1.00 each	312,148	180,007
– 112,717,000 H-shares of RMB1.00 each	112,717	65,000
	424,865	245,007

Except for the currency in which dividends are paid and the restrictions as to whether the shareholders can be PRC investors or foreign investors, A-shares and H-shares rank *pari passu* in all material respects with each other.

(ii) Changes in share capital

On 22 December 2006, a "Share Increase via Capital Reserve" proposal (the "Share Increase Proposal No. 1") (whereby 1.5606 new shares would be allotted for every 10 existing shares) and the "Share Reform" proposal (the "Share Reform Proposal") (whereby holders of non-circulating shares would pay 2.7 shares for every 10 existing shares to holders of circulating A-shares as consideration for non-circulating shares becoming listed and tradable) were considered and approved at an Extraordinary General Meeting and a shareholders' meeting in relation to the A-share market, respectively. On 30 January 2007, the aforesaid proposals were approved by the relevant government authorities.

On 26 February 2007, the Company implemented the Share Increase Proposal No. 1 and 1.5606 new shares were allotted for every 10 existing shares to all shareholders. In total, the share capital of the Company increased by 38,235,855 shares, of which 28,091,955 shares were A-shares and 10,143,900 shares were H-shares. The par value of the issued ordinary shares was transferred from the share premium account. After the implementation of the Share Increase Proposal No. 1, the total issued share capital of the Company was 283,243,255 shares.

On 7 March 2007, the Share Reform Proposal was implemented in the A-share market where the holders of non-circulating shares of the Company paid a total of 18,728,355 shares to the holders of circulating A-shares (excluding holders of H-shares) as consideration for the circulation of their non-circulating shares. Accordingly, each holder of circulating A-shares received 2.7 shares for every 10 existing shares from the holders of non-circulating shares.

On 29 June 2007, another "Share Increase via Capital Reserve" proposal (the "Share Increase Proposal No. 2") (whereby 5 new shares would be allotted for every 10 existing shares) were considered and approved at the Annual General Meeting and Class Meeting. On 15 August 2007, this proposal was approved by the relevant government authorities.

On 19 November 2007, the Company implemented the Share Increase Proposal No. 2, and 5 new shares were allotted for every 10 existing shares to all shareholders. In total, the share capital of the Company increased by 141,621,628 shares, of which 104,049,678 shares were A-shares and 37,571,950 shares were H-shares. The par value of the issued ordinary shares was transferred from the share premium account.

After the implementation of the Share Increase Proposal No. 1 and the Share Increase Proposal No. 2, the total issued share capital of the Company was RMB424,865,000.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

39. CAPITAL AND RESERVES *(Continued)*

(d) Nature and purpose of reserves

(i) *Share premium*

The application of the share premium account of the Company is governed by the PRC Company Law.

(ii) *Capital reserve*

The capital reserve represents the profit of Kunming Machine Tool Plant for the period from 1 July 1993 to 18 October 1993 less an amount of RMB7,000,000 which the Company paid in cash to the Yunnan Provincial People's Government pursuant to a demerger agreement dated 20 November 1993 between Kun Ji Group and the Company.

(iii) *Statutory surplus reserve*

The statutory surplus reserve represents appropriations from profit after taxation in accordance with the PRC Company Law. Statutory surplus reserve is part of the shareholders' equity and when its balance reaches an amount equal to 50% of the relevant company's registered capital, further appropriation need not be made. According to the PRC Company Law, the statutory surplus reserve may be used to make up past losses or to increase capital by means of conversion. However, when funds from the statutory surplus reserve are converted to capital, the funds remaining in such reserve shall not be less than 25% of the registered capital.

(iv) *Statutory public welfare fund*

According to the PRC Company Law, the statutory public welfare fund is no longer required and therefore, the Group discontinued the recognition of its statutory public welfare commencing from 1 January 2006. Such statutory public welfare fund was transferred to the statutory surplus reserve during the year ended 31 December 2006.

(e) Distributability of reserves

At 31 December 2007, the aggregate amount of reserves available for distribution to equity shareholders of the Company was RMB220,823,000 (2006: RMB42,989,000, as restated).

(f) Capital management

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

Consistent with industry practice, the Group monitors its capital structure on the basis of a net debt-to-adjusted capital ratio. For this purpose the Group defines net debt as total debt (which includes interest-bearing loans and borrowings, trade and bills payable, other payables and accrued expenses and amounts due to related parties) less cash and cash equivalents. Adjusted capital comprises all components of equity, less unaccrued proposed dividends.

During 2007, the Group's and the Company's strategy, which was unchanged from 2006, was to maintain the net debt-to-adjusted capital ratio in the range of 30% to 50% and 15% to 30%, respectively. In order to maintain or adjust the ratio, the Group may adjust the amount of dividends paid to shareholders, issue new shares, return capital to shareholders, raise new debt financing or sell assets to reduce debt.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

39. CAPITAL AND RESERVES (Continued)

(f) Capital management (Continued)

The net debt-to-adjusted capital ratio at 31 December 2007 and 2006 was as follows:

	The Group		The Company	
	2007	2006	2007	2006
	RMB'000	(Restated) RMB'000	RMB'000	RMB'000
Bank loans due within one year	–	40,000	–	20,000
Trade and bills payable	120,798	96,480	45,775	54,688
Other payables	557,466	309,840	314,715	143,714
Obligations under finance leases due within one year	213	213	213	213
Amounts due to subsidiaries and related parties	13,872	29,639	66,699	30,417
Bank loans due after one year	50,000	20,000	50,000	20,000
Obligations under finance leases due after one year	2,772	2,985	2,772	2,985
Long-term payables	7,200	7,200	–	–
Less: Cash at bank and in hand	(370,351)	(165,806)	(322,699)	(113,885)
Net debt	381,970	340,551	157,475	158,132
Total equity	943,350	699,098	811,698	612,735
Net debt-to-adjusted capital ratio	40%	49%	19%	26%

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

40. COMMITMENTS

- (a) Capital commitments outstanding at 31 December 2007 not provided for in the financial statements were as follows:

	The Group		The Company	
	2007	2006	2007	2006
	RMB'000	RMB'000	RMB'000	RMB'000
Contracted for	50,074	34,923	49,837	30,540
Authorised but not contracted for	398	–	398	–
	50,472	34,923	50,235	30,540

- (b) At 31 December 2007, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group		The Company	
	2007	2006	2007	2006
	RMB'000	RMB'000	RMB'000	RMB'000
Within 1 year	2,776	1,992	2,351	1,828
After 1 year but within 5 years	9,113	22,489	8,632	7,312
After 5 years	23,675	52,045	23,675	18,126
	35,564	76,526	34,658	27,266

The Group leases a number of its land use rights, office properties, factories and staff quarters under operating leases. The leases typically run for an average term of 20 years, and none of the leases includes contingent rentals.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

41. MATERIAL RELATED PARTY TRANSACTIONS

(a) Transactions with related parties

Name of party	Nature of transactions	The Group Year ended 31 December	
		2007 RMB'000	2006 RMB'000
Management of the Company			
Ms. Yu Yan	Disposal of building by the Group (i)	–	259
Mr. Pei Xi An	Disposal of building by the Group (i)	–	262
Mr. Zhao Nai Bin	Disposal of building by the Group (i)	–	259
Associate			
Xi'an Ruite	Sale of subsidiary (ii)	14,000	–
Jointly controlled entity			
TOS	Sales (iii)	10,901	3,387
	Consultancy fees	11	2,255
	Disposal of property, plant and equipment	–	12
	Purchases (iv)	50,862	38,923
	Disposal of materials	–	539

Notes:

- (i) The Group disposed three buildings with an aggregate carrying value of RMB780,000 to the senior management of the Company during the year ended 31 December 2006.
- (ii) This represents the sale of Hengtong by the Company to Xi'an Ruite.
- (iii) These mainly represent the sale of materials to TOS for production purposes.
- (iv) These mainly represent the sale of machine tools by TOS to the Group.
- (v) Key management personnel remuneration

Remuneration for key management personnel of the Group, including amounts paid to the Company's directors as disclosed in note 10 and certain of the highest paid employees as disclosed in note 11, is as follows:

	2007 RMB'000	2006 RMB'000
Short-term employee benefits	6,447	2,331

Total remuneration is included in "staff costs" (note 8(b)).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

41. MATERIAL RELATED PARTY TRANSACTIONS (Continued)

(b) Balances with related parties

Name of party	Nature of transactions	The Group and the Company	
		2007 RMB'000	2006 RMB'000
TOS	Balance due from/(to)		
	– trade payables (i)	(13,872)	(994)
	– non-trade payables (ii)	–	(17,213)
	– trade receivables (iii)	5,654	4,960
	– non-trade receivables (ii)	61	1,134
		(8,157)	(12,113)
Xi'an Ruite	Balance due from/(to)		
	– non-trade payables (ii)	–	(10,000)
		–	(10,000)
Other parties	Balance due from/(to)		
	– non-trade payables (ii)	–	(1,432)
		–	(1,432)

Notes:

- (i) These mainly represent the sale of machine tools by TOS to the Group.
- (ii) These mainly represent cash advances that are unsecured, interest-free and repayable on demand.
- (iii) These mainly represent the sale of materials to TOS for production purposes.

(c) Balances with subsidiaries

As at 31 December 2007, the amounts due to subsidiaries mainly represent advances received from third party customers by the Company on behalf of General Machine.

The amounts due from subsidiaries as at 31 December 2007 mainly represent receivables due from General Machine relating to sale of materials by the Company and salaries paid on behalf of General Machine. The amounts due from subsidiaries as at 31 December 2006 mainly represent cash advances to Winko and the amounts were unsecured, interest-bearing, and repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

41. MATERIAL RELATED PARTY TRANSACTIONS *(Continued)*

(d) Transactions with other state-owned entities in the PRC

The Group operates in an economic regime currently dominated by entities directly or indirectly controlled by the PRC government through its government authorities, agencies, affiliations and other organisations ("state-owned entities"). Transactions with other state-owned entities include but are not limited to the following:

- purchase, sale and leases of property and other assets; and
- rendering and receiving of utilities and other services.

These transactions are conducted in the ordinary course of the Group's business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services. Such pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. Having due regard to the substance of the relationship, the directors of the Company are of the opinion that none of these transactions are related party transactions that require separate disclosure.

42. FINANCIAL INSTRUMENTS

Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

(a) Credit risk

The Group's credit risk is primarily attributable to trade and bills receivable. Management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis. In respect of trade and bills receivable, individual credit evaluations are performed on all customers requiring credit over a certain amount. These evaluations focus on the customer's past history of making payments when due and current ability to pay, and take into account information specific to the customer as well as pertaining to the economic environment in which the customer operates. Normally, the Group does not obtain collateral from customers.

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The default risk of the industry and country in which customers operate also has an influence on credit risk but to a lesser extent. At the balance sheet date, the Group has no significant concentration of credit risk because the exposure is spread over a number of counterparties and customers.

The maximum exposure to credit risk without taking account of any collateral held is represented by the carrying amount of each financial asset in the balance sheet after deducting any impairment allowance. The Group does not provide financial guarantees to parties outside the Group which would expose the Group or the Company to credit risk.

Further quantitative disclosures in respect of the Group's exposure to credit risk arising from trade and bills receivable are set out in note 25.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS (Continued)

(b) Liquidity risk

Individual operating entities within the Group are responsible for their own cash management, including the raising of loans to cover expected cash demands, subject to approval by the parent company when the borrowings exceed certain predetermined levels of authority. The Group's policy is to regularly monitor its liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

The following table details the remaining contractual maturities at the balance sheet date of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the balance sheet date) and the earliest date the Group can be required to pay:

The Group	Carrying amount RMB'000	Total contractual undiscounted cash flow RMB'000	2007			
			Within 1 year or on demand RMB'000	More than 1 year but less than 2 years RMB'000	More than 2 years, but less than 5 years RMB'000	More than 5 years RMB'000
Bank loans	50,000	(58,428)	(3,650)	(3,780)	(50,998)	-
Obligations under finance leases	2,985	(4,790)	(342)	(342)	(1,026)	(3,080)
Bills payable, creditors and accrued expenses	243,659	(243,659)	(243,659)	-	-	-
Amounts due to related parties	13,872	(13,872)	(13,872)	-	-	-
Long term payables	7,200	(7,200)	-	-	(7,200)	-
Early retirement benefits obligation	19,799	(23,331)	(4,523)	(4,145)	(9,165)	(5,498)
	<u>337,515</u>	<u>(351,280)</u>	<u>(266,046)</u>	<u>(8,267)</u>	<u>(68,389)</u>	<u>(8,578)</u>

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS (Continued)

(b) Liquidity risk (Continued)

	Carrying amount (Restated) RMB'000	Total contractual undiscounted cash flow RMB'000	2006			
			Within 1 year or on demand RMB'000	More than 1 year but less than 2 years RMB'000	More than 2 years, but less than 5 years RMB'000	More than 5 years RMB'000
Bank loans	60,000	(64,160)	(42,732)	(21,428)	-	-
Obligations under finance leases	3,198	(5,132)	(342)	(342)	(1,026)	(3,422)
Bills payable, creditors and accrued expenses	177,106	(177,106)	(177,106)	-	-	-
Amounts due to related parties	29,639	(29,639)	(29,639)	-	-	-
Long term payables	7,200	(7,200)	-	-	(7,200)	-
Early retirement benefits obligation	23,088	(27,719)	(4,655)	(4,532)	(10,431)	(8,101)
	<u>300,231</u>	<u>(310,956)</u>	<u>(254,474)</u>	<u>(26,302)</u>	<u>(18,657)</u>	<u>(11,523)</u>
The Company				2007		
	Carrying amount RMB'000	Total contractual undiscounted cash flow RMB'000	Within 1 year or on demand RMB'000	More than 1 year but less than 2 years RMB'000	More than 2 years, but less than 5 years RMB'000	More than 5 years RMB'000
Bank loans	50,000	(58,428)	(3,650)	(3,780)	(50,998)	-
Obligations under finance leases	2,985	(4,790)	(342)	(342)	(1,026)	(3,080)
Bills payable, creditors and accrued expenses	101,505	(101,505)	(101,505)	-	-	-
Amounts due to related parties	66,699	(66,699)	(66,699)	-	-	-
Early retirement benefits obligation	19,799	(23,331)	(4,523)	(4,145)	(9,165)	(5,498)
	<u>240,988</u>	<u>(254,753)</u>	<u>(176,719)</u>	<u>(8,267)</u>	<u>(61,189)</u>	<u>(8,578)</u>

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS (Continued)

(b) Liquidity risk (Continued)

	Carrying amount (Restated) RMB'000	Total contractual undiscounted cash flow RMB'000	2006			
			Within 1 year or on demand RMB'000	More than 1 year but less than 2 years RMB'000	More than 2 years, but less than 5 years RMB'000	More than 5 years RMB'000
Bank loans	40,000	(42,997)	(21,569)	(21,428)	-	-
Obligations under finance leases	3,198	(5,132)	(342)	(342)	(1,026)	(3,422)
Bills payable, creditors and accrued expenses	82,193	(82,193)	(82,193)	-	-	-
Amounts due to related parties	30,417	(30,417)	(30,417)	-	-	-
Early retirement benefits obligation	23,088	(27,719)	(4,655)	(4,532)	(10,431)	(8,101)
	<u>178,896</u>	<u>(188,458)</u>	<u>(139,176)</u>	<u>(26,302)</u>	<u>(11,457)</u>	<u>(11,523)</u>

(c) Interest rate risk

The Group adopts a policy of ensuring that 100% of its borrowings are effectively on a fixed rate basis. Therefore, the Group's interest rate risk arises primarily from floating rate bank deposits. Floating rate bank deposits expose the Group to cash flow interest rate risk. The Group's interest rate profile as monitored by management is set out in (i) below.

(i) Interest rate profile

The following table details the interest rate profile of the Group's and the Company's floating rate bank deposits at the balance sheet date.

The Group	2007		2006	
	Effective interest rate %	RMB'000	Effective interest rate %	RMB'000
Floating rate bank deposits	0.72%	368,900	0.74%	144,106
The Company	2007		2006	
	Effective interest rate %	RMB'000	Effective interest rate %	RMB'000
Floating rate bank deposits	0.70%	322,049	0.80%	92,388

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS *(Continued)*

(c) Interest rate risk *(Continued)*

(ii) *Sensitivity analysis*

At 31 December 2007, it is estimated that a general increase/decrease of 20 basis points in interest rates, with all other variables held constant, would increase/decrease the Group's profit after tax and retained profits by approximately RMB618,000 (2006: RMB244,000). Other components of consolidated equity would not increase/decrease in response to the general increase/decrease in interest rates.

The sensitivity analysis above has been determined assuming that the change in interest rates had occurred at the balance sheet date and had been applied to the exposure to interest rate risk for floating rate bank deposits in existence at that date. The 20 basis point increase or decrease represents management's assessment of a reasonably possible change in interest rates over the period until the next annual balance sheet date. The analysis is performed on the same basis for 2006.

(d) Currency risk

(i) *Forecast transactions*

The Group is exposed to currency risk primarily through sales and purchases that are denominated in a currency other than the functional currency of the operations to which they relate. The currencies giving rise to this risk are primarily the United States dollars.

Depreciation or appreciation of the Renminbi against foreign currencies can affect the Group's results. The Group did not hedge its foreign currency exposure other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange.

(ii) *Recognised assets and liabilities*

In respect of other trade receivables and payables held in currencies other than the functional currency of the operations to which they relate, the Group ensures that the net exposure is kept to an acceptable level, by buying or selling foreign currencies at spot rates where necessary to address short-term imbalances.

All the Group's borrowings are denominated in Renminbi. Given this, management does not expect that there will be any significant currency risk associated with the Group's borrowings.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS (Continued)

(d) Currency risk (Continued)

(iii) Exposure to currency risk

The following table details the Group's and the Company's exposure at the balance sheet date to currency risk arising from forecast transactions or recognised assets or liabilities denominated in a currency other than the Renminbi.

The Group	2007			2006		
	United States Dollars ('000)	Hong Kong Dollars ('000)	Euros ('000)	United States Dollars ('000)	Hong Kong Dollars ('000)	Euros ('000)
Cash and cash equivalents	1,100	30,810	24	370	24,701	65
Trade and bills receivable	411	-	414	551	-	-
Deposits, other receivables and prepayments	231	-	1,125	226	-	230
Trade and bills payables	-	-	(156)	-	-	-
Advances from customers	(46)	-	-	(227)	-	-
Overall net exposure	<u>1,696</u>	<u>30,810</u>	<u>1,407</u>	<u>920</u>	<u>24,701</u>	<u>295</u>
The Company	2007			2006		
	United States Dollars ('000)	Hong Kong Dollars ('000)	Euros ('000)	United States Dollars ('000)	Hong Kong Dollars ('000)	Euros ('000)
Cash and cash equivalents	1,100	30,810	12	333	24,701	3
Trade and bills receivable	411	-	414	23	-	-
Deposits, other receivables and prepayments	231	-	1,125	54	-	162
Overall net exposure	<u>1,742</u>	<u>30,810</u>	<u>1,551</u>	<u>410</u>	<u>24,701</u>	<u>165</u>

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS *(Continued)*

(d) Currency risk *(Continued)*

(v) Sensitivity analysis

The following table indicates the approximate change in the Group's profit after tax (and retained profits) in response to reasonably possible changes in the foreign exchange rates to which the Group has significant exposure at the balance sheet date.

The Group	2007		2006	
	Increase/ (decrease) in foreign exchange rates	Effect on profit after tax and retained profits RMB'000	Increase/ (decrease) in foreign exchange rates	Effect on profit after tax and retained profits RMB'000
United States Dollar	6% (6%)	684 (684)	3% (3%)	175 (175)
Hong Kong Dollars	7% (7%)	1,668 (1,668)	3% (3%)	722 (722)
Euros	4% (4%)	508 (508)	7% (7%)	167 (167)

The sensitivity analysis has been determined assuming that the change in foreign exchange rates had occurred at the balance sheet date and had been applied to the Group's exposure to currency risk for non-derivative financial instruments in existence at that date, and that all other variables, in particular interest rates, remain constant.

The stated changes represent management's assessment of reasonably possible changes in foreign exchange rates over the period until the next annual balance sheet date. Results of the analysis as presented in the above table represent an aggregation of the effects on each of the Group's profit after tax and equity measured in the respective functional currencies, translated into Renminbi at the exchange rate ruling at the balance sheet date for presentation purposes. The analysis is performed on the same basis for 2006.

(e) Equity price risk

As at 31 December 2006, the Group was exposed to equity price changes arising from equity investments classified as available-for-sale investments. However, these available-for-sale investments could not be freely-traded in an active market (see note 27). Accordingly, no sensitivity analysis has been presented because the directors believe such an analysis would be unrepresentative of the situation as at 31 December 2006.

These investments have since been liquidated as at 31 December 2007.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

42. FINANCIAL INSTRUMENTS *(Continued)*

(f) Fair values

The carrying amounts of the significant financial assets and liabilities are not materially different from their fair values as at 31 December 2007.

(i) *Cash and cash equivalents, trade and bills receivable, other receivables, trade and bills payable, other payables and amounts due from/to related parties*

The carrying values are not materially different from their fair values because of the short maturities of these items.

(ii) *Bank loans*

The carrying amounts of bank loans are not materially different from their fair values based on the borrowing rates currently available for bank loans with similar terms and maturities.

43. SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group's internal financial reporting. As the Group mainly operates in the PRC, no geographical segment information is presented. The business segment of the Group comprises:

- (i) the design, manufacture and sale of boring machines;
- (ii) the design, manufacture and sale of sensors and turbo tables, and computerised embroidery machines;
- (iii) the design, manufacture and sale of intelligent electrical appliances;
- (iv) the design, manufacture and sale of turbo machines; and
- (v) the design, manufacture and sale of laser prototyping machines (discontinued).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

43. SEGMENT REPORTING

	Boring machines		Sensors and turbo tables and computerised embroidery machines		Intelligent electrical appliances		Turbo machines		Laser prototyping machines (Discontinued)		Inter-segment elimination		Consolidated		Less: Laser prototyping machines (Discontinued)		Continuing operations		
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue from external customers	1,016,835	622,092	11,139	10,057	6,840	8,825	231,893	177,111	45	9,001	-	-	1,266,752	827,086	45	9,001	1,266,707	818,085	-
Inter-segment revenue	12,664	1,563	3,988	1,942	-	55	-	-	-	-	(16,652)	(3,560)	-	-	-	-	-	-	-
Total	1,029,499	623,655	15,127	11,999	6,840	8,880	231,893	177,111	45	9,001	(16,652)	(3,560)	1,266,752	827,086	45	9,001	1,266,707	818,085	-
Segment result	250,950	137,399	(3,754)	(5,712)	(10,649)	(733)	23,946	18,766	(957)	(3,480)	18,022	(2,377)	277,558	143,863	(957)	(3,480)	278,515	147,343	-
Unallocated operating income/(expenses)													18,940	(10,664)	4	(3,124)	18,936	(7,540)	
Profit from operations													296,498	133,199	(953)	(6,604)	297,451	139,803	
Finance costs													(3,064)	(6,236)	-	-	(3,064)	(6,236)	
Share of profits of associate and jointly controlled entity													4,979	1,523	-	-	4,979	1,523	
Loss on sale of discontinued operation													(1,027)	-	(1,027)	-	-	-	
Taxation													(47,248)	(16,666)	-	(6)	(47,248)	(16,660)	
Profit/(loss) for the year	23,893	22,344	321	1,165	1,119	731	5,486	6,126	317	1,630			250,138	111,820	(1,980)	(6,610)	252,118	118,430	
Depreciation and amortisation for the year																			
Impairment of property, plant and equipment	(75)	-	(696)	(1,573)	-	-	-	-	-	(295)									
- construction in progress	-	(314)	-	-	-	-	-	-	-	-									
- goodwill	-	-	-	(2,036)	(3,270)	-	-	-	-	(2,439)									
- intangible assets	-	-	-	-	(1,447)	-	-	-	-	(3,561)									
Segment assets	1,042,373	739,535	9,829	15,133	67,695	73,950	307,347	243,179	-	16,910	(99,759)	(65,980)	1,327,485	1,022,727					
Investments in associate and jointly controlled entity																			
Unallocated assets																			
Total assets	489,085	205,882	23,795	24,719	58,515	46,749	222,584	169,208	-	2,630	(93,607)	(14,913)	1,764,718	1,256,360			35,657	26,473	
Segment liabilities																			
Unallocated liabilities																			
Total liabilities																			
Capital expenditure incurred during the year	90,075	45,671	241	839	2,097	882	6,969	7,020	-	140									

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

44. NON-ADJUSTING POST BALANCE SHEET EVENTS

Subsequent to the balance sheet date, the Company submitted its proposal to the State-owned Assets Supervision and Administration Commission of the Shenyang Municipal Government in connection with its intention to dispose of Siyuan, which represents the intelligent electrical appliances segment of the Group. As at the date of this report, the proposed sale of Siyuan is still in progress.

45. MAJOR NON-CASH TRANSACTIONS

During the year ended 31 December 2007, the Group transferred its inventories at cost of RMB12,248,000 (2006: Nil) to property, plant and equipment.

46. COMPARATIVE FIGURES

As a result of adopting HKFRS 7, *Financial Instruments: Disclosure*, and the amendment to HKAS 1, *Presentation of Financial Statements: Capital Disclosures*, certain comparative figures have been adjusted to conform with changes in accounting disclosures in the current year and to show separately comparative amounts in respect of items disclosed for the first time in 2007. Further details of these developments are disclosed in note 3.

47. ACCOUNTING ESTIMATES AND JUDGEMENTS

(a) Key sources of estimation uncertainty

Notes 20 and 42 contain information about the assumptions and their risk factors relating to goodwill impairment and fair value of financial instruments respectively.

(b) Critical accounting judgments in applying the Group's accounting policies

Certain critical accounting judgements in applying the Group's accounting policies are described below.

(i) Impairment

In considering the impairment losses that may be required for certain of the Group's assets which include property, plant and equipment, construction in progress, intangible assets and lease prepayments (see note 2(k)(iii)), the recoverable amount of the asset needs to be determined. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for these assets may not be readily available. In determining the value in use, expected cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to items such as level of sale volume, selling price and amount of operating costs. The Group uses all readily available information in determining an amount that is reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of items such as sale volume, selling price and amount of operating costs.

In considering the impairment losses that may be required for current receivables and other financial assets, future cashflows need to be determined. One of the key assumptions that has to be applied is the ability of the debtors to settle the receivables. Notwithstanding that the Group has used all available information to make this estimation, inherent uncertainty exists and actual write-offs may be higher than the amount estimated.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi unless otherwise indicated)

47. ACCOUNTING ESTIMATES AND JUDGEMENTS *(Continued)*

(b) Critical accounting judgments in applying the Group's accounting policies *(Continued)*

(ii) Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets regularly. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

48. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2007

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2007 and which have not been adopted in these financial statements.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Company's results of operations and financial position.

The following developments may result in new or amended disclosures in the financial statements:

	Effective for accounting periods beginning on or after
HKFRS 8, <i>Operating Segments</i>	1 January 2009
HKAS 23 (Revised), <i>Borrowing Costs</i>	1 January 2009

DOCUMENTS AVAILABLE FOR INSPECTION

Hereunder is the e-version of the last pages of the AR, follow the KPMG's notes

1. Financial statements signed and chopped by legal representative and financial officer;
2. Original copy of Auditors' Report;
3. Original copy of the Announcements and all documents disclosed under newspaper identified by the China Securities Regulatory Commission within the reporting period;
4. 2007 Annual Report;
5. Written recognition for the 2007 Annual Report by directors and senior management officers;
6. Written approval by Supervisory Committee for 2007 Annual Report made by the board of directors.

Note: Written recognition by directors and senior management officers for the 2007 Annual Report

DECLARATION

The board of directors, directors and senior management officers of the Company confirmed that the information in the 2007 Annual Report does not contain any false information, misleading statements or material omissions. They also jointly and severally accept full responsibility for the truthfulness, accuracy and completeness of the contents of the report.

Signature of Declaratory Persons:

Directors:

Gao Minghui	Zhang Hanrong	Song xingju	Sun Kai
Wang Xing	Wang Sheng	Pi Jianguo	Wayne Yu
Liu Minghui	Chen Ying	Li Dongru	

Senior management officers:

Zhang Xiaoyi	Zhuo Guoxing	Ye Nong	Yu Yan
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Board of Directors
Shenji Group Kunming Machine Tool Company Limited
24th April, 2008

Note: Written approval by Supervisory Committee for 2007 Annual Report made by the board of directors.

DOCUMENTS AVAILABLE FOR INSPECTION

OPINIONS OF THE SUPERVISORY COMMITTEE

Regarding the 2007 Annual Report provided by the board of directors, we have the following opinions:

1. The preparation of the 2007 Annual Report and the auditing procedures are in strict compliance with laws and regulations, the Articles of Association and rules of the Company's internal management system.
2. The content and format of the 2007 Annual Report were in strict compliance with the regulations of the China Securities Regulatory Commission and Shanghai Stock Exchange. The messages included in the 2007 Annual Report can truly reflect the Company's operating management and financial status and other matters of the period.
3. Before providing the above opinions, we did not discover any person related in the preparation of the 2007 Annual Report or any auditing personnel has violated the rule of confidentiality.

Supervisors:

Li Hongshu

Zhang Weiming

Yan Shiwen

Li Zhenxiong

Zhao Qiongfeng

Supervisory Committee

Shenji Group Kunming Machine Tool Company Limited

24th April, 2008