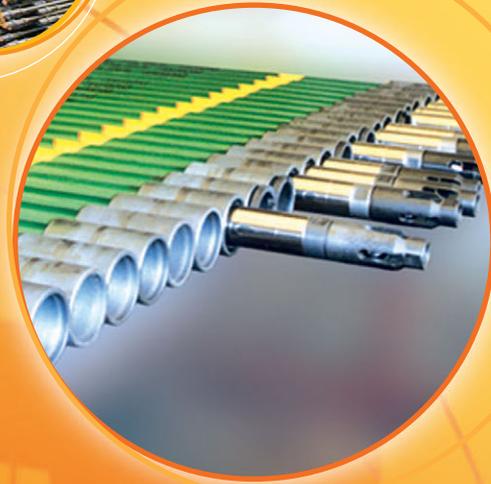




山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited*

(a Sino-foreign joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 568)



2010
Annual
Report



| | | |
|-----|------------|--|
| 2 | Important: | |
| 3 | I. | Company Information |
| 5 | II. | Summary of Financial and Operating Results |
| 9 | III. | Changes in Share Capital and Shareholders |
| 15 | IV. | Directors, Supervisors and Senior Management and the Staff |
| 22 | V. | Corporate Governance Report |
| 32 | VI. | Particulars about the Shareholders' Meeting |
| 33 | VII. | Directors' Report |
| 57 | VIII. | Supervisory Committee's Report |
| 59 | IX. | Material Matters |
| 68 | X. | PRC Auditors' Report and Financial Statements and Notes thereto Prepared in Accordance with Accounting Standards for Business Enterprises |
| 204 | XI. | Documents Available for Inspection |



Important

The board of directors (the “Board”), the supervisory committee (the “Supervisory Committee”) and the directors (the “Directors”), supervisors (the “Supervisors”) and senior management (the “Senior Management”) of the Company hereby warrant that there are no false representations, misleading statements or material omissions contained in this report (the “Report”), and jointly and severally accept full responsibility for the truthfulness, accuracy and completeness of its contents. This Report has been prepared in both Chinese and English. For any discrepancies, the Chinese version shall prevail.

None of the Directors, Supervisors and the Senior Management declare that they are unable to guarantee the truthfulness, accuracy and completeness of the annual report or disagree with the contents of the annual report.

Zhang En Rong, the chairman of the Company, Cui Huan You, the financial controller of the Company and Liu Xiang hua, the head of the financial department, declare that they guarantee the truthfulness and completeness of the financial statements of the Annual Report.

Definitions: “Company”, “the Company”, and “Shandong Molong” refer to Shandong Molong Petroleum Machinery Company Limited, and the Company and its subsidiaries are collectively referred to as “the Group” in this report; “SZSE” refer to Shenzhen Stock Exchange, “SEHK” refer to Stock Exchange of Hong Kong Limited, “ Listing Rules of SZSE” refer to the Rules governing the listing of securities on the Shenzhen Stock Exchange, “Listing Rules of SEHK” refer to the Rules governing the listing of securities on the Hong Kong Stock Exchange, unless otherwise specified.

I. Company Information



1. Legal Chinese name of the Company: 山東墨龍石油機械股份有限公司
Legal English name of the Company: Shandong Molong Petroleum Machinery Company Limited
Abbreviation of the English name: Shandong Molong
2. Legal Representative of the Company: Zhang En Rong
3. Directors
Executive Directors: Mr. Zhang En Rong (Chairman), Mr. Zhang Yun San (Vice Chairman), Mr. Lin Fu Long, Mr. Xie Xin Cang
Non-executive Directors: Mr. Wang Ping, Mr. Chen Jian Xiong
Independent Non-executive Directors: Mr. John Paul Cameron, Mr. Chau Shing Yim, David, Ms. Wang Chun Hua
4. Special Committee
Members of Nomination Committee
Ms. Wang Chun Hua (Chairman), Mr. Zhang Yun San, Mr. John Paul Cameron, Mr. Chau Shing Yim, David
Members of Remuneration and Evaluation Committee
Mr. John Paul Cameron (Chairman), Mr. Chau Shing Yim, David, Mr. Zhang Yun San, Ms. Wang Chun Hua
Members of Audit Committee
Mr. Chau Shing Yim, David (Chairman), Mr. John Paul Cameron, Ms. Wang Chun Hua
5. Supervisors
Mr. Liu Huai Duo (Chairman), Mr. Liu Wan Fu, Mr. Fan Ren Yi
6. Secretary to the Board of the Company: Xie Xin Cang
Company Secretary: Chan Wing Nang, Billy
Securities Affairs Representatives: Zhao Hong Feng
Correspondence Address: No. 99 Beihuan Road, Shouguang City, Shandong Province
Telephone: (86)-0536-5100890
Facsimile: (86)-0536-5100888
Email address: dsh@molonggroup.com
7. Authorised Representatives: Mr. Xie Xin Cang, Mr. Chan Wing Nang, Billy
8. Authorised Person to Accept Service of Process and Notices
Mr. Chan Wing Nang, Billy
9. Registered Address and Office address of the Company: No. 99 Beihuan Road, Shouguang City, Shandong Province
Postal Code: 262700
Website of the Company: <http://www.molonggroup.com>
Email address: sdml@molonggroup.com
10. Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
Designated Domestic Website for the Publication of the Annual Report as approved by China Securities Regulatory Commission: <http://www.cninfo.com.cn>
Designated Overseas Website for the Publication of the Annual Report: <http://www.hkex.com.hk>
Places for Inspection of the Company's Annual Report: Board of Directors Office of the Company



I. Company Information

11. Stock Information
A shares Shenzhen Stock Exchange Stock Abbreviation: 山東墨龍 Stock Code: 002490
H shares The Stock Exchange of Hong Kong Limited Stock Abbreviation: 山東墨龍 Stock Code: 00568
12. Share Registrar
A Share Registrar:
China Securities Depository and Clearing Corporation Limited Shenzhen Branch
18th Floor, CITIC Plaza, 1093 Shennan Zhong Road, Shenzhen
H Share Registrar:
Tricor Investor Services Limited
26/F, Tesbury Centre, No. 28 Queen's Road East, Wanchai, Hong
13. Other Relevant Information of the Company:
Date of First Registration: 30 December, 2001
Date of the latest Change in Registration: 3 December, 2010
Registered Address: No. 99 Beihuan Road, Shouguang City, Shandong Province
Legal Person Business License: 370000400000030
Registration Number: 370783734705456
Organization No.: 73470545-6
14. Auditors Retained by the Company
Auditors: Deloitte Touche Tohmatsu Certified Public Accountants Ltd.
Office Address: 30th Floor, Bund Center, NO. 222 Yanan Road, Huangpu District, Shanghai
15. PRC and Hong Kong Legal Advisers Retained by the Company
PRC Legal Advisers: Beijing Dacheng Law Offices
5th, 12th, and 15th Floor, Guohua Investment Building, 3 South Avenue, Dongzhimen, Dongcheng District, Beijing
Hong Kong Legal Advisers: DLA Piper Hong Kong
The Landmark, 17th Floor, Edinburgh Tower, 15 Queen's Road, Central, Hong Kong
16. Principal Bankers
Agricultural Bank of China Co., Ltd, Shouguang Branch
No. 118 Guangchang Street, Shouguang City, Shandong Province, PRC
Bank of China Limited, Shouguang Branch
No. 193 Yin Hai Street, Shouguang City, Shandong Province, PRC
China Bank of Communications Co., Ltd
Transportation Bureau, Development Zone, Shouguang City, Shandong Province, PRC
China Construction Bank Co., Ltd
No. 283 Eastern Shengcheng Street, Shouguang City, Shandong Province, PRC

II. Summary of Financial and Operating Results



I. Major Financial Data for the Year of the Group

Financial highlights prepared in accordance with Accounting Standards for Business Enterprises

| NO. | Key financial indicators | Unit: RMB | |
|-----|--|-----------|----------------|
| | | | Amount |
| 1 | Operating profit | | 276,716,731.19 |
| 2 | Total profit | | 324,483,801.45 |
| 3 | Net profit attributable to equity holders of the Company | | 276,149,165.54 |
| 4 | Net profit after extraordinary gains or losses attributable to equity holders of the Company | | 251,864,439.10 |
| 5 | Net cash flows from operating activities | | 389,013,515.49 |

Extraordinary gains or losses items

| Extraordinary gains or losses items | Unit: RMB | |
|---|-----------|---------------|
| | | Amount |
| Gains or losses arising from the disposal of non-current assets | | -498,622.95 |
| Government grant recognised in current profit and loss | | 29,580,022.42 |
| Reversal of bad debt provision for accounts receivable provided for impairment separately | | 513,766.81 |
| Non-operating gain or loss other than the above | | 935,042.70 |
| Effect of extraordinary gains or losses on income tax | | -6,200,727.22 |
| Amount of the affected minority equity (after tax) | | -44,755.33 |
| Total | | 24,284,726.43 |



II. Summary of Financial and Operating Results

II. Major Financial Data and Indicators of the Last Three Years Prepared in Accordance with Standards for Business Enterprises Accounting

Consolidated Balance Sheet

| Item | 31 December 2010 | 31 December 2009 (Restated) | Unit: RMB |
|-----------------------------------|-------------------------|--------------------------------|--------------------------------|
| | | | 31 December 2008 (Restated) |
| Current assets: | | | |
| Cash and bank balances | 892,286,589.93 | 305,509,495.54 | 609,100,174.63 |
| Held for trading financial assets | — | — | 49,650,000.00 |
| Dividends receivable | 150,000.00 | — | — |
| Bills receivable | 19,120,729.91 | 34,631,397.12 | 32,115,083.24 |
| Accounts receivable | 500,867,640.05 | 455,109,180.76 | 443,918,064.40 |
| Prepayments | 158,601,512.56 | 54,615,164.00 | 97,757,437.67 |
| Other receivable | 30,281,650.63 | 24,369,143.50 | 6,125,225.89 |
| Inventory | 743,553,547.47 | 713,655,725.39 | 795,937,880.98 |
| Other current assets | 41,054,637.00 | — | — |
| Total current assets | 2,385,916,307.55 | 1,587,890,106.31 | 2,034,603,866.81 |
| Non-current assets: | | | |
| Long-term equity investment | 12,477,279.82 | 12,436,028.87 | 12,338,891.72 |
| Fixed assets | 1,648,583,610.99 | 908,171,388.20 | 899,357,146.10 |
| Construction in progress | 131,446,242.52 | 391,594,169.80 | 94,161,782.87 |
| Construction materials | 7,540,351.49 | 16,175,945.86 | — |
| Intangible assets | 249,918,129.97 | 165,630,624.75 | 102,998,896.83 |
| Goodwill | 142,973,383.21 | 142,973,383.21 | 142,973,383.21 |
| Long-term deferred expenses | — | 4,886,660.51 | — |
| Deferred income tax assets | 15,095,861.12 | 17,091,629.15 | 27,913,095.78 |
| Other non-current assets | 23,279,221.87 | — | — |
| Total non-current assets | 2,200,494,507.63 | 1,668,716,797.34 | 1,300,805,802.88 |
| Total assets | 4,586,410,815.18 | 3,256,606,903.65 | 3,335,409,669.69 |

II. Summary of Financial and Operating Results



| Item | 31 December 2010 | Unit: RMB | |
|---|-------------------------|--------------------------------|--------------------------------|
| | | 31 December 2009 (Restated) | 31 December 2008 (Restated) |
| Current liabilities: | | | |
| Short-term borrowings | 712,866,417.20 | 274,648,512.00 | 268,522,706.00 |
| Held for trading financial liabilities | — | — | 44,380,000.00 |
| Bills payable | 482,816,088.17 | 373,611,268.50 | 770,211,405.31 |
| Accounts payable | 501,771,570.34 | 345,188,404.83 | 385,166,723.53 |
| Advance receipts | 34,721,719.22 | 52,528,174.61 | 36,622,516.54 |
| Salaries payable | 17,839,689.76 | 15,713,925.78 | 23,439,747.28 |
| Taxes payable | 29,428,377.89 | 40,385,354.67 | 67,514,747.08 |
| Interests payable | 955,547.63 | 563,315.00 | 2,106,879.78 |
| Dividends payable | 23,788,680.00 | 39,591,725.86 | 29,735,850.00 |
| Other payables | 25,991,912.66 | 17,271,010.07 | 28,321,507.92 |
| Non-current liabilities due within 1 year | — | 193,000,000.00 | — |
| Total current liabilities | 1,830,180,002.87 | 1,352,501,691.32 | 1,656,022,083.44 |
| Non-current liabilities: | | | |
| Long-term loans | — | 580,000,000.00 | 550,000,000.00 |
| Deferred income tax liabilities | 13,027,452.38 | 10,470,001.64 | 19,363,816.25 |
| Total non-current liabilities | 13,027,452.38 | 590,470,001.64 | 569,363,816.25 |
| Total liabilities | 1,843,207,455.25 | 1,942,971,692.96 | 2,225,385,899.69 |
| Shareholders' equity: | | | |
| Share capital | 398,924,200.00 | 328,924,200.00 | 328,924,200.00 |
| Capital reserve | 1,248,406,190.92 | 121,667,859.42 | 121,667,859.42 |
| Surplus reserve | 140,393,447.06 | 108,376,005.02 | 80,086,723.93 |
| Undistributed profit | 898,749,873.79 | 694,089,054.29 | 519,848,018.05 |
| Foreign currency translation differences | -483,325.64 | (736,933.63) | (810,297.59) |
| Total equity attributable to owners of the Company | 2,685,990,386.13 | 1,252,320,185.10 | 1,049,716,503.81 |
| Minority interests | 57,212,973.8 | 61,315,025.59 | 60,307,266.19 |
| Total shareholders' equity | 2,743,203,359.93 | 1,313,635,210.69 | 1,110,023,770.00 |
| Total liabilities and shareholders' equity | 4,586,410,815.18 | 3,256,606,903.65 | 3,335,409,669.69 |



II. Summary of Financial and Operating Results

Consolidated Income Statements

| Item | 2010 | Unit: RMB | |
|---|-------------------------|--------------------|--------------------|
| | | 2009 (Restated) | 2008 (Restated) |
| I.Total revenue from operations | 2,703,906,835.19 | 2,075,551,285.67 | 2,809,629,259.89 |
| Including: operating revenue | 2,703,906,835.19 | 2,075,551,285.67 | 2,809,629,259.89 |
| II.Total cost of operations | 2,427,381,354.95 | 1,805,362,399.46 | 2,469,729,924.84 |
| Including: Operating cost | 2,237,506,663.67 | 1,678,634,536.19 | 2,273,850,906.51 |
| Business tax and surcharges | 4,812,307.46 | 3,706,491.83 | 5,043,090.40 |
| Selling expenses | 51,360,828.52 | 61,250,637.79 | 59,892,299.97 |
| Administrative expenses | 91,383,971.04 | 63,829,412.03 | 67,479,701.73 |
| Finance costs | 44,341,872.74 | 10,656,881.54 | 43,246,146.61 |
| Asset impairment losses | -2,024,288.48 | (12,715,559.92) | 20,217,779.62 |
| Add: Gains from changes in fair value | — | (5,270,000.00) | 5,270,000.00 |
| Investment income | 191,250.95 | 5,827,137.15 | 331,450.90 |
| Including: Gains from investment in associates and joint ventures | 191,250.95 | 247,137.15 | 331,450.90 |
| III. Operating profit | 276,716,731.19 | 270,746,023.36 | 345,500,785.95 |
| Add: Non-operating income | 50,431,757.52 | 54,154,013.57 | 8,931,528.87 |
| Less: Non-operating expenses | 2,664,687.26 | 619,598.32 | 1,176,373.20 |
| Including: Loss from disposal of non-current assets | 2,123,471.06 | 312,747.82 | 776,481.84 |
| IV. Total profit | 324,483,801.45 | 324,280,438.61 | 353,255,941.62 |
| Less: Income tax expenses | 47,503,492.81 | 50,458,156.21 | 33,856,699.47 |
| V. Net profit | 276,980,308.64 | 273,822,282.40 | 319,399,242.15 |
| Net profit attributable to shareholders of the Company | 276,149,165.54 | 268,315,157.33 | 305,810,742.74 |
| Minority interests | 831,143.10 | 5,507,125.07 | 13,588,499.41 |

III. Rate of Return on Net Assets and Earnings Per Share in Accordance with Preparation Criteria of Information Disclosure by Companies Offering Securities to the Public No. 9 Issued by China Securities Regulatory Commission

| | Rate of Return on net assets (%) | | Earnings per share (RMB) | |
|--|----------------------------------|------------------|--------------------------|---------|
| | Fully diluted | Weighted average | Basic | Diluted |
| Net profit attributable to shareholders of the Company | 10.28 | 17.70 | 0.81 | N/A |
| Net profit after extraordinary gains or losses attributable to shareholders of the Company | 9.38 | 16.14 | 0.74 | N/A |

III. Changes in Share Capital and Shareholders



I. Changes in Share Capital

| | Prior to the change | | Increase/decrease as a result of the change (+, -) | | | | | After the change | |
|--|---------------------|----------------|--|-------------------------------|--------|--------|------------|------------------|----------------|
| | Number of shares | Percentage (%) | New issue | Transfer from capital reserve | | | Sub-total | Number of share | Percentage (%) |
| | | | | Bonus issue | Others | Others | | | |
| I. Shares subject to lock-up | 200,861,000 | 61.07 | 14,000,000 | | | | 14,000,000 | 214,861,000 | 53.86 |
| I.1 State-owned shares | | | | | | | | | |
| I.2 State-owned corporate shares | | | | | | | | | |
| I.3 Other domestic shares | 6,031,500 | 1.83 | 14,000,000 | | | | 14,000,000 | 20,031,500 | 5.02 |
| Comprising: | | | | | | | | | |
| Domestic non-state-owned corporate shares | 2,622,000 | 0.80 | 12,687,774 | | | | 12,687,774 | 15,307,774 | 3.84 |
| Domestic natural person shares | | | | | | | | | |
| I.4 Foreign shares | 3,409,500 | 1.04 | 1,312,226 | | | | 1,312,226 | 4,721,726 | 1.18 |
| Comprising: | | | | | | | | | |
| Foreign corporate shares | | | | | | | | | |
| Foreign natural person shares | | | | | | | | | |
| I.5 Senior management shares | 194,829,500 | 59.23 | | | | | | 194,829,500 | 48.84 |
| II. Shares not subject to lock-up | 128,063,200 | 38.93 | 56,000,000 | | | | 56,000,000 | 184,063,200 | 46.14 |
| II.1 RMB ordinary shares | | | 56,000,000 | | | | 56,000,000 | 56,000,000 | 14.04 |
| II.2 Domestic-listed foreign shares | | | | | | | | | |
| II.3 Overseas-listed foreign shares (H shares) | 128,063,200 | 38.93 | | | | | | 128,063,200 | 32.10 |
| II.4 Others | | | | | | | | | |
| III. Total number of shares | 328,924,2006 | 100 | 70,000,000 | | | | 70,000,000 | 398,924,200 | 100 |

Note: The change means that the Company issued 70,000,000 A Shares on Shenzhen Stock Exchange on October 21, 2010.

II. Offering of Shares and Listing of the Company in the Last Three Years

- As approved by the approval document [2010] No. 1285 "On Approval of the Issue of Shares by Shandong Molong Petroleum Machinery Company Limited from China Securities Regulatory Commission (the "CSRC")", and the approval document "On Shandong Molong Petroleum Machinery Company Limited" (SZSE [2010] No. 336) from the Shenzhen Stock Exchange, the Company issued RMB ordinary shares (A shares) in Shenzhen Stock Exchange on 21 October, 2010, Stock Abbreviation is "山東墨龍", the Stock Code is 002490. The public offering is a total of 7,000 million with RMB1.00 par value, and the offering price is RMB18.00 per share.
- No staff shares of the Company have been issued.



III. Changes in Share Capital and Shareholders

III. Shareholders' Profiles

1. Change in restricted shares

Unit: Shares

| Names of shareholders | Restricted shares at the beginning of the year | Restricted Shares released this year | Restricted Shares increased this year | Restricted Shares at the end of the year | Reason for restriction | Date of release from restriction |
|---|--|--------------------------------------|---------------------------------------|--|--|----------------------------------|
| Zhang En Rong | 139,758,500 | 0 | 0 | 139,758,500 | Not yet reach date of release of the shareholder | 2013-10-21 |
| Lin Fu Long | 17,108,000 | 0 | 0 | 17,108,000 | Not yet reach date of release of the shareholder | 2011-10-21 |
| Zhang Yun San | 15,304,000 | 0 | 0 | 15,304,000 | Not yet reach date of release of the shareholder | 2013-10-21 |
| Xie Xin Cang | 10,705,000 | 0 | 0 | 10,705,000 | Not yet reach date of release of the shareholder | 2011-10-21 |
| Liu Yun Long | 7,335,000 | 0 | 0 | 7,335,000 | Not yet reach date of release of the shareholder | 2011-10-21 |
| Cui Huan You | 4,619,000 | 0 | 0 | 4,619,000 | Not yet reach date of release of the shareholder | 2011-10-21 |
| Liang Yong Qiang | 3,409,500 | 0 | 0 | 3,409,500 | Not yet reach date of release of the shareholder | 2011-10-21 |
| Shengli Oil Field Kaiyuan Petroleum Development Company | 2,622,000 | 0 | 0 | 2,622,000 | Not yet reach date of release of the shareholder | 2011-10-21 |
| Off-line allotment | 0 | 0 | 14,000,000 | 14,000,000 | Off-line allotment | 2011-1-21 |
| Total | 200,861,000 | 0 | 14,000,000 | 214,861,000 | — | — |

III. Changes in Share Capital and Shareholders



2. Top ten shareholders and the top ten shareholders of non-restricted shares

Unit: shares

The total number of shareholders was 27008, of which, 26959 were holders of A Shares, 49 were holders of H Shares

Total number of shareholders

49 were holders of H Shares

Shareholdings of the top ten shareholders

| Name of shareholders | Nature of shareholders | Percentage of shareholding | Total number of shares held | Number of Restricted shares held | Number of shares pledged or locked-up |
|---|---------------------------------------|----------------------------|-----------------------------|----------------------------------|---------------------------------------|
| Zhang En Rong | domestic natural person | 35.03% | 139,758,500 | 139,758,500 | 0 |
| HKSCC Nominees Limited | Overseas non-state-owned legal person | 32.03% | 127,777,545 | 0 | 0 |
| Lin Fu Long | domestic natural person | 4.29% | 17,108,000 | 17,108,000 | 0 |
| Zhang Yun San | domestic natural person | 3.84% | 15,304,000 | 15,304,000 | 0 |
| Xie Xin Cang | domestic natural person | 2.68% | 10,705,000 | 10,705,000 | 0 |
| Liu Yun Long | domestic natural person | 1.84% | 7,335,000 | 7,335,000 | 0 |
| Cui Huan You | domestic natural person | 1.16% | 4,619,000 | 4,619,000 | 0 |
| Liang Yong Qiang | domestic natural person | 0.85% | 3,409,500 | 3,409,500 | 0 |
| Shengli Oil Field Kaiyuan Petroleum Development Company | Domestic non-state-owned legal person | 0.66% | 2,622,000 | 2,622,000 | 0 |
| Industrial and Commercial Bank of China — 南方成份精選股票型證券投資基金(LOF) | Domestic non-state-owned legal person | 0.47% | 1,862,182 | 0 | 0 |

Shareholdings of the top ten shareholders of non-restricted shares

| Name of shareholders | Number of non-restricted shares held | Class of shares |
|---|--------------------------------------|-----------------|
| HKSCC Nominees Limited | 127,777,545 | H share |
| Industrial and Commercial Bank of China — 南方成份精選股票型證券投資基金(LOF) | 1,862,182 | A share |
| Bank of Communication—農銀匯理行業成長股票型證券投資基金 | 1,356,449 | A share |
| GF Securities Co., LTD | 999,967 | A share |
| Bank of Communication—易方達科訊股票型證券投資基金 | 799,935 | A share |
| China Construction Bank—農銀匯理策略價值股票型證券投資基金 | 656,155 | A share |
| Liu Yu | 410,800 | A share |
| Ren Feng Jie | 355,100 | A share |
| Xu Lan Zhi | 329,000 | A share |
| Shen Ping | 250,000 | A share |

Connected relationship or concert-party relationship among the above shareholders

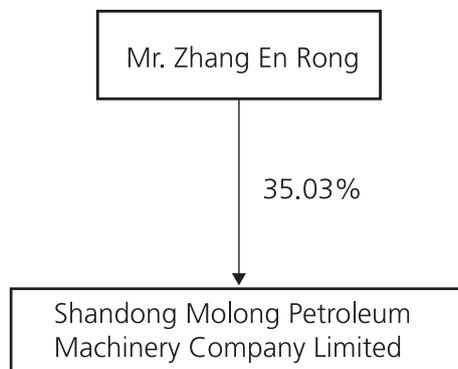
Zhang En Rong is the controlling shareholder of the Company and the father of Zhang Yun San, the Company has no information and does not know whether the other shareholders have connected relationships or are acting in concert.



III. Changes in Share Capital and Shareholders

3. Profile of controlling shareholder and beneficial controller

- (1) The Company's controlling shareholder and beneficial controller remain unchanged during the reporting period.
- (2) The controlling shareholder and beneficial controller of the Company is Zhang En Rong, who is a Chinese citizen with no right of permanent residence abroad. Zhang En Rong is the chairman and legal representative of the Company, his address is No. 102 Beihai Road, Shouguang City, Shandong Province. At the end of the reporting period, Mr. Zhang Enrong held 139,758,500 company shares, representing 35.03% of the total share capital of the Company.
- (3) Chart illustrating the relationship between the Company and the beneficial controller.



III. Changes in Share Capital and Shareholders



4. Substantial Shareholders' and Other Persons' Interests and Short Positions in Shares, Underlying Shares and Debentures

As at 31 December 2010, so far as it is known to the Directors, Supervisors or chief executive of the Company, the following persons (other than a Director, Supervisor or chief executive of the Company) had, or were deemed or taken to have interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO:

Long positions in the H Shares of the Company

| Name | Type of interest | Number of H Shares | Percentage of H Shares | Percentage of total issued shares |
|---|--|------------------------|------------------------|-----------------------------------|
| Paul G. Desmarais (Note 1) | Interest of controlled corporation | 29,491,200 (Note 1) | 23.03% | 7.39% |
| Nordex Inc. (Note 1) | Interest of controlled corporation | 29,491,200 (Note 1) | 23.03% | 7.39% |
| Gelco Enterprises Ltd. (Note 1) | Interest of controlled corporation | 29,491,200 (Note 1) | 23.03% | 7.39% |
| Power Corporation of Canada (Note 1) | Interest of controlled corporation | 29,491,200 (Note 1) | 23.03% | 7.39% |
| Power Financial Corporation (Note 1) | Interest of controlled corporation | 29,491,200 (Note 1) | 23.03% | 7.39% |
| IGM Financial Incorporation (Note 1) | Interest of controlled corporation | 29,491,200 (Note 1) | 23.03% | 7.39% |
| Cheah Capital Management Limited (Note 2) | Interest of controlled corporation | 9,077,200 | 7.09% | 2.28% |
| Cheah Company Limited (Note 2) | Interest of controlled corporation | 9,077,200 | 7.09% | 2.28% |
| Hang Seng Bank Trustee International Limited (Note 2) | Trustee | 9,077,200 | 7.09% | 2.28% |
| Value Partners Group Limited (Note 2) | Interest of controlled corporation | 9,077,200 | 7.09% | 2.28% |
| Value Partners Limited (Note 2) | Investment Manager | 9,077,200 | 7.09% | 2.28% |
| Xie Qing Hai (Note 2) | Interest of founder of Discretionary trust | 9,077,200 | 7.09% | 2.28% |
| Du Qiao Xian (Note 2) | Interest of spouse | 9,077,200 | 7.09% | 2.28% |
| Martin Currie (Holdings) Limited (Note 3) | Interest of controlled corporation | 8,849,200 | 6.91% | 2.22% |



III. Changes in Share Capital and Shareholders

Note 1: According to the best knowledge of the Directors of the Company and the disclosure of interest notices filed by Paul G Desmarais, Gelco Enterprises Ltd., IGM Financial Inc., Nordex Inc., Power Corporation of Canada and Power Financial Corporation, each of these companies was interested in 29,491,200 H Shares as at 31 December 2010. Among these 29,491,200 H Shares in which these companies were deemed to have interest, 28,241,200 H Shares were directly held by Mackenzie Cundill Investment Management Ltd. and 1,250,000 H Shares were directly held by Mackenzie Cundill Investment MGMT (Bermuda) Ltd.

Mackenzie Cundill Investment Management Ltd. is a wholly-owned subsidiary of Mackenzie Financial Corporation, which in turn is a wholly-owned subsidiary of Mackenzie Inc. Mackenzie Inc. is a wholly owned subsidiary of IGM Financial Inc., which in turn is owned as to 55.99% by Power Financial Corporation, Power Financial Corporation is owned as to 66.40% by 171263 Canada Inc, which in turn is a wholly-owned subsidiary of 2795957 Canada Inc. 2795957 Canada Inc is a wholly-owned subsidiary of Power Corporation of Canada, which in turn is owned as to 53.83% by Gelco Enterprise Ltd., Gelco Enterprise Ltd. is owned as to 94.95% by Nordex Inc., which in turn is owned as to 68% by Paul G. Desmarais.

Mackenzie Cundill Investment Mgmt (Bermuda) Ltd, is a wholly-owned subsidiary of Mackenzie (Rockies) Corp. which in turn is a wholly-owned subsidiary of Mackenzie Financial Corporation.

Note 2: According to the best knowledge of the Directors, Supervisor or chief executive of the Company and the disclosure of interest notices filed by Cheah Capital Management Limited, Cheah Company Limited, Hang Seng Bank Trustee International Limited, Value Partners Group Limited, Value Partners Limited, Ms. To Hau Yin and Mr. Cheah Cheng Hye, each of these companies and individuals was interested in 9,077,200 H Shares as at 31 December 2010.

Value Partners Limited was interested in H Shares as investment manager. Value Partners Limited is a wholly-owned subsidiary of Value Partners Group Limited, which in turn is owned as to 31.23% by Cheah Capital Management Limited, which in turn is a wholly-owned subsidiary of Cheah Company Limited. Hang Seng Bank Trustee International Limited wholly owned Cheah Company Limited as trustee of The C H Cheah Family Trust. Mr. Cheah Cheng Hye is the founder of the above-mentioned trust. Ms. To Hau Yin is the spouse of Mr. Cheah Cheng Hye.

Note 3: According to the best knowledge of the Directors, Supervisor or chief executive of the Company and the disclosure of interest notices filed by Martin Currie (Holdings) Limited, the company was interested in 8,849,200 H Shares of the Company as at 31 December 2010. Among these 8,849,200 H Shares, 3,806,000 H Shares were directly held by Martin Currie Inc and 5,043,200 H Shares were directly held by Martin Currie Investment Management.

Martin Currie Inc and Martin Currie Investment Management are wholly-owned subsidiaries of Martin Currie Ltd., which in turn is a wholly-owned subsidiary of Martin Currie (Holdings) Limited.

Save as disclosed above, no persons (other than being a Director, Supervisor or chief executive of the Company) who had, or were deemed or taken to have interests or short positions in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register required to be kept under section 336 of the SFO.

IV. Directors, Supervisors and Senior Management and the Staff



I. Changes in Shareholdings and Annual Remunerations of the Directors, Supervisors and Senior Management

| Name | Position | Sex | Age | Terms in office | Shares held at the beginning of the year (share) | Shares held at the end of the year (share) | Reasons for change | Total remuneration Received from the Company during the reporting period (in ten Thousands RMB) (pre-tax) |
|---|---|-----|-----|----------------------------|--|--|--------------------|---|
| I. Executive Directors | | | | | | | | |
| Zhang En Rong (Note 1) | Chairman of the Company | M | 70 | 25 May 2010 to 24 May 2013 | 139,758,500 | 139,758,500 | — | 71.00 |
| Zhang Yun San (Note 1) | Deputy Chairman and General Manager | M | 48 | 25 May 2010 to 24 May 2013 | 15,304,000 | 15,304,000 | — | 56.96 |
| Lin Fu Long (Note 1) | Director | M | 58 | 25 May 2010 to 24 May 2013 | 17,108,000 | 17,108,000 | — | 30.56 |
| Xie Xin Cang (Note 1) | Director, Deputy general manager and Secretary to the Board | M | 48 | 25 May 2010 to 24 May 2013 | 10,705,000 | 10,705,000 | — | 38.71 |
| II. Non-executive Directors | | | | | | | | |
| Chen Jian Xiong (Note 2) | Directors | M | 55 | 6 May 2008 to 5 May 2011 | 0 | 0 | — | 0.00 |
| Wang Ping | Directors | M | 55 | 12 May 2009 to 11 May 2012 | 0 | 0 | — | 0.00 |
| III. Independent non-executive Directors | | | | | | | | |
| Wang Chun Hua | Independent Director | F | 57 | 12 May 2009 to 11 May 2012 | 0 | 0 | — | 3.60 |
| John Paul Cameron | Independent Director | M | 45 | 12 May 2009 to 11 May 2012 | 0 | 0 | — | 9.48 |
| Chau Shing Yim, David (Note 1) | Independent Director | M | 47 | 25 May 2010 to 24 May 2013 | 0 | 0 | — | 9.48 |
| IV. Supervisors | | | | | | | | |
| Liu Huan Duo | Chairman of Supervisory Committee | M | 35 | 12 May 2009 to 11 May 2012 | 0 | 0 | — | 5.93 |
| Liu Wan Fu | Supervisor | M | 71 | 12 May 2009 to 11 May 2012 | 0 | 0 | — | 2.40 |
| Fan Ren Yi | Supervisor | M | 45 | 12 May 2009 to 11 May 2012 | 0 | 0 | — | 1.20 |
| V. Senior Management | | | | | | | | |
| Guo Huan Ran | Deputy general manager | M | 43 | 21 Dec 2008 to 20 Dec 2011 | 0 | 0 | — | 41.32 |
| Zhang Shou Kui | Deputy general manager | M | 40 | 17 Mar 2010 to 16 Mar 2013 | 0 | 0 | — | 22.14 |
| Cui Huan You | Financial controller of the Company | M | 61 | 30 Mar 2009 to 29 Mar 2012 | 4,619,000 | 4,619,000 | — | 11.68 |
| Liu Yun Long | Deputy general manager | M | 41 | 26 Aug 2009 to 25 Aug 2012 | 7,335,000 | 7,335,000 | — | 38.73 |
| Total | — | — | — | | 194,829,500 | 194,829,500 | — | 343.19 |

Notes:

- Mr. Zhang En Rong, Mr. Zhang Yun San, Mr. Liu Fu Long, Mr. Xie Xin Cang and Mr. Chau Shing Yim, David were re-appointed at the 2009 AGM
- The term of appointment of Mr. Chen Jian Xiong shall expire on 5 May 2011 and the Board has decided not to renew his term of appointment. Pursuant to the recommendation of the nomination committee and the remuneration and evaluation committee of the Company, the Board has involved to propose that Mr. Xiao Qing Zhou to be appointed as a non-executive director, whose appointment shall be effective from the date on which the resolution to regarding his appointment is passed at the 2010 AGM.
- None of the Directors, Supervisors and Senior Management of the Company had received any remunerations from shareholder or other related entities. The remuneration for Chan Wing Nang, Billy, the company secretary of the Company, was HK\$192,000.



IV. Directors, Supervisors and Senior Management and the Staff

II. CHANGES IN SHAREHOLDINGS AND REMUNERATIONS OF THE DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

1. Directors

Executive Directors

Mr. Zhang En Rong, Chinese nationality with no right of permanent residence abroad, is the chairman of the Company and an executive Director. Mr. Zhang, born in January 1940, Junior college degree, is a founder of the Company and is responsible for the overall strategic planning, management and business development of the Group. Zhang En Rong has held various positions in the Group. Mr. Zhang was the legal representative and factory manager of Shandong Shouguang Petroleum Machinery Parts Factory, Shandong Shouguang Petroleum Machinery Factory and Weifang Molong Industrial Company from 1987 to 1993 and the general manager of Shandong Molong Holdings Company from 1994 to 2001. Mr. Zhang has been the Chairman of the Company since 2001. Mr. Zhang is the father of Mr. Zhang Yun San, an executive Director.

Mr. Zhang En Rong was a member of the 12th session, 13th session and 14th session of the Weifang City People's Congress of the PRC, a member of the 5th session and the 6th session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr. Zhang was granted the "Good Enterprise Management Personnel" certificate in 1988 and 2001, and the "Wealth Attainment and Development of Shandong medal of Shandong Province in 2004.

Mr. Zhang Yun San, Chinese nationality with no right of permanent residence abroad, is an executive Director, the deputy chairman, and the general manager of the Company. Mr. Zhang, born in January 1962, Bachelor Degree, is a founder of the Company. He is responsible for assisting the chairman of the Board in the overall strategic planning and management and business development of the Group. Mr. Zhang has served in Weifang Molong Industrial Company since 1993 and served in the Company as deputy general manager from 1994 to 2001, deputy chairman and deputy general manager from 2001 to 2007, and has serves as deputy chairman and general manager since 2007. He has abundant experience in the development, manufacture and sales of petroleum drilling and extraction machinery and the management of the Group. Mr. Zhang is the son of Mr. Zhang En Rong, an executive Director.

Mr. Zhang held an advanced certificate in Training Course of Chinese Communist Party School for Entrepreneurs and was granted the "Excellent Private Enterpriser of Weifang City" in 2004, "Top Ten Young Entrepreneurs of Weifang City" in 2005, "Excellent Chief Information Officer of Weifang City" in 2006 and was appointed as the member of the 10th session of the Weifang City People's Congress of the PRC and the member of the 15th session of the Shouguang City People's Congress of the PRC in 2007, and was awarded the "Model Worker of Shandong Province", "Top Ten Persons of 'Moving State Duty' of Weifang in 2007", and was awarded "Excellent Chief Information Officer of Shouguang City" in 2010. Mr. Zhang is currently a member of the 15th session of the Standing Committee of Shouguang City People's Congress of the PRC, Deputy Chairman of Shouguang City Association of Entrepreneurs and Vice President of Shouguang City Industries and Commerce Association.

Mr. Lin Fu Long, Chinese nationality with no right of permanent residence abroad, is an executive Director and responsible for major project management of the Group. Mr. Lin, born in December 1952, high school diploma, is a founder of the Company. Mr. Lin was deputy manager of Petroleum Machinery Parts Factory, Petroleum Machinery Factory and Weifang Molong from 1989 to 1993, deputy general manager of Molong Holdings from 1994 to 2001 and director and general manager of the Company from 2001 to 2007. Mr. Lin was awarded the "Capable Sales Person" title by the Shouguang City People's Government in 1994.

IV. Directors, Supervisors and Senior Management and the Staff



Mr. Xie Xin Cang, Chinese nationality with no right of permanent residence abroad, is an executive Director, deputy general manager and the secretary to the Board of the Company. Mr. Xie, born in February 1962, graduated from the chairman class of college of continuing education in Tsinghua University for executive master of business administration, is an engineer and a founder of the Company. Mr. Xie served as deputy general manager of Molong Holdings from 1995 to 2001, and has served as Director, deputy general manager and the Secretary to the Board of the Company since 2001.

Mr. Xie Xin Cang graduated from Xian Jiaotong University with a Bachelor of Engineering degree in mechanical engineering and majored in metal materials and their heat treatment. Mr. Xie has successfully applied the nickel plating phosphorus alloy technology in the manufacturing of petroleum drilling and extraction machinery and invented the "MB424 steel wire teasel" that possess international advanced level. Mr. Xie was awarded the "Shandong Province Town and Village Enterprise Technology Innovation Leader" certificate by the Shandong Province Town and Village Enterprise Management Bureau in 1998. Mr. Xie was a standing committee member of the seventh session of the Shouguang City committee of the National Committee of the Chinese People's Political Consultative Conference and is a member of the 8th Session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference.

Non-executive directors

Mr. Chen Jian Xiong, born in June 1955, Chinese nationality with no right of permanent residence abroad, Junior college degree, is a non-executive Director of the Company. Mr. Chen has worked for Rodless Oil Pump Company of the Shengli Petroleum Administration Bureau ("Rodless Oil Pump") for over 20 years. Since 1994, Mr. Chen has been the chairman of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited ("Kaiyuan Oil") and was an assistant manager of Rodless Oil Pump. In 2004, he served as manager of Rodless Oil Pump. Mr. Chen is currently the Chairman of Kaiyuan Oil and Shengli Pump Industry Co., Ltd., Shengli Oilfield. Mr. Chen has served as a non-executive Director of the Company since December 28, 2001.

Mr. Wang Ping, born in May 1955, Chinese nationality with no right of permanent residence abroad, PHD, is a non-executive Director of the Company and has over 20 years of experience in metallurgy. Since 2000, Mr. Wang is a professor at the University of Science and Technology of Beijing. Mr. Wang is currently the director of Hanking Group and Hanking Group Shenyang Toyo Steel Co., Ltd. Mr. Wang has served as a non-executive Director of the Company since March 29, 2003.

Independent non-executive Directors

Ms. Wang Chun Hua, born in November 1953, Chinese nationality with no right of permanent residence abroad, is an independent non-executive Director and the Chairman of Nonnominations Committee of the Company. Ms. Wang, graduated from Shandong University with a Bachelor degree, is now retired. Ms. Wang has over 20 years of experience in the court work and had held the various positions in Shandong Shouguang People's Court including the judge, associate chief judge and the chief judge of the No. 1 criminal justice division, vice-president, president and the Party secretary. And Ms. Wang had been appointed as the Vice Chairman of the eighth session of the Shouguang City Committee of the Chinese People's Political Consultative Conference. Ms. Wang has served as independent Director of the Company since May 12, 2009.



IV. Directors, Supervisors and Senior Management and the Staff

Mr. John Paul Cameron, born in May 1965, British nationality, is an independent non-executive Director and the Chairman of the Remuneration and Evaluation Committee of the Company. He holds a Masters of Science degree in investment analysis from the University of Stirling in Scotland, UK, a Bachelor of Arts degree in Economics and a Bachelor of Arts degree in Mathematics from Carleton University in Ottawa, Canada. Mr. Cameron's extensive public market experience includes detailed knowledge of both corporate governance as well as knowledge of the North American and UK Oil and Gas industry. Mr. Cameron has over 15 years as a professional investor and public company analyst. He worked as a Senior Fund Manager at JO Hambro Capital Management Group (London, UK) and as a Fund Manager at F&C Special Utilities Trust (London, UK). Mr. John Paul Cameron is Chairman and CEO of East Wind Consulting Limited Company and Chairman of Dongfang Shangjin Investment Consulting (Beijing) Co., Ltd. Mr. John Paul Cameron has served as an independent non-executive Director of the Company since May 12, 2009.

Mr. Chau Shing Yim, David, born in December 1963, British nationality, Bachelor Degree, is an independent non-executive Director and the Chairman of the Audit Committee. Mr. Chau Shing Yim, David has over 20 years' experience in corporate finance, working on projects ranging from initial public offering transactions and restructuring of PRC enterprises to crossborder and domestic takeover transactions. Mr. Chau was formerly a partner of one the big four accounting firms in Hong Kong, holding the position as their head of Merger and Acquisition and Corporate Advisory. he is a member of the Hong Kong Securities Institute, the Institute of Chartered Accountants of England and Wales and the Hong Kong Institute of Certified Public Accountants ("HKICPA"), Mr. Chau was formerly a partner of one the big four accounting firms in Hong Kong, holding the position as their head of Merger and Acquisition and Corporate Advisory, and was an ex-committee member of the Disciplinary Panel of HKICPA. He is currently an executive director of Tidetime Sun (Group) Limited and a non-executive director of Lee & Man Paper Manufacturing Limited, both companies being listed on the main board of the Stock Exchange of Hong Kong Limited. Mr. Chau Shing Yim, David has served as an independent non-executive Director of the Company since January 8, 2009.

2. Supervisors

Mr. Liu Huai Duo, born in October 1975, Chinese nationality with no right of permanent residence abroad, is the Chairman of the supervisory committee of the Company (the "Supervisory Committee"). Mr. Liu graduated from Liaoning Sciences and Technologies College with a junior college degree in industrial automation instrument. Mr. Liu has abundant experience and techniques in electric automatization and PLC Programmable control. Mr. Liu has served in the Company since 2000, he is currently the team dispatcher of 180 High-grade Special Pipe Factory.

Mr. Liu Wan Fu, born in January 1939, Chinese nationality with no right of permanent residence abroad, senior engineer, is a Supervisor of the Company. Mr. Liu has been appointed as a Supervisor since March 29, 2003. Mr. Liu has over 40 years of experience in the petroleum industry, he is currently a consultant of China National Petroleum Corporation.

Mr. Fan Ren Yi, Chinese nationality with no right of permanent residence abroad, is a Supervisor of the Company. Mr. Fan, born in November 1965, Bachelor Degree, is a certified public accountant in the PRC. He has been appointed as a Supervisor since March 29, 2003. Mr. Fan Ren Yi graduated from Xian Jiaotong University and is currently the vice general manager and CFO of Shandong Charming Home-Textiles Co., Ltd.

IV. Directors, Supervisors and Senior Management and the Staff



3. Senior Management

As for the information about Zhang Yun San, the general manager, and Xie Xin Cang, the deputy general manager and secretary to the Board, please refer to "1. Directors" of "II. CHANGES IN SHAREHOLDINGS AND REMUNERATIONS OF THE DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT" in this section. Other senior managements are as follows:

Mr. Guo Huan Ran, born in April 1967, Chinese nationality with no right of permanent residence abroad, executive master of business administration degree from Tsinghua University, is deputy general manager of the Company. Mr. Guo has served in the Company since March 1991 as technician, and held workshop supervisor and Production Director of the Company from 1994 to 2001. Mr. Guo has held the posts of Production Director and deputy general manager since 2001. Mr. Guo has extensive experience in areas including production management and technology research and development of petroleum drilling and extraction machinery. Mr. Guo has directed the innovation of various items for export, such as liner for mud pump and valve body. Some of the products, such as "Special Centralizer for Electrical Submersible Pump System", won the third prize of "Science and Technology Achievements Award from Village & Township Enterprises Administration of Ministry of Agriculture of People's Republic of China". Mr. Guo has been granted the title of "Outstanding Young Entrepreneur of Shouguang City" in November 2007.

Mr. Zhang Shou Kui, born in August 1970, Chinese nationality with no right of permanent residence abroad, executive master of business administration degree from Tsinghua University, is deputy general manager of the Company. Mr. Zhang has served in the Company since 1990 as inspector, the Chief of Inspection Station from 1994 to 2001. He has held consecutively the positions of General Manager of Branch Plant, Manager of Production Department and deputy general manager in the Group since 2001, and he has extensive experiences in production management. Mr. Zhang is responsible for organizing the Group's production.

Mr. Cui Huan You, Chinese nationality with no right of permanent residence abroad, is in charge of the finance of the Company. Mr. Cui, born in February 1949, junior college degree, is a founder of the Company. Mr. Cui Huan You graduated from Shandong Province Financial Zhigong University, he has significant experience in finance, accounting and taxation, and joined Molong Holdings as an accounting supervisor in June 1995. Mr. Cui has been in charge of the finance of the Company since 2001. Mr. Cui was awarded the "Outstanding Financial Management Personnel" in 1992 and the "Advanced Accountant of Weifang City" in 2004.

Mr. Liu Yun Long, Chinese nationality with no right of permanent residence abroad, is deputy general manager of the Company. Mr. Liu, born in May 1969, executive master of business administration degree from Tsinghua University, is a founder of the Company. Mr. Liu joined Molong Holdings in March 1990, and held consecutively workshop supervisor, the manager of the branch factory, the general manager of the subsidiary and so on. He has held consecutively the positions of the manager of the branch production factory, general manager of Weihai Baolong Special Petroleum Materials Co., Ltd and Shouguang Baolong, and deputy general manager of the Company. Mr. Liu has significant experience in managing production of petroleum extraction machinery.

4. Company Secretary

Mr. Chan Wing Nang, Billy, born in June 1961, is the company secretary of the Company. Mr. Chan graduated from the University of Newcastle, United Kingdom with a bachelor degree in Civil Engineering in 1986. He also has a master degree in business administration from the University of Warwick, United Kingdom. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants. Mr. Chan has over 20 years of experience in the accounting and consulting field. Prior to joining the Group, Mr. Chan was a director in a consulting company. Mr. Chan joined the Group on 13 December 2004.



IV. Directors, Supervisors and Senior Management and the Staff

III Information concerning Directors, supervisors, and senior management holding position in shareholder of the company

| Name | Position in the Company | the company in which hold a post | Relationship between the company in which hold a post and the Company | Position |
|----------------|-----------------------------------|---|---|---------------------------|
| Zhang Yun San | Vice Chairman, general manager | Molong Drilling Equipment | Wholly-owned subsidiary | Director |
| | | MPM International Limited | holding subsidiary | Executive director |
| Lin Fu Long | Director | Maolong Machinery Company Limited | Wholly-owned subsidiary | Director, general manager |
| Guo Huan Ran | Vice general manager | Molong Drilling Equipment | Wholly-owned subsidiary | Chairman |
| | Vice general manager | Shouguang Baolong Petroleum Material Company Limited | holding subsidiary | Chairman |
| | Vice general manager | Shouguang Molong Electro-mechanical Equipment Company Limited | Wholly-owned subsidiary | Director |
| | Vice general manager | Weihai Baolong Company Limited | Wholly-owned subsidiary | Director |
| Zhang Shou Kui | Vice general manager | Shouguang Mihe Water Company Limited | share subsidiary | Director |
| Cui Huan You | Financial controller | Shouguang Maolong Old Metals Recycle Company Limited | Wholly-owned subsidiary | Supervisor |

IV. Directors, Supervisors and Senior Management and the Staff



IV. Annual Remunerations of Directors, Supervisors and Senior Management

1. The Company will pay each of the independent non-executive Directors of the Company annual allowance of RMB30,000 – RMB100,000 (before tax). The non-executive Directors of the Company don't get remuneration from the Company. The travel expenses for attending board meetings and shareholders' meeting of the Company and fees incurred reasonably in the performance of their duties under the Articles of Association by independent non-executive Directors and non-executive Directors are reimbursed as expensed.
2. The annual remuneration of each of the executive Directors and senior management of the Company fall between the range of RMB117,000 – RMB710,000 (before tax), while actual amount shall be determined based on the main financial indicators and operation target completion of the Company, the scope of work and main responsibilities of the Directors and senior management of the Company, the target completion of Directors and senior management as assessed by the duty and performance appraisal system, as well as business innovation capability and profit generation ability of the Directors and senior management. The actual implementation proposal shall be determined by the internal remuneration committee of the Board as well as considered and decided by the Board.
3. For the remunerations received from the Company by Directors, Supervisors and Senior Management in 2010, please refer to Part I of this section.

V. Change of Directors, Supervisors and Senior Management

1. On March 28, 2010, the annual general meeting of the Company in 2009 considered the resolution in relation to the appointment and re-appointment of Directors of the Company, upon election: Zhang En Rong, Zhang Yun San, Lin Fu Long, and Xie Xin Cang were appointed as executive Directors of the third session of the Board of the Company; Chau Shing Yim, David was appointed as an independent non-executive Director of the third session of the Board of the Company.
2. As the term of office of Zhang Yun San, the general manager of the Company, would be end of tenure on December 31, 2010, nominated by the Board Nomination Committee, the third session of fifth Board meeting deliberated and determined to re-appoint Zhang Yun San as the general manager of the Company, and the term of office is three years start from January 1, 2011.

VI. Personnel of the Company

At the end of the reporting period, the Group had 2,731 employees in aggregate, including 2,235 production staff, 64 sales staff, 75 technical staff, 41 financial staff, 110 administrative staff and 206 other staff. By level of education, there were 168 employees with bachelor's degree or above, 286 employees with college degree, 1299 employees with technical secondary school education and 978 employees with high school, technical school education and levels below technical secondary school education.

There was no ex-employees or retired employees for which the Company owed any obligations.



V. Corporate Governance Report

I. Corporate Governance

Under the requirement of Company Law (《公司法》), Securities Law (《證券法》), Code of Corporate Governance for Listed Companies (《上市公司治理準則》), Listing Rules of SZSE (《深圳證券交易所股票上市規則》), Listing Rules of SEHK and the related requirements as required by China Securities Regulatory Commission, the Company further improved and optimized its legal person governance structure in the reporting period. The Board considers there is no material deviation of the Company in its corporate governance from the documented regulatory requirements provided for listed companies in respect of corporate governance.

The Company completed the issue of A Shares during the reporting period, and adopted new Articles of Association according to the regulatory requirements of the mainland capital market.

In line with the new Articles of Association adopted by the Company subsequent to the issue of A shares, the Company held a shareholders' meeting to seek shareholders' approval for the corresponding amendments to the Procedural Rules of the Shareholders' General Meetings, the Procedural Rules of the Board Meetings and the Procedural Rules of the Supervisory Committee Meetings, the amendments to 11 systems including The Independent Directors' Rules, Management System for Information Disclosure Issues, and Administration Rules for the use of proceeds, the adoption of 14 systems including the Implementation Rules of the Cumulative Voting System, and Change Management System for Directors, Supervisors and Senior Management held shares of the Company, to further improved and optimized its governance structure.

- (I) **Shareholders and general meetings:** The Company has established a corporate governance structure to ensure that all shareholders can fully exercise their rights and enjoy equal status, in particular for minority shareholders. Sufficient time is provided at general meetings of shareholders, which are to be convened legally and validly, for the discussion of each proposal, to provide a good opportunity for communications between the Board and the shareholders. In addition, shareholders may contact the Company through its shareholder hotline during normal working hours or through its designated e-mail address for any enquiries.
- (II) **Controlling shareholder and the listed company:** the Company's controlling shareholder is Zhang Enrong. The controlling shareholder exercises its rights as an investor in strict compliance with the law, without adversely affecting the lawful rights and interests of the Company and other shareholders. Candidates for election as Directors and Supervisors are nominated in strict compliance with laws and regulations and the terms and procedures as set out in the Articles. The staffing, assets, financial affairs, organization and business of the controlling shareholder are independent to those of the listed company, with the controlling shareholder. The controlling shareholder has not directly or indirectly interfered with the decision-making and business activities of the Company beyond the general meeting.
- (III) **Directors and the Board:** the Company appoints directors in strict compliance with the procedures set out its Articles, ensuring that the directors are appointed in an open, fair, just and independent manner. In order to fully reflect the opinions of minority shareholders, a cumulative voting scheme is adopted for the appointment of directors. The Board of Directors has a reasonable professional structure, acting in the best interests of the Company and in good faith. The Company has formulated a set of rules of procedure for Board of Directors meetings, and board meetings are convened and held in strict compliance with the Articles and Rules of Procedure of the Board of Directors Meetings. To optimise the corporate governance structure, three specialist committees — the Nomination Committee, Audit Committee and Remuneration and Evaluation Committee — have been established by the Board of Directors in accordance with the Governance Standards for Listed Companies. The majority of members and the convenors in each of these committees are Independent Directors, providing scientific and professional opinions for reference by the Board of Directors in its decision-making.

V. Corporate Governance Report



- (IV) **Supervisors and the Supervisory Committee:** The Supervisors possess professional knowledge and work experience in legal, accounting and other areas and are elected by way of cumulative voting. They monitor the financial affairs and supervise the lawful and regulatory performance of duties by the Company's Directors, the General Manager and other members of the senior management, and safeguard the legal rights and interests of the Company and shareholders. The Company has formulated rules of procedure for the Supervisory Committee meetings. Meetings of the Supervisory Committee are convened and held in strict compliance with the Articles and the Rules of Procedure for Supervisory Committee Meetings.
- (V) **Performance appraisal and incentive mechanism:** During the year, the Remuneration and Evaluation Committee of the Board of Directors linked the salaries of the senior management with the results of the Company and personal performance in accordance with the Articles of Association of the Company. Senior management personnel are recruited and appointed in strict compliance with relevant rules, regulations and the Articles of Association of the Company.
- (VI) **Information disclosure and transparency:** the Secretary to the Board of Directors is responsible for handling information disclosure, arranging receptions of visiting shareholders and answering enquiries on behalf of the Company. Relevant information is disclosed in strict compliance with Rules on Fair Information Disclosure by Companies Listed on the Shenzhen Stock Exchange and the Articles in a true, accurate, complete and timely manner, ensuring that all shareholders have equal access to information. There were no instances of majority shareholders or de facto controllers owning information otherwise not publicly disclosed or other irregularities in corporate governance during 2010.
- (VII) **Stakeholders:** the Company respects the legal rights and interests of banks and other stakeholders such as creditors, employees, consumers, and suppliers, and works actively with these stakeholders to promote the sustainable and healthy development of the Company.



V. Corporate Governance Report

II. Performance of the independent non-executive Directors

In the reporting period, each of the independent non-executive Directors continued to suggest constructive opinion on the material matters relating to operations and management and internal control of the Company. They issued their independent opinion on related matter pursuant to related requirements, thus raising the science and objectiveness of Board decisions. Attendance of independent nonexecutive Directors at Board meetings in 2010 is as follows:

| Name of independent non-executive Directors | Number of Board meetings requiring attendance | Number of Attendance in person | Number of Attendance by proxy | Number of Absence |
|--|--|---------------------------------------|--------------------------------------|--------------------------|
| Wang Chun Hua | 6 | 6 | 0 | 0 |
| John Paul Cameron | 6 | 6 | 0 | 0 |
| Chau Shing Yim, David | 6 | 6 | 0 | 0 |

In the reporting period, independent non-executive Directors of the Company issued their independent opinions on the connected transactions pursuant to the related laws and regulations, they raised no objection opinion on the proposals of Board meetings or other issues.

III. Particulars about the Separation of Businesses, Personnel, Assets, Organizations, and Finance from the Controlling Shareholder

1. In terms of business: The Company was completely independent from the controlling shareholder, and had its independent and complete business operation capability.
2. In terms of personnel: The labour, personnel and remuneration management were completely separated from the controlling shareholder.
3. In terms of assets: There was only shareholding relationship between the Company and its controlling shareholders. The assets of the Company were completely separated from those of the controlling shareholder.
4. In terms of organization: The Company had a mature and independent organization structure, which was established according to the legal processes and the business practice of the Company. It was completely separated from that of the controlling shareholder.
5. In terms of finance: The Company had its own accounting department, accounting system, financial management system, and bank accounts which were independent of the controlling shareholder.

IV. Internal Control of the Company

1. Internal control overview

The Company established the procedural rules for shareholders' meetings, board meetings, and the Supervisory Committee meetings to ensure their decision-making, execution, and supervision duties to be carried out effectively. Meanwhile, the Company also established the Nomination Committee, Audit Committee and Remuneration and Assessment Committee of the Board. In accordance with their respective terms of reference, they assumed the functions of discussing the material matters and decision making, raising the science and professionalism of Board decisions.



Through the Company's internal corporate governance department, the Board can monitor the set-up, improvement and implementation of internal control systems. The Audit Committee is charged with the review and monitor of material connected transactions.

The Company established a complete internal control system covering production management, financial management, connected transactions, external guarantee, use of proceeds, and material investment of the Company and its subsidiaries.

2. The establishment and optimization of the internal control of the Company

(1) Administration of and control over controlling subsidiaries

The Company managed its controlling subsidiaries and set up the "Subsidiary Management System" according to the related laws and regulations and relevant Listing Rules of the SZSE and the SEHK. According to the requirements of Company Law, subsidiaries established their respective board of directors and supervisory committee and lawfully conducted management and supervision duties. Sound operation and financial management systems were established according to the practices of the Company's business operations. By exercising its rights as a shareholder, the Company controlled the director and key management nomination process and decision-making process of the subsidiaries. As a result, the Company was assured that its subsidiaries were under firm control and the decisions and systems of the Company were effectively, promptly and consistently implemented within its subsidiaries. So all the tasks within the Company and its subsidiaries were consistently dealt with.

(2) Administration of and control over connected transactions

The Articles of Association of the Company has provided clear rules for the authorities of the Board and Shareholders' Meeting to examine connected transactions, the auditing procedure, and waiving of voting by related Directors and shareholders. According to "Shenzhen Stock Exchange Guidelines on Internal Controls of Listed Companies" (《深圳證券交易所上市公司內部控制指引》), the "Company prepared its Administration on Connected Transactions" (《關聯交易管理辦法》), which set out the regulations regarding classification, identification, contract execution and disclosure of connected transactions. The Company also set up the "Special System to Take Precautions against Controlling Shareholders and Related Parties from Embezzling the Company's Fund" (《防範控股股東及關聯方資源佔用制度》). None of capital, assets, or other resources of the Company has been appropriated or transferred by the controlling shareholder and its related persons. All connected transactions were conducted under the principle of faithfulness, fairness, voluntary, and open and their information was disclosed according to the disclosure requirements and published in the annual report of the Company. No action was conducted which was harmful to the benefits of the Company and the shareholders. Overall, the connected transactions of the Company were in compliance with "Shenzhen Stock Exchange Guidelines on Internal Controls of Listed Companies" (《深圳證券交易所上市公司內部控制指引》) and the related laws and regulations.

(3) Administration of and control over external guarantee

The authority of external guarantee was stipulated by the Articles of Association and the Company had implemented the requirements relating to aggregate amount of external guarantees according to the Rules Governing Listing of Stocks on SZSE. Meanwhile the Company had set up "Administration System of External Guarantees". The Company made no external guarantees in the reporting period. Overall, external guarantees of the Company were in compliance with "Shenzhen Stock Exchange Guidelines on Internal Controls of Listed Companies" (《深圳證券交易所上市公司內部控制指引》) and the related laws and regulations.



V. Corporate Governance Report

(4) Administration of and control over using of financing proceeds

"The Company had set up Administration Criteria of Financing Proceeds" (《募集資源管理辦法》) to govern the use, approval, deposit, change of use, report and supervision of financing proceeds and liabilities. Financing proceeds were used according to their intended usage. The Company disclosed the information about the use of financing proceeds in compliance with related requirements.

(5) Administration of and control over capital

"Financial Examining System", and "Decision System for Financing", which set up strict procedures for authorization and approval of receipts and payments of monetary capital, separated the incompatible positions in the process of monetary capital operation and established a checking system in the related organization and staff. The Company set up procedures such as those for approval of receipts and payments of monetary capital and strictly implemented verification and investigation of receipts and payments of monetary capital.

(6) Administration of and control over material investments

Material investment operations were conducted under principles of lawfulness, cautiousness, safety and effectiveness. The Articles of Association has clearly set out the authorities of shareholders' meeting and the Board on approval of major investment operations. The Company has been focusing on its main businesses and made no material investment other than the main businesses so far.

(7) Administration of and control over finance

In accordance with the laws and regulations such as Company Law, Accounting Law, and Accounting Standards for Business Enterprises and their supplementary requirements, the Company prepared its "Financial Examination and Approval Rules" (《財務審批制度》), which set out the procedures and rules for major financial decisions, standardized the procedures for accounting evidence, books and reports, defined the responsibilities of accounting staff and set up the evidence flow. Transactions were implemented with evidence timely prepared and delivered to the accounting department and filing department for record and filing. Meanwhile, the records were compared with the corresponding accounting entries to build up a sound internal control system of accounting in the form of computerization. The Company introduced ERP system as the common platform for the management techniques. The platform effectively standardized corporate and foundation information and business operations, increased the management efficiency and timely provided the management of the Company and the Board with related information. The financial system of the Company is sound and complete and in compliance with the requirements of related laws and regulations.

(8) Administration of and control over information disclosure

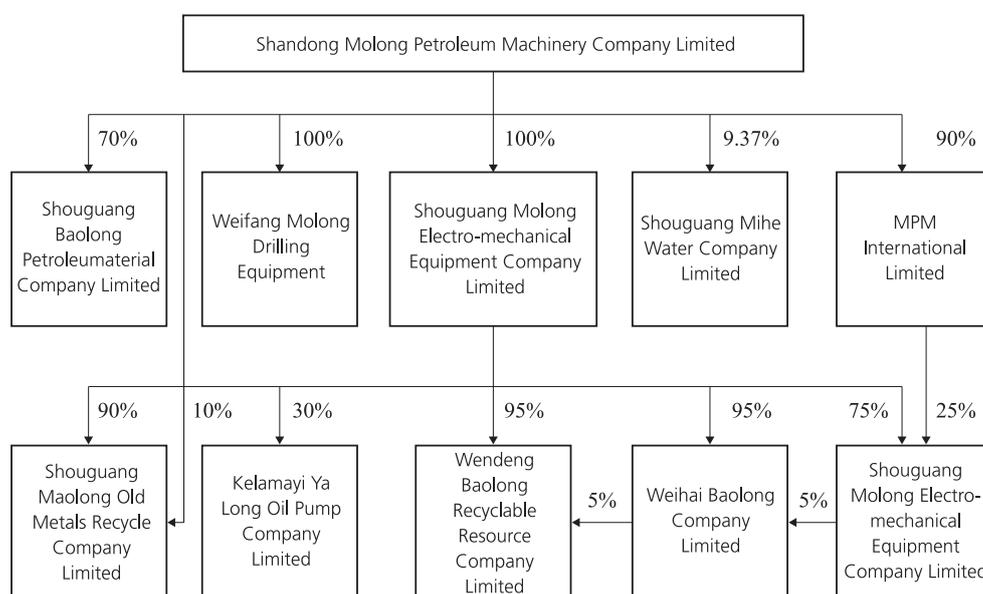
The Company prepared the "Information Disclosure Criteria" (《資訊披露管理制度》), "Internal Reporting of Material Information" (《重大資訊內部報告制度》), and "Investor Relationship Management Criteria" (《投資者關係管理制度》), which set out the extent, reporting, examination, disclosure, and confidentiality of material information. China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News, the website of CHINF (www.cninfo.com.cn) and SEHK's website were the designated information disclosure media of the Company, through which the information of the Company was first disclosed. The Company also timely released its public information through its own website to communicate with the investors. Reception of visitors and online road shows were lawfully conducted to ensure open, just and fair information disclosure.



(9) Establishment of the Responsibility System for Major Errors in Information Disclosure in Annual Reports of the Company

The Company has established the Accountability System for Major Errors in Information Disclosure in Annual Reports (《年報信息披露重大差錯責任追究制度》) pursuant to the requirements set out in CSRC Document [2009] No. 34, which provides clarity on the accountability mechanism in respect of major errors in information disclosure in annual reports.

(10) Shareholding structure of the subsidiaries of the Company



3. Implementation of internal control system

The Company performed inspection and monitoring operation on implementation of internal control system. The Audit department was in charge of inspecting and monitoring the internal control system and made amendments from time to time to ensure effective implementation of the internal control system and normal production and operating activities. The Company took a approach in the annual inspection to assess the compliance of the financial system and financial audit of the subsidiaries. The audit department of the Company performed random audit on the financial position the Company and its subsidiaries.

4. Overall assessment on the internal control system

The Board is of opinion that the internal control system of the Company and its measures were comprehensive and reasonable and practically effective. The internal control system was consistent with the actual situation of the Company and was implemented seriously and effectively. It proved to be effective as illustrated by its practices from many years without significant fault.

After a series of amendment and formulation, the internal control system became more comprehensive. Directors, Supervisors and the Senior Management of the Company became more aware of the importance of corporate governance and standard operation, thus laying a foundation for continuous improvement on corporate governance.



V. Corporate Governance Report

5. Supervisors and independent non-executive Directors of the Company made the following self-evaluation comments on the internal controls of the Company:

The internal control measures of the Company are in compliance with the requirements of the relevant regulations and the securities regulatory authorities, while are also appropriate taking into account of the prevailing practical needs of the Company. The internal control measures of the Company provided better results in controlling of all the processes and integral parts of company management. The "Self-evaluation Report on Internal Controls" adopted by the Company objectively reflected the actual circumstances of internal control within the Company and formed a comprehensive overview on the internal controls of the Company.

| Relevant situation on internal control | Remarks/Explanation (please explain the specific Yes/No/N/A reason if No/N/A is chosen) |
|---|---|
| 1. Establishment of internal audit system | |
| 1. Whether the Company has established internal audit system and whether the internal audit system has been reviewed and passed by the board of the Company | Yes |
| 2. Whether the board of the Company has established the audit committee and whether the Company has established an internal audit department independent of its financial department | Yes |
| 3. (1) Whether the members of the audit committee are all directors, with independent directors accounting for over half of the composition and hold the position of convener, and at least one of the independent directors is accounting professional | Yes |
| (2) Whether the internal audit department comprises of over 3 (inclusive) dedicated staff to engage in internal audit | Yes |
| 2. Annual internal audit control self-assessment report and the disclosure of relevant situation | |
| 1. Whether the Company has issued annual internal audit control self-assessment report in accordance with relevant requirements | Yes |
| 2. Whether the internal control self-assessment report concludes internal control is effective.(If internal control is ineffective, please explain the material defects existing in internal control) | Yes |
| 3. Whether accounting firm is engaged to issue verification report on the effectiveness on internal control | No |
| 4. Whether accounting firm has issued unqualified opinion on the conclusion verification report on the effectiveness of the Company's internal control. If unqualified opinion on the conclusion verification report is issued, whether the board and supervisory board of the Company have made specific description on matters involved in conclusion verification | N/A |
| 5. Whether independent directors and the supervisory board has issued clear consent opinions(if opposition opinions are issued, please describe) | Yes |
| 6. Whether sponsor and its representative(s) have issued clear consent review opinions | Yes |
| 3. Major contents of the work of audit committee and internal audit department and its effectiveness for the current year | |
| <p>During the reporting period, the audit committee of the Company has convened meetings in accordance with the requirements, and made review on the report on the internal audit of the Company, report on use of funds raised and the information disclosure report submitted by internal audit department. During the reporting period, the internal audit committee has also reviewed the implementation of every items of internal control system and the operation of the Company via on-site understanding, enquiries and perusal of relevant information, etc. Evaluation and conclusion on the audit on the Company carried out by external auditing firm, and recommendation has been made on re-appointment.</p> <p>During the reporting period, the audit department has commenced orderly internal audit with focus placed on the effectiveness on the Company's internal control, the truthiness and completeness of financial information, the use of funds raised and the standardization of information disclosure in accordance with the specific working requirements of the board and audit committee. During daily course of business, departments of every function are thoroughly understood to identify problems on a timely basis, optimize each items of internal control system for the Company and actively provide advices and strategies on the prevention of risks, thereby achieving a relatively good working effectiveness.</p> | |
| 4. Other situation required to be explained in the Company's opinion | |
| Nil | |

V. Corporate Governance Report



V. Assessment and incentive mechanism for the Senior Management in the reporting period

The Senior Management of the Company is assessed monthly and annually. Monthly assessments were conducted in line with the direction of the annual major tasks, and were focused on appraisals of two fixed indicators, namely the completion status of in each month and the evaluation on important performance indicators. It was carried out monthly by way of cross assessment and supervision among the related departments. The annual assessments were carried out by the Remuneration and Assessment Committee with reference to the results of monthly assessments and overall performances over the year, including the integrated quality of senior management and internal training of talents.

VI. Disclosures in accordance with the Listing Rules of SEHK

1. Comply with the requirements set out in the “Code on Corporate Governance Report”

The Company put strong emphasis on the superiority, steadiness and rationality of corporate governance. In order to enhance the management standard, the Company has set up a committee to review its internal management structure. During the reporting period, the Company has complied with the requirements set out in the “Code on Corporate Governance Report”, Appendix 14 of the Listing Rules SEHK.

2. Directors’ Securities Transactions

The Company has adopted the Model Code, which requires the securities transactions of the Directors to be conducted in accordance with the Model Code. The Model Code is also applicable to the senior management of the Company. After making specific enquiries, all Directors have confirmed that they had fully complied with the Model Code throughout 2010.

3. The Board

The Board is responsible for planning and overseeing the overall development and management of the Group with the objective of enhancing Shareholders’ value. The Board, led by the Chairman, is responsible for the approval and monitoring of the overall strategies and policies of the Group, approval of annual budgets and business plans, evaluation of the Company’s performance and oversight of the works of management. In 2010, the Board comprised nine Directors, including four executive Directors, two non-executive Directors and three independent non-executive Directors. Biographical details of the Directors are set out in the section IV in this annual report. Pursuant to Rule 3.13 of the Listing Rule, the Company has received the confirmation letter from each independent non-executive Director. The independent non-executive Director will only be regarded as independent by the Board if it is confirmed that such Director does not have any other direct or indirect relationship with the Group. The Chairman of the Board, Mr. Zhang En Rong, is the father of Mr. Zhang Yun San, an executive Director. Aside from this, there is no financial, business and relatives relationship among members of the Board.

In 2010, the Board had convened six meetings.



V. Corporate Governance Report

Attendance record of the Directors:

| Members of Directors | Position | Number of meetings attended |
|-----------------------------|--|------------------------------------|
| Zhang En Rong | Chairman and executive Director | 6/6 |
| Zhang Yun San | Deputy Chairman and executive Director | 6/6 |
| Lin Fu Long | Executive Director | 6/6 |
| Xie Xin Cang | Executive Director | 6/6 |
| Chen Jian Xiong | Non-executive Director | 6/6 |
| Wang Ping | Non-executive Director | 6/6 |
| Chau Shing Yim David | Independent non-executive Director | 6/6 |
| John Paul Cameron | Independent non-executive Director | 6/6 |
| Wang Chun Hua | Independent non-executive Director | 6/6 |

4. Chairman and General Manager

The Chairman provides leadership for the Board. He is responsible for approving and monitoring the overall strategies and policies of the Group, approving annual budget and business plan, assessing the performance of the Company and overseeing the duties of management. The General Manager is responsible for the daily operations of the Group. The roles of Chairman and General Manager are separate and are not performed by the same individual. During the current year, Mr. Zhang En Rong was the Chairman and Mr. Zhang Yun San was the General Manager.

5. Non-executive Director

The appointment of non-executive Director, Mr. Wang Ping, is valid from 12 May 2009 to 11 May 2012. The appointment of non-executive Director, Mr. Chen Jian Xiong, is valid from 6 May 2008 to 5 May 2011.

The resolution regarding to appoint Mr. Xiao Qing Zhou as a non-executive director which has been approved by the sixth meeting of the third session of the Board meeting held on 29 March 2011, will be submitted and approved by annual general meeting of 2010

6. The Directors confirmed their responsibilities in preparing the Group's financial statements

The Directors acknowledged the responsibility for preparing the accounts and have confirmed that the preparation of the Group's financial statement is in compliance with the relevant regulations and applicable accounting standards. The Directors also warrant that the Group's financial statement will be distributed in due course.

7. Working conditions of the Audit Committee and the Remuneration and Evaluation Committee held under the Board

Please refer to "V. DAY-TO-DAY OPERATION OF THE BOARD" in the VII section of this annual report.



8. Internal Control

The Board places great importance on internal control and risk management and is responsible for establishing and maintaining adequate internal control over financial reporting for the Company and assessing the overall effectiveness of those internal controls. The Board has reviewed the internal control system of the Group and is of the view that the system is effective.

The Company has an Internal Audit Department which plays a major role in monitoring the internal governance of the Company. The major tasks of the Internal Audit Department are reviewing the financial condition and management of the Company and conducting comprehensive audits of all operating units of the Company on a regular basis. The Company has taken many steps to enhance the internal control of the Company in 2010, such as having all departments internal control inspection and appraisal, strengthening the checks and supervision of implementation of the internal control systems by the Audit Department and according to some weakness found during examination of the internal control, further improving the internal control system and strengthening the implementation of all the internal control systems.

During the year of 2010, the Internal Audit Department issued reports to the senior management covering various operational and financial units of the Company and also conducted reviews of areas of concern identified by the Company's management.

9. Going Concern

For 2010, there was no uncertainty or conditions of a material nature that would affect the Company's ability to continue as a going concern.

10. Investor Relations

For details, please refer to "VIII. LAUNCH OF VARIOUS CHANNELS TO COMMUNICATE AND STRENGTHEN INVESTOR'S RELATION MANAGEMENT" in the section IX of this annual report.



VI. Particulars about the Shareholders' Meeting

I. Shareholders' Annual Meeting

The 2009 annual shareholders' meeting was held on 28 March 2010. 8 resolutions, among other things, regarding directors' reports, supervisory committee's report of the Company for 2009, profit distribution plan for 2009, Change the term of the Board, and Extend the Term of Validity of Issuing A Shares were passed at the meeting. For specific details, please refer to the relevant announcements published on the website of the Hong Kong Stock Exchange (www.hkex.com.hk) on 28 March 2010.

II. Shareholders' Extraordinary Meetings

No shareholders' extraordinary meeting was held in 2010.



I. Management Discussion and Analysis

1. Overall operations during the reporting period

2010 witnessed an extremely important year for the development of the Company. Though domestic economy has gradually walked out of the negative impact on the international financial crisis and shown rapid growth, specific situation of different industry us still complex. As oil machinery equipment, being the specialized equipment for oil extraction, has a high concentration of application scope, professional and falls within an industry with complex market situation, market competition is increasingly keen with the co-existence of both opportunities and challenges as well as development and elimination. In 2010, the Company has ensured the completion of pre-set annual operational targets, while organized and planned the construction of projects. With the continuous increase in efforts on technology research, steady exploration of the scope of market and the active enhancement on management standard, the Company has gradually strengthened the construction of its own culture and completed the listing of its A Shares, thereby getting itself well-prepared for the opportunities and challenges brought by the strategically prominent era amidst the implementation of the "Twelfth-Five Year Plan".

2. Business Review

The Company reported RMB2,703,91 million in operating revenue for the year 2010, representing a 30.27% growth compared with the previous year. Total profit in 2010 of RMB324.48 million remained unchanged with the previous year; the net profit attributable to shareholders of the Company in 2010 increased by 2.92% as compared with the previous year to RMB276.15 million. The net profit of the Company after non-recurring profit and loss was RMB251.86 million, increased by 14.44% compared with last year.

In terms of capacity promotion, the 250,000-tonne oil casing production line reached its full designed production capacity in 2009, and brought a substantial growth in oil casing output and the production capacity of high-added value non-API casing of the Group. At the same time, "180" mm special petroleum pipes technical reconstruction Project" (the "180mm Project"), the A Share proceeds-funded project, in which the Group intends to invest approximately RMB720 million, will release 60% of its newly increased capacity in 2011, which will be beneficial to the substantial growth in the production capacity of the OCTG, and in turn beneficial to the future development of the business and the competitiveness of the Group.

In terms of domestic market expansion, the Group's main customers are major oil fields in the PRC, including Daqing Oil Field (大慶油田), Changqing Oil Field (長慶油田), Xinjiang Oil Field (新疆油田), Liaohe Oil Field (遼河油田), Qinghai Oil Field (青海油田), Talimu Oil Field (塔里木油田), Huabei Oil Field (華北油田), Jidong Oil Field (冀東油田) and Jilin Oil Field (吉林油田), all of which are oil fields of PetroChina Company Limited and its subsidiaries (collectively, "PetroChina Group"), as well as Shengli Oil Field (勝利油田), Zhongyuan Oil Field (中原油田), Jiangsu Oil Field (江蘇油田) and Jiangnan Oil Field (江漢油田), all of which are oil fields of China Petroleum & Chemical Corporation and its subsidiaries (collectively, "Sinopec Group").

During the period under review, the Group increased its efforts to cooperate with existing oil field customers, and gained wide market evaluation, Sales to the above oil fields under the PetroChina Group and the Sinopec Group accounted for approximately 23.65% of the Group's sales revenue.

After the oil well pipes fully entering into CNOOC Limited and its subsidiaries (collectively, "CNOOC Group"), the Group had supplied more than 7,768 tonnes of products with sales revenue of more than RMB41.72 million, which signifies the increasing market share of the Company in the offshore oil market during the reporting Period; After the Company's products such as casing, oil well pumps and oil well sucker rods have abundantly supplied to



VII. Directors' Report

Shanxi Yanchang Petroleum (Group) Co., Ltd. ("Yanchang Petroleum"), the Company continually maintain close and long-term cooperative relationships with it and sales 43,000 meters oil well sucker rods. During the current year, the cooperation between the Group with the four major domestic oil groups increased greatly, and further implemented stated strategies of overall cooperation with the four major domestic oil groups. In addition, the Company's products such as oil well pipes, oil well pumps and oil well pumping machines have continually being supplied to customers such as Zhongyu Group (Jiaozuo) Coalbed Methane Corp (中裕集團(焦作)煤層氣開發有限公司), which is a subsidiary of the Zhongyu Group (中裕集團), and Shanxi Qinshui Lanyan Coalbed Methane Corp (山西沁水蘭焰煤層氣有限公司) which is a subsidiary of Shanxi Jinmei Group (山西晉煤集團). With the rapid scale development of the emerging field of coalbed gas, the demand for the Company's products will continue to increase.

In terms of overseas market, after the financial crisis, the overseas market began to gradually recover. During the year, with overcoming the negative effect of American anti-dumping, the Group further strengthened the existing markets including Southeast Asia, Middle East, South America, while the Group continued to step up its efforts in developing its business to regions such as South America, North Africa, Middle East and had achieved good performance. For example, the Group newly developed customers such as Samasu International Oil Corporation in Sudan (the staple market is Sudan), SteelForce Far East Ltd. (the staple market is Columbia), CORPAC (the staple market is Columbia), France TFE (the staple market is North Africa), Marubeni Corporation (the staple market is Southeast Asia countries such as Thailand), LG International Corp. in Korea (the staple market is Australia), Mid-Continent Tubular Pte. Ltd. in Singapore (the staple market is Australia), 3 Wins Asia Oil-field Equipment Purchasing Service Company in Hong Kong (the staple market is Australia) and further expanded the overseas market. The Group continued to establish and maintain good and long-term cooperative relationships with many overseas stock companies and oil field service companies, which in turn boosted the sales of its products in the overseas markets. For the financial year ended 31 December 2010, the Group's revenue generated from exports accounted for approximately 35.80% of the Group's total sales revenue. Such increase formed a solid foundation for the Group to further expand its overseas market in the future.

In terms of the development of new products, the Group continued to increase its efforts to develop high-end products and strengthened technological cooperation with research institutes such as Xi'an Jiaotong University, Xi'an Pipe Material Research Institute of PetroChina Group. Meanwhile the Company was recognized as the "Province-class Enterprise Technical Center of Shandong Province" by Commission of Industry and Information Technology of Shandong Province, and was approved by Ministry of Human Resources and Social Security of the PRC to set up "Shandong Molong post-doctoral research station", which will improve the research strength to a new level. With the advantages, the Company increased its efforts to develop new products, expand product mix and enrich product categories, and has successively developed products including casing and tubing which can use in the sour environment to meet the requirement of Canada Directive 010, Tubing with special OD coupling, line pipe with special performance, Nickel plating anticorrosive sucker rod, Non-API special sucker rod, Nickered polish rod, high-pressure boiler tube, low/medium-pressure boiler tube, high-pressure chemical fertilizer pipe, tube for conveyance of fluid, high-performance impeller with high-emissions, all of which have been complete trial producing and sold domestic and overseas. And the Nickel plating anticorrosive sucker rod was included in the Province-class technology innovation projects of Shandong province. The CO₂ corrosion resistant 9Cr Tubing and Casing which is being developed was included in Weifang technology innovation projects of Shandong province. In addition, the Company achieved a breakthrough in the development of new products and applications: seven products including "Processing of Drill Pipe End Upsetting", "self-locking sucker rod preventing flipping", prevent tripping device of sucker rod", "Anti-bending and compression OCTG threading connector", Anti-spurting and grit oil-well pump with inner-leakage oil function", "anti-corrosion and wearable pump barrel", "High-sealing OCTG threading connector" were awarded National Patent, and the three patent application for "anti-twisting and gluing OCTG threading connector", "sucker rod", and "sheradizing OCTG coupling" were officially accepted by the State Intellectual Property Office of the PRC.



3. Principal operations of the Company and analysis on their operations

(1) Business scope of the Company

Business scope of the Company include: production and sales of sucker rod pumps, sucker rods, pumping units, casing and tubing, petroleum machinery parts and textile machinery; development of petroleum machinery and relevant products; products information service (excluding intermediary).

(2) Principal operations by industry and by product

Unit: RMB'000

| By industry or by product | Revenue from operations | Cost of sales | Gross profit margin (%) | Revenue from operations by industry | | |
|---------------------------------|----------------------------|------------------|-------------------------------|--------------------------------------|--|---|
| | | | | Year-on-year increase/decrease | | Year-on-year increase/decrease in gross profit margin (%) |
| | | | | in revenue from Operations (%) | Increase/decrease in cost of sales (%) | |
| Tubings & Casings | 2,126,590 | 1,722,880 | 18.98 | 23.25 | 24.38 | -0.74 |
| Three kinds of pumping units | 111,660 | 88,480 | 20.75 | 5.61 | 10.22 | -3.31 |
| Petroleum machinery | 148,490 | 125,040 | 15.79 | 77.82 | 93.72 | -6.91 |
| Others | 266,010 | 253,520 | 4.70 | 109.88 | 115.12 | -2.32 |
| Total | 2,652,750 | 2,189,920 | 17.45 | 29.95 | 32.90 | -1.83 |

(3) Breakdown of revenue from principal operations by geographical segment

Unit: RMB'000

| Geographical segment | Revenue from operations | Year-on-year increase/ decrease in revenue from operations (%) |
|----------------------|----------------------------|---|
| | | |
| PRC | 1,703,050 | 30.15 |
| Abroad | 949,70 | 29.59 |
| Total | 2,652,750 | 29.95 |

(4) Gross Profit

The Group's gross profit increased from approximately RMB393,590,000 for the year ended 31 December 2009 to approximately RMB462,82 million for the current year, with RMB69.23 (17.59%) increased, which was mainly attributable to sales revenue growth.



VII. Directors' Report

(5) Consolidated Gross Profit Margin

The consolidated gross profit margin of the Group is approximately 17.45% for the year ended 31 December 2010, decreased 1.83% compared with 19.28% of 2009, which mainly due to the price of materials increased more than the product price.

(6) Net Profit Attributable to shareholders of the Company

The Group's net profit attributable to shareholders of the Company increased from approximately RMB268.32 million for the year ended 31 December 2009 to approximately RMB276.15 million for the current year, representing an increase of approximately 2.92%. The increase of net profit was mainly due to the sales volume increased substantially.

(7) Cost of Operation

The Group's cost of operation increased from approximately RMB1,647.78 million for the year ended 31 December 2009 to approximately RMB2,189.92 million for the current year, representing an increase of approximately 32%. The significant increase in cost of sales was mainly attributable to the sales volume and the price of the materials increased.

(8) Operation Expenses

The selling expenses decreased from approximately RMB61.25 million for the year ended 31 December 2009 to approximately RMB51.36 million for the year ended 31 December 2010. The decrease of selling expenses is mainly due to the decrease of marketing expenses with the warmer and warmer marketing environment. Operation expenses was approximately 2.95% of the Group's total revenue in 2009 and decreased to approximately 1.90% in 2010.

(9) Administrative Expenses

The Group's administrative expenses increased from approximately RMB63.83 million for the year ended 31 December 2009 to approximately RMB91.38 million for the current year, representing an increase of approximately 43.17%. Administrative expenses was approximately 3.08% of the Group's total revenue in 2009 and increased to approximately 3.38% in 2010, representing a decrease of approximately 0.3%. The decrease of proportion is mainly due to the increase of development expenditure for new products.

(10) Finance Cost

The finance cost of the Group for the current year was approximately RMB44.34 million, representing approximately 1.64% of the Group's total revenue and an increase of RMB33.68 million when compared to the finance cost of RMB10.66 million for the year ended 31 December 2009 over the same period. The increase in finance costs was principally due to the increase of short-term borrowings and exchange loss from the appreciation of the RMB.

(11) Research and Development Cost

The research and development cost of the Group for the current year was approximately RMB21.33 million, representing an increase of approximately RMB11.16 million when compared to the research and development cost of RMB10.17 million for 2009. The increase was mainly due to the increased input in new product development.



(12) Current Assets and Liabilities

As at 31 December 2010, the total current assets of the Group amounted to approximately RMB2,385.92 million (2009: approximately RMB1,587.89 million) which comprises: (1) cash and bank balances for the total amount of approximately RMB892.29 million (2009: approximately RMB305.51 million) and pledged time deposit to RMB235.51 million (2009: approximately RMB183.92 million); (2) Trade receivable and notes receivable amounted to approximately RMB519.99 million (2009: approximately RMB485.74 million). (3) Inventories amounted to approximately RMB743.35 million (2009: approximately RMB713.66 million).

As at 31 December 2010, the total current liabilities of the Group amounted to approximately RMB1,830.18 million (2009: RMB1,352.5 million) which comprises: (1) trade and bills payables approximately RMB984.59 million (2009: RMB718.81 million); (2) bank loans amounted to approximately RMB712.87 million (2009: approximately RMB464.65 million), this is due to the increased short-term bank loans for the expansion of the scale of the Company. According to the planned arrangement of the present current asset condition and future cash flow, the Company anticipates that it will have sufficient repayment ability to support the Group's operation.

(13) Banking Loans

For the current year, the Group had interest-bearing bank credit loans amounting to approximately RMB712.87 million (2009: approximately RMB1,047.65 million). In addition, eleven banks, including the Agricultural Bank of China, have granted credit facilities to the Group amounting to approximately RMB2,549.89 million (2009: approximately RMB911.61 million) that have not been utilised.

(14) Cash Flow

As at 31 December 2010, the cash and cash equivalents of the Company increased by approximately RMB528.10 million as compared with that of the year ended 31 December 2009. The net cash flow from operations of the year amounted to approximately RMB389.01 million (2009: RMB94.77 million). Such increase is primarily attributable to the increase of taxes refunds of RMB56.58 million and the decrease of cash for purchasing and labor spending of RMB476.53 million. Other cash flow items increased approximately RMB51.59 million as the additional pledged fixed deposits, approximately RMB582.95 million as capital expenditures for the purchase of certain property, plant and equipment and intangible assets, approximately RMB55.64 million for distribution of dividends for 2009, and approximately RMB334.78 million as proceeds of new bank loan facilities.

(15) Capital Structure

As at 31 December 2010, the liability ratio of the Group was approximately 67.19% (2009: approximately 147.91%). The increase was mainly attributable to the proceeds from the Company successfully listing and repay bank loans for the proceeds funded projects.

(16) Gearing Ratio

The Group's gearing ratio was approximately 40.19% (2009: approximately 59.66%) which is calculated based on the Group's total liabilities of approximately RMB1,843.21 million (2009: approximately RMB1,942.97 million) and total assets of approximately RMB4,586.41 million (2009: approximately RMB3,256.61 million).



VII. Directors' Report

(17) Pledge of Assets

The pledged deposits of the Group are as security for bills payable which amounted to approximately RMB229.47 million (2009: approximately RMB230.57 million).

(18) Foreign Exchange Exposure

The Group's foreign exchange exposure mainly comes from certain receivables, cash and cash equivalents denominated in a currency other than the functional currency Renminbi.

(19) Segment Information

An analysis of the Group's revenue and segment results by operating segments for the current year is set out in note IX to the financial statements.

(20) Capital Commitment

For the current year, the Group had capital commitments of approximately RMB75.56 million (2009: approximately RMB173.73 million) in respect of fixed assets.

(21) Significant Investments

In the year ended 31 December 2010, the Group has completed investment of approximately RMB841.02 million in the newly-commenced 180mm Project.

(22) Acquisitions and Disposals during the Year and Future Investment Plans

In the year ended 31 December 2010, the Group did not have other relevant acquisitions, disposals or significant investment plans.

4. Analysis and explanation on major year-on-year changes in composition of assets of the Company during the reporting period

| Item | 2010 | 2009 | Unit: RMB millions |
|--------------------------|-----------------|--------|--|
| | | | Increase/ decrease from the last year (%) |
| Cash and bank balances | 892.29 | 305.51 | 192.07 |
| Bills receivable | 19.12 | 34.63 | -44.79 |
| Prepayments | 158.60 | 54.62 | 190.40 |
| Fixed assets | 1,648.58 | 908.17 | 81.53 |
| Construction in progress | 131.45 | 391.59 | -66.43 |
| Intangible assets | 249.92 | 165.63 | 50.89 |
| Short-term borrowings | 712.87 | 274.65 | 159.56 |
| Accounts payable | 501.77 | 345.19 | 45.36 |
| Advance receipts | 347.22 | 52.53 | -33.90 |
| Dividends payable | 23.79 | 39.59 | -39.92 |
| Other payables | 25.99 | 17.27 | 50.49 |
| Long-term loans | 0 | 580.00 | -100 |
| Capital reserve | 1,248.41 | 121.67 | 926.08 |

VII. Directors' Report



- 1) The cash and bank balance in the current year increased of RMB586.78 million (192.07%), compared with the end of last year, which mainly because with the Company successfully listing, the proceeds made the cash flow improved, in addition, with the improved economic environment the sales increased, which all improved the cash conditions of the Company.
- 2) The bills receivable in the current year decreased RMB15.51 million (44.79%), compared with the end of last year. The decrease is mainly because the bills were endorsed to pay for the goods as soon as received as the purchasing quantity of material increased in the current year.
- 3) The prepayments in the current year increased RMB103.98 million (190.40%), compared with the end of last year. The increase is mainly because the Company predicted the price of materials would rise and the Company prepaid the supplier to lock the highest purchasing price of primary material.
- 4) The fixed assets in the current year increased RMB740.41 million (81.53%), compared with the end of last year. The increase is mainly because the "180mm special petroleum pipes technical reconstruction project" transferred into fixed assets after finished in the current year.
- 5) The construction in progress in the current year decreased RMB260.14 million (66.43%), compared with the end of last year, which mainly because the "180mm Project" transferred into fixed assets after finished in the current year.
- 6) The intangible assets in the current year increased RMB84.28 million (50.89%), compared with the end of last year, which mainly attribute to the land-use right purchased for "180mm Project" and the development spending of intangible assets capitalised.
- 7) The short-term borrowings in the current year increased RMB438.22 million (159.56%), compared with the end of last year. The increase mainly due to the increased short-term borrowings for prepayments of materials and financial products such as outward documentary bill which improved the foreign exchange loan amount in the current year.
- 8) The accounts payable in the current year increased RMB156.58 million (45.36%), which mainly due to the increased purchase quantity of materials and engineering equipment.
- 9) The advance receipts in the current year decreased RMB178.10 million (33.90%), compared with the end of last year. The decrease is mainly due to the increased delivery.



VII. Directors' Report

- 10) The dividends payable in the current year decreased RMB15.8 million (39.92%) which is because the Company paid for the dividends of H-share shareholders in the current year.
- 11) Other payables in the current year increased RMB8.72 million (50.49%), compared with that of the end of last year. The increased is mainly due to the increased accrued electricity and transportation, and the newly increased listing fee of A shares.
- 12) The long-term loans in the current year decreased RMB580 million, compared with that of the end of last year, which is because long-term loans were repaid.
- 13) The capital reserve in the current year increased RMB1,126.74 million (926.08%), which is mainly due to the generated capital stock premium from issuing A shares.

5. Analysis and explanation on major year-on-year changes in profit and loss indicators during the reporting period

| Item | 2010 | Unit: RMB millions | |
|--|--------------|--------------------|------------|
| | | 2009 | change (%) |
| Administrative Expenses | 91.38 | 63.73 | 43.17 |
| Finance Expenses | 44.34 | 10.66 | 316.09 |
| Asset Impairment Losses | -2.02 | -12.72 | 84.08 |
| Gains on the changes in the Fair Value | 0.00 | 5.27 | -100 |
| Income from Investment | 0.19 | 5.83 | -96.72 |
| Less: Non-operation Expenses | 2.66 | 0.62 | 330.07 |

- 1) The administrative expenses in the current year increased RMB27.55 million (43.17%), compared with that of last year which is mainly due to the increase of development expenses for new products.
- 2) The finance expenses in the current year increased RMB33.68 million (316.09%), compared with that of last year which is mainly due to the increase of short-term loans and exchange loss from the appreciation of the RMB.
- 3) The asset impairment losses in the current year decreased RMB10.7 million (84.08%), compared with that of last year (which is mainly because the Company got the bad debt reserves of RMB846,116,298 from South China Petrochemical Corporation in the current year.)

VII. Directors' Report



- 4) The gains on the changes in the fair value of the current year decreased of RMB5.27 million, compared with that of last year, which is mainly because there was no trading financial assets and liabilities in the current year, and the trading financial assets and liabilities occurred in 2008 had been finished in last year.
- 5) The income from investment in the current year decreased of RMB5.64 million (96.72%), compared with that of last year, which is mainly because the Company received the income from investment of RMB5.58 million when disposing trading financial assets and liabilities in the previous year, but in the current year, there is no other income except the net income from Kelamayi Ya Long Oil Pump Company Limited, a related company of the Group.
- 6) The non-business expenses in the current year increased of RMB2.04 million (330.07%), compared with that of last year, which is mainly because the donations contributed and the net loss when disposing fixed assets increased.

6. Cash flow generated from operating activities of the Company during the reporting period

| Item | 2010 | 2009 | Unit: RMB'000 | |
|--|-----------------|----------|-----------------------------|---------------------------------|
| | | | Amount of increase/decrease | Percentage of increase/decrease |
| Net cash flow from operating activities | 389,010 | 94,770 | 294,240 | 310.48% |
| Net cash flow from investment activities | -577,860 | -453,820 | -124,030 | -27.33% |
| Net cash flow from financing activities | 716,770 | 169,500 | 547,270 | 322.87% |

- 1) Net cash flow from operating activities increased by RMB294.24 million year-on-year, which was mainly due to tax rebates received during the year increased by RMB565.8 million from the same period in last year, while cash paid for commodities purchased and services received decreased by RMB4.7653 billion from the same period in last year.
- 2) Net cash flow from investment activities decreased by RMB124.03 million year-on-year, which was mainly due to the increase in expenses for acquiring and constructing fixed assets via fund raising projects during the period.
- 3) Net cash flow from financing activities increased by RMB547.27 million year-on-year, which was mainly due to the successful fund raising via issuance of shares during the period.



VII. Directors' Report

7. Operation and results of major controlling subsidiaries of the Company

(1) 濰坊墨龍鑽探設備有限公司 (Weifang Molong Drilling Equipment Company Limited)

濰坊墨龍鑽探設備有限公司 (Weifang Molong Drilling Equipment Company Limited) was established on 29 September 2004 with a registered capital and paid-in capital of RMB6 million. The address and major production and operation site of the Company is at the northern side of Wenmiao Street Shouguang City. The business scope is the production and sales of oil well pumping, drilling equipment and accessories, etc. Molong Drilling is a wholly-owned subsidiary of the Company.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the total assets amounted to RMB26.68 million and the net assets amounted to RMB22.95 million, realizing operating revenue of RMB18.78 million, operating profit of RMB1.15 million and net profit of RMB2.73 million.

(2) 壽光寶隆石油器材有限公司 (Shouguang Baolong Petroleum Material Company Limited)

壽光寶隆石油器材有限公司 (Shouguang Baolong Petroleum Material Company Limited) was established on 30 April 2007 with a registered capital and paid-in capital of RMB150 million. The address and major production and operation site of the Company is at eastern Xingze Road Shouguang City (southwestern corner of Shangjia Village, Gucheng Street). The business scope is the production and sales of petroleum materials and its major products include castings, pipe billets, connecting rod head, materials of connecting rod head and other petroleum drilling machinery, etc. The Company and Shengcheng Investment hold 70% and 30% of Shouguang Baolong respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the total assets amounted to RMB498.09 million and the net assets amounted to RMB187 million, realizing operating revenue of RMB1.62335 billion, operating profit of RMB2.94 million and net profit of RMB2.21 million.

(3) MPM International Limited

MPM International Limited was formerly known as Molong (Asia) Holding Limited, and was registered in Hong Kong on 24 May 2004 with an authorized capital of HKD 10,000 upon establishing. 1 share with nominal value of HKD 1 was issued and the shareholder was Jade Nominees Limited. On 28 March 2005, upon the approval and reply by Office for Foreign Trading and Economic Co-operation of Shandong Province, the Company acquired the equity interests in the company from Jade Nominees Limited. On 1 April 2005, the Company has obtained "Approval Certificate for Mainland Enterprise to Invest in Hong Kong and Macau" * 《內地企業赴港澳地區投資批准證書》) issued by the Ministry of Commerce.

On 15 May 2005, the board of Molong (Asia) Holding Limited has decided to increase the authorized capital to HKD 8 million, of which, the Company subscribed for 7,019,999 shares and Maolong Machinery subscribed for 780,000 shares. Since then, the capital in issue of the company has increased to HKD 7.8 million. Till now, the Company holds 90% of equity interests in MPM, which mainly engages in petroleum exploration and purchase and sale of chemical machinery and electrical equipment.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the operating revenue amounted to RMB80.29 million, operating profit amounted to RMB8.32 million and net profit amounted to RMB1.58 million.

VII. Directors' Report



(4) 壽光懋隆機械電氣有限公司 (Shouguang Maolong Machinery Company Limited)

壽光懋隆機械電氣有限公司 (Shouguang Maolong Machinery Company Limited) was established on 1 August 2000 with a registered capital and paid-in capital of RMB12.38 million. The address and major production and operation site of the Company is at 99 Beihuan Road Shouguang City Shandong. The business scope is the production and sales of petroleum equipment and accessories, high pressure isolation switches and high pressure electrical appliances, and processing and sales of alloy accessories.

Maolong Machinery became the wholly-owned subsidiary of the Company on 27 December 2007.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the total assets amounted to RMB61.75 million and the net assets amounted to RMB60.34 million, realizing operating revenue of RMB1.23 million, operating profit of RMB41.33 million and net profit of RMB41.33 million.

(5) 壽光墨龍機電設備有限公司 (Shouguang Molong Electro-mechanical Equipment Company Limited)

壽光墨龍機電設備有限公司 (Shouguang Molong Electro-mechanical Equipment Company Limited) was established on 6 November 2001 with a registered capital and paid-in capital of USD1 million. The address and major production and operation site of the Company is at 99 Beihuan Road Shouguang City Shandong. The business scope is the production and sales of externally thickened oil well pipes and electrical equipment, etc. Currently, Maolong Machinery and MPM holds 75 % and 25% equity interests in Molong Electro-mechanical respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the total assets amounted to RMB70.32 million and the net assets amounted to RMB26.34 million, realizing operating revenue of RMB133.61 million, operating profit of RMB14.68 million and net profit of RMB10.99 million.

(6) 威海市寶隆石油專材有限公司 (Weihai Baolong Special Petroleum Materials Co., Ltd.)

威海市寶隆石油專材有限公司 (Weihai Baolong Special Petroleum Materials Co., Ltd.) was established on 26 November 2003 with a registered capital and paid-in capital of RMB10 million. The address and major production and operation site of the Company is at south of Wanjia Village, Gaocun Town of Wendeng City. The business scope is the manufacturing and sales of petroleum specialized metal materials. As at 31 December 2010, Maolong Machinery and Molong Electro-mechanical hold 95% and 5% of its equity interests respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the total assets amounted to RMB278.39 million and the net assets amounted to RMB136.47 million, realizing operating revenue of RMB436.74 million, operating profit of RMB7.67 million and net profit of RMB14.67 million.



VII. Directors' Report

(7) 壽光市懋隆廢舊金屬回收有限公司 (Shouguang Maolong Old Metals Recycle Company Limited)

壽光市懋隆廢金屬回收有限公司 (Shouguang Maolong Old Metals Recycle Company Limited) was established on 13 December 2002 with a registered capital and paid-in capital of RMB0.5 million. The address and major production and operation site of the Company is at eastern Xingze Road Shouguang City (southwestern corner of Shangjia Village, Gucheng Street). The business scope is the acquisition of scrap metals. Currently, the Company and Maolong Machinery hold 10% and 90% of equity interests in Maolong Recycle respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant: As at 31 December 2010, the total assets amounted to RMB29.36 million and the net assets amounted to RMB1.54 million, realizing operating revenue of RMB91.82 million, operating profit of RMB8.23 million and net profit of RMB0.53 million.

(8) 文登市寶隆再生資源有限公司 (Wendeng Baolong Recyclable Resource Company Limited)

文登市寶隆再生資源有限公司 (Wendeng Baolong Recyclable Resource Company Limited) was established on 2 August 2004 with 50% of its equity interests held by natural persons Chen Juxiang (陳居響) and Lin Shiwu (林詩武) respectively. On 4 August 2005, Maolong Machinery and Weihai Baolong hold 95% and 5% of its equity interests respectively. Currently, the registered capital and paid-in capital of Wendeng Baolong is RMB0.3 million. The address and major production and operation site of the Company is at Gao Zhen Village of Wendeng City. The business scope is the purchase and sale of scrap metals.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2010, the total assets amounted to RMB2.90 million and the net assets amounted to RMB2.50 million, realizing operating revenue of RMB87.87 million, operating loss of RMB10.57 million and net profit of RMB1.13 million.

8. Explanation on single subsidiaries with net profit (or investment gains) accounting for over 5% of the net profit of the Company

Maolong Machinery realized a net profit of RMB41.33 million in 2010, representing 14.92% of the Company's net profit of RMB276.98 million. Net profit of Maolong Machinery was mainly generated from investment gain on subsidiaries.



II. Prospect of the Future Developments of the Company

1. The development trend of the industry to which the Company belongs and the strategic plans for the Company's future development

According to the data disclosed in "World Energy Outlook" released by the U.S. International Energy Agency which expects a steady economic growth worldwide, the demand for crude oil will still keep a growth trend, and it will reach daily 110 million barrels in the year 2025 with global oil consumption yearly growth of 1.4% per year to the year 2025 while the yearly growth of the oil production is 1.25%, being a little lower than the oil consumption yearly growth. Therefore from the medium to long run analysis, the scale of oil exploration and drilling special equipment industry will continue to expand, with a promising market. According to the forecast of "World Energy Outlook" released by the U.S. International Energy Agency, in the year 2025, China's oil consumption will remain 3.5% growth, higher than the global growth rate.

Meanwhile, the U.S. International Energy Agency states that to avoid the oil crisis and to deal with the increase in demand and the decline in the output of oil, there is a need to invest heavily in the crude oil production industry, to update the basic infrastructure and to improve the oil extraction ability of existing facilities over the next 20 years.

The Group considers that with the global economy beginning to recover, and the oil industry as the pillar industries of the PRC, the government of the PRC also expressly encouraging the investment in petroleum industry in its "Twelfth Five-Year Plan", the petroleum industry will keep solid growth under these policies and the petroleum machinery industry in which the Company operates will definitely benefit from these policies. The Group will continue to input more resources into new projects and research and development of the technology of high end products and the production technology so as to guarantee product quality, reserve high-quality technology and enhance accessory production capacity. Subject to ensuring the continuing growth in the domestic market, the Group will continue to consolidate the overseas markets.

2. In line with its strategic plans, the work of the Company will focus on the following areas in 2011:

- 1 In respect of product research and development, the Group plans to further enhance its efforts on the research and development of high value-added products non-API products of self propriety series. The Group will continue to place its focus on the development of new products such as high end aluminum casings (strong and highly bearable), strong anti-pressure+anti-H₂S corrosion casing, L80-9Cr anti-CO₂ corrosion casing, ultra 13Cr and anti-H₂S+CO₂ corrosion casing, ML110-9Cr anti-CO₂ corrosion casing, API acid conduit pipes, grouping tubular premium connections into series, thermal well casing, floating single-cylindrical pipes, petroleum cracking pipes, thin layer high pressure boiler pipes to satisfy customized needs for the Group's products of various kinds of domestic and foreign customers, expanding the proportion of high-end products and thereby strengthening the profitability and competitiveness of the Group's products.
- 2 In respect of new product exploration, the Group will, being knowledgeable of the rich petroleum exploration machinery and technology as well as the demand for natural gas products, actively research on natural gas products of higher level in accordance with the special requirements and development trend of natural gas and coalbed methane by the market. For coalbed methane exploration equipment, the Group has already formulated its foundation and will research on appropriate low-cost product with better customization on users, thus enhancing our competitive edges in the industry.



VII. Directors' Report

- 3、 In respect of production capacity, the "180 mm Special Project" has commenced production at the end of December 2010. With 60% newly added production capacity released in 2011, the Company's production capacity to be will be raised sharply, which is constructive to the enhancement of the profitability and market competitiveness of the Company.
- 4、 In respect of domestic market, apart from consolidating the existing domestic customer relationship, the Group will further explore new customers with potential. Leveraging on the strength brought by the enhancement of production volume and the fruitful result of high-end products, more efforts will be put on oil casing in domestic market to expand market shares. Emphasis will be placed to promote the subsequent co-operation with Yanzhang oil fields and oil fields under CNOOC Group to strive for larger share.
- 5、 In respect of foreign market, the Group will thoroughly consider the trading policy of various oil producing nations and the development and demand of overseas regional market, increasing the development in markets such as South America, Middle East and Africa to diversify market concentration. Meanwhile, long-term co-operation with foreign inventory operators with market resources, service advantages and good reputations will also be reinforced. With the successful exploration of new markets such as Middle East, South America, Africa and Australia, the Company is confident to continue to expand the market coverage of the Group via enhancement in marketing activities and active introduction of new products.

3. The risk factors in the course of realization of the future development strategies and operating targets of the Company

- 1、 When there is any extraordinary fluctuation in global petroleum drilling industry, it will directly lead to the fluctuation of product demand, and we will be adjusting product structure and market deployment in accordance with changes in market on a timely basis.
- 2、 When there is any extraordinary fluctuation in raw material price, it will directly affect the production cost of the product and result in direct impact on the price of products.
- 3、 When the exchange rate of Renminbi appreciates, it will lower the competitiveness of products in the international market, and we will adopt measures on expanding the coverage of market to avoid the risks resulted from any change in exchange rate of Renminbi.

4. Future capital requirement, sources of funds and their planned use

The Company conducted public offering of shares in Shenzhen Stock Exchange for the first time to raise funds, which sufficiently guaranteed the funding for the construction of investment projects. With the production of the project commenced, the production and sale scale of the Company would expand and the related liquidity needs will be satisfied by our own funding and bank loans.



III. Investments During the Reporting Period

1. Use of proceeds during the reporting period

Unit: RMB'000

| Project undertaken | Proposed investment | Project change | Actual investment | Benefits realized | Progressing as scheduled | Progressing as scheduled with estimated benefits | Use of total proceeds during the reporting period | | |
|---|--|----------------|-------------------|---|--------------------------|--|---|-----------------------------------|--|
| | | | | | | | Use of total proceeds during the reporting period | Accumulated use of total proceeds | |
| | | | | | | | 720,000 | 720,000 | |
| Total proceeds | 1,196,738.3 | | | | | | | | |
| Φ 180mm special petroleum pipes technical reconstruction Project | 72,000 | NO | 72,000 | Have commenced operation and production | YES | YES | | | |
| Total | 72,000 | — | 72,000 | — | — | — | | | |
| Explanation on failure to progress as scheduled and realize benefits (by project) | | | Nil | | | | | | |
| Reasons for modification and modification procedures (by project) | | | Nil | | | | | | |
| Use of unutilized proceeds and their status | The entire unused portion of the proceeds to be utilized according to legal procedures was deposited at special deposit bank accounts. | | | | | | | | |

2. Establishment of controlling subsidiaries during the reporting period

There is no controlling subsidiaries was established during the reporting period.

3. Other investments during the reporting period

As at 31 December 2010, the accumulated investment amount for the Company's high-end petroleum equipment amounted RMB60.5279 million. It is intended to invest a total of RMB179.97 million on that project, which is conducted in accordance with the local government's policy of "relocation to industrial zone" (退城進園). It is removed to different place on the foundation of production lines such as original oil pipe processing, oil well sucker, oil well machinery, and conducts technical modification via upgrading with advanced equipment partially.



VII. Directors' Report

IV. Auditors of the Company, Deloitte Touche Tohmatsu Certified Public Accountants Ltd., Issued Standard Auditors' Reports for the Year without Qualified Opinion Company

V. Day-to-day Operation of the Board

1. Board meetings and their resolutions

During the reporting period, the Board held six meetings.

- (1) On 5 February 2010, the second session of the Board held its seventeenth meeting, at which, 10 resolutions were considered and approved, including the report of the Board for 2009, the report of audit and performance for 2009, the profit distribution plan for 2009, general authority for the Board of further issuing new shares, appointment of auditors, change the term of the Board, and extend the term of validity of issuing A shares.
- (2) On 28 March 2010, the third session of the Board held its first meeting, at which, 2 resolutions were considered and approved, including change the term of the Board and confirmation of the members of special committees.
- (3) On 23 July 2010, the third session of the Board held its second meeting, at which, 4 resolutions were considered and approved, including the report of audit and performance for the interim period, and the profit distribution plan for the interim period.
- (4) On 20 October 2010, the third session of the Board held its third meeting, at which considered and approved the resolutions of amending Articles of Association effective after the issuance of A Shares and accomplishing the changes of industrial and commercial registration.
- (5) On 29 October 2010, the third session of the Board held its fourth meeting, at which, 2 resolutions were considered and approved, including using the net proceeds of the A shares issue to replace the self-raised funds in advance for proceeds-funded projects, and appointment of securities representative. The related resolution announcement was published on China Securities Journal, Securities Daily, Securities Times, Shanghai Securities News, the website of CHINF (<http://www.cninfo.com.cn>) on 30 October 2010 and the website of the Hong Kong Stock Exchange (www.hkex.com) on 29 October 2010.
- (6) On 17 December 2010, the third session of the Board held its fifth meeting, at which, 5 resolutions were considered and approved, including using the over-raised proceeds of issuing A shares, appointment of general manager, and amendment of policies of the Company. The related resolution announcement was published on China Securities Journal, Securities Daily, Securities Times, Shanghai Securities News, the website of CHINF (<http://www.cninfo.com.cn>) on 18 December 2010 and the website of the Hong Kong Stock Exchange (www.hkex.com) on 17 December 2010.



2. Implementation of resolutions of general meetings by the Board

The Board discharged its duties diligently as authorized by general meetings and the Articles of Association. It completed the principal tasks under the authorization of general meetings as follows:

- (1) Implementation of the profit appropriation plan for 2009
The 2009 annual general meeting resolved the 2009 profit appropriation plan of the Company: based on the date of 28 March 2010, the total number of shares of 328,924,200 (of RMB1.00 each), dividend of RMB0.12 (before tax) per share was to be paid. The deserved final dividend for H-shares shareholders shall be exchanged to HKD for paid, and the exchange rate is RMB87.957 for 100 Hong Kong dollars, being the averages of foreign currency benchmark price published by Peoples Banks of China during the seven days before the date of dividend payout (from 21 March 2010 to 27 March 2010). The relevant announcement was published by the Company on the website of the Hong Kong Stock Exchange (www.hkex.com) on 9 July 2009, the final dividend will be paid to the shareholders of the Company before 14 May 2010.
- (2) The 2009 annual general meeting resolved to extend the authorised term of validity of A shares issue, and the Company issued A shares with the number of at most 70,000,000. With the thorough arrangement of the Board, the staff of the relevant department communicated and consulted with the underwriter for many times and made application materials together and submitted document of approval from competent department. The A Shares of the Company was listed and commenced trading on the Shenzhen Stock Exchange on 21 October 2010.
- (3) The 2009 annual general meeting of the Company approved the resolution regarding the Company appointed DTT CPA and Deloitte Touche Tohmatsu as the Company's domestic and overseas auditor for 2010 respectively. The Stock Exchange of Hong Kong Limited, the Ministry of Finance of the PRC and the China Securities Regulatory Commission came to an agreement that mainland audit firms approved by the Ministry of Finance of the PRC and the China Securities Regulatory Commission can apply the accounting policies in the Mainland when providing services to the Mainland incorporated issuers which are listed in Hong Kong for the financial year ending on or after 15 December 2010. So the Board of Directors of the Company proposes to, subject to the approval by the shareholders of the Company at the annual general meeting for the year ended 31 December 2010 ("AGM") to be convened, not to re-appoint its overseas auditor, Deloitte Touche Tohmatsu, whilst DTT CPA will be the only auditor auditing the Company's financial statements for 2010 in accordance with the China Accounting Standard for Business Enterprises.

3. Discharge of duties by the audit committee of the Board

The Audit Committee was established on 20 March 2004 and its current members are Mr. Chau Shing Yim David, Mr. John Paul Cameron and Ms. Wang Chun Hua, with Mr. Chau Shing Yim David as the Chairman of the Committee. The audit committee of the Board discharged of its duties with diligence in accordance with the related requirements of the China Securities Regulatory Commission and the SZSE and the work instructions of the audit committee of the Board as follows:

- (1) The following major tasks were completed by the Audit Committee during 2010:
 - ① It conducted pre-audit communication with external auditor engaged by the Company in respect of the 2009 financial report auditing on pre-auditing work, reviewed the 2009 auditing report and financial report and submitted such reports to the Board of the Company;
 - ② It reviewed the 2010 interim financial statements for the six months ended 30 June 2010, which was passed to the Board for approval.



VII. Directors' Report

- (2) Auditing work conducted on the 2010 financial report of the Company by the Audit Committee was as follows:
- ① It reviewed the 2010 auditing plan and the related information of the Company with the auditing certified public accountants and the finance department of the Company prior to the on site audit and negotiated and determined the schedule of an audit of the 2010 financial statements of the Company with Deloitte Touche Tohmatsu Certified Public Accountants Ltd.;
 - ② It reviewed the draft of financial statements of the Company prior to an annual on site audit performed by the auditing certified public accountants and issued its approval to audit;
 - ③ It kept in close contact with the auditors upon the annual on site audit and issued a letter to the auditors to urge the submission of the auditors' report on schedule;
 - ④ It reviewed the financial statements of the Company again upon the issue of draft opinion on the annual audit by the auditing certified public accountants, and considered the financial statements of the Company to be true, accurate and complete to reflect the overall position of the Company;
 - ⑤ At the first meeting of the audit committee in 2011, the auditors' report on the annual audit issued by the certified public accountants was approved and then was passed to the Board;
 - ⑥ It reviewed the report on internal audit and internal control of the Company for the year ended 31 December 2010.

| Members of the Audit Committee | Duties | Number of meetings attended |
|---------------------------------------|---|------------------------------------|
| Chau Shing Yim David | Committee Chairman and Independent non-executive Director | 2/2 |
| Wang Chun Hua | Independent non-executive Director | 2/2 |
| John Paul Cameron | Independent non-executive Director | 2/2 |



4. Discharge of duties by the nomination committee of the Board

The Nomination Committee was established on 18 January 2005 and its current members are Ms. Wang Chun Hua, Mr. Zhang Yun San, Mr. Chau Shing Yim, David and Mr. John Paul Cameron, with Ms. Wang Chun Hua as the Chairperson of the Nomination Committee. In the reporting period, the nomination committee held two meetings in total, at which, the principal matters considered included nomination of Zhang En Rong, Lin Fu Long, Zhang Yun San, Xie Xin Cang, and Chau Shing Yim, David as candidates for the third session of the Board of the Company, which then were passed to the seventeenth meeting of the second session of the Board for consideration and approval; discussion about reappointment of Zhang Yun San as the general manager of the Company, which then were passed to the fifth meeting of the third session of the Board for consideration and approval.

| Members of the Nomination committee | Duties | Number of meetings attended |
|-------------------------------------|---|-----------------------------|
| Wang Chun Hua | Committee Chairman and Independent non-executive Director | 2/2 |
| John Paul Cameron | Independent non-executive Director | 2/2 |
| Zhang Yun San | Deputy Chairman and executive Director | 2/2 |
| Chau Shing Yim David | Independent non-executive Director | 2/2 |

5. Discharge of duties by the remuneration committee of the Board

The remuneration and assessment committee of the Company was established on 18 January 2005 and its current members are Mr. John Paul Cameron, Mr. Zhang Yan San, Mr. Chau Shing Yim, David and Ms. Wang Chun Hua. Mr. John Paul Cameron is the Chairman of the Remuneration and Evaluation Committee. It was primarily responsible for formulating the remuneration and assessment for the Directors and the Senior Management of the Company and formulating and examining the remuneration package of the Directors and the Senior Management of the Company, and accountable to the Board. In the reporting period, the remuneration and assessment committee formulated the 2009 remuneration package of the Directors and the Senior Management of the Company, which then was passed to the Board for approval, based on the production and operation conditions of 2009 and assessment of the Directors and the Senior Management of the Company; and formulated the 2010 remuneration package of the Directors and the Senior Management of the Company, which then was passed to the Board for approval, based on the production and operation conditions of 2010 and assessment of the Directors and the Senior Management of the Company.

| Members of the remuneration and assessment committee | Duties | Number of meetings attended |
|--|---|-----------------------------|
| John Paul Cameron | Committee Chairman and Independent non-executive Director | 1/1 |
| Wang Chun Hua | Independent non-executive Director | 1/1 |
| Zhang Yun San | Deputy Chairman and executive Director | 1/1 |
| Chau Shing Yim David | Independent non-executive Director | 1/1 |



VII. Directors' Report

6. Establishment of a management policy on external information users and a registration policy on personnel with insider information

In order to regulate the management on communication of information to units outside the Company, the Company formulated the "management policy on external information use and submission" based on the relevant rules. Meanwhile, the Company formulated the "registration policy on personnel with insider information" (《内幕息知情人登記制度》), in order to further enhance the management on information disclosure matters, clearly define insider information and scope of personnel with insider information of the Company, as well as establish reporting procedures, information security measures, confidential responsibility and recourse on personnel in breach of their duties.

VI. The Proposed Profit Distribution Plan of 2010

Based on the total share capital of 398,924,200 shares as at the end of 2010, a cash bonus of RMB1.50 (before tax) per 10 shares was to be paid to all shareholders and the total cash bonus in this distribution was RMB59,838,630.00 (before tax), which accounted for 21.67% of the net profit attributable to shareholders of the company in 2010. The undistributed profit would be rolled over for distribution in subsequent years. The above cash bonus for A shares of the Company will be paid in RMB whereas dividend for H shares will be declared in wand paid in Hong Kong dollars.

VII. The Cash Bonus of the Company in the Last Three Years

Unit: RMB

| Cash bonus year | Amount for profit for cash bonus (before tax) | Net profit attributable to equity holders of the Company for the cash bonus year | Ratio of cash bonus to net profit attributable to equity holders of the Company | Distributable profit of the year |
|-----------------|---|--|---|----------------------------------|
| 2009 | 39,470,904 | 268,315,157 | 14.71% | 575,546,933.68 |
| 2008 | 65,784,840 | 305,810,743 | 21.51% | 386,728,243.79 |
| 2007 | 49,338,630 | 200,329,546 | 24.63% | 246,367,401.79 |

The accumulated amounts for cash bonus in the last three years as a percentage of distributable profit (%) 59.89

VIII. Major Suppliers and Customers

The purchase from the largest supplier of the Group for 2010 was RMB493.65 million, which accounted for 23.42% of the total purchase of the Group for the year and the total purchase from the five largest suppliers was RMB1,149.34 million, which accounted for 54.53% of the total purchases of the Group for the year. None of the Directors, Supervisors and their respective associates, or, so far as the Directors were aware, shareholders who owned more than 5% of the Company's issued share capital had any interest in any of the five largest suppliers of the Group.

VII. Directors' Report



The sales to the largest customer of the Group for 2010 was RMB491.13 million, which accounted for 18.16% of the total sales of the Group for the year and the total sales from the five largest customers was RMB1,439.75 million, which accounted for 53.24% of the total sales of the Group for the year. None of the Directors, Supervisors and their respective associates, or, so far as the Directors were aware, shareholders who owned more than 5% of the Company's issued share capital had any interest in any of the five largest customers of the Group.

IX. Disclosures in Accordance with the Listing Rules of SEHK

1. Results

The Group's profit for the current year and the state of financial affairs of the Group and the Company at that date are set out in the consolidated financial statements on pages 69 to 75 of the annual report.

2. Financial Summary

A summary of the results and of the assets and liabilities of the Group for the past five financial years is as follows:

Results

| | 2010 RMB'000 | For the year ended 31 December | | | |
|--|------------------|--------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | | 2009 RMB'000 (Restated) | 2008 RMB'000 (Restated) | 2007 RMB'000 (Restated) | 2006 RMB'000 (Restated) |
| Total revenue from operation | 2,703,907 | 2,075,551 | 2,809,639 | 1,813,110 | 1,057,271 |
| Profit from operation | 276,717 | 270,746 | 345,501 | 212,906 | 156,411 |
| Total profit | 324,484 | 324,280 | 353,256 | 238,239 | 161,774 |
| Net profit | 276,980 | 273,822 | 319,399 | 201,029 | 142,673 |
| Minority interests | 831 | 5,507 | 13,588 | 699 | 3,270 |
| Net profit attributable to shareholders of the Company | 276,149 | 268,315 | 305,811 | 200,330 | 139,403 |
| Basic earning share (RMB) | 0.81 | 0.82 | 0.93 | 0.62 | 0.43 |

Assets and Liabilities

| | 2010 RMB'000 | For the year ended 31 December | | | |
|-------------------|------------------|--------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | | 2009 RMB'000 (Restated) | 2008 RMB'000 (Restated) | 2007 RMB'000 (Restated) | 2006 RMB'000 (Restated) |
| Total assets | 4,586,411 | 3,256,607 | 3,335,410 | 2,268,811 | 1,454,217 |
| Total liabilities | 1,843,207 | 1,942,972 | 2,225,386 | 1,429,034 | 917,452 |
| Net assets | 2,743,203 | 1,313,634 | 1,110,024 | 839,777 | 536,765 |



VII. Directors' Report

3. Changes in Share Capital

Details of changes in the share capital of the Company for 2010 are set out in notes V to the consolidated financial statements.

4. Reserves and Distributable Reserves

Details of changes in the reserves and distributable reserves of the Group for 2010 are set out in notes V to consolidated financial statements.

5. Property, Plant and Equipment, and Investment Properties

Details of changes in the property, plant and equipment and investment properties of the Group for 2010 are set out in notes V to the consolidated financial statements.

6. Capitalised Interest

For 2010, the Group had capitalised interest amounting to RMB26.58 million.

7. Directors' and Supervisors' Service Contracts or Letters of Appointment

Each of the Directors and Supervisors (including the independent non-executive Directors and the Supervisors) has entered into a service contract or letter of appointment with the Company. None of the Directors or Supervisors have entered into any service contracts with the Company which is not determinable by the Company within one year without payment compensation, other than statutory compensation.

8. Special Committee

Details of the Audit Committee and the Remuneration and Evaluation Committee held under the Board are set out in "V. DAY-TO-DAY OPERATION OF THE BOARD" in this section VII of this annual report.

9. Continuing Related Party Transactions

For continuing related party transaction with Yalong Oil Well Pump, please refer to notes VI to the consolidated financial statements. This continuing related party transaction didn't consist the "Connected Transactions" or "Continuing Connected Transactions" under Chapter 14A of Listing Rules of SEHK.



10. According to the Hong Kong Securities and Futures Ordinance, disclosure of Directors', Supervisors' and Chief Executive's Interests in Shares, Underlying Shares and Debentures

As at 31 December 2010, interests and short positions of the Directors, Supervisors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to the Model Code for Securities Transactions by Directors of Listed Company as set out in Appendix 10 of the Listing Rules, to be notified to the Group and to the Stock Exchange, were as follows:

Long positions in the A Shares of the Company

| Name | Type of interest | Number of A shares | Percentage of A shares | Percentage of total issued share capital |
|---------------|------------------|--------------------|------------------------|--|
| Zhang En Rong | Beneficial | 139,758,500 | 51.60% | 35.03% |
| Lin Fu Long | Beneficial | 17,108,000 | 6.32% | 4.29% |
| Zhang Yun San | Beneficial | 15,304,000 | 5.65% | 3.84% |
| Xie Xin Cang | Beneficial | 10,705,000 | 3.95% | 2.68% |

Save as disclosed above, to the best knowledge of the Directors, Supervisors and chief executive, none of the Directors, the Supervisors or chief executive had any interests or short position in shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), which will have to be notified to the Company and the Stock Exchange under Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under the SFO) or will be required pursuant to section 352 of the SFO to be entered in the register referred to therein, or which will be required pursuant to the Model Code for Securities Transactions by Directors of Listed Company as set out in Appendix 10 of the Listing Rules, to be notified to the Group and to the Stock Exchange.

11. Annual Salary of the Directors, Supervisors and Senior Management

As for the situation of salary of the Directors, Supervisors and Senior Management got from the Company in 2010, please refer to section IV of this annual report.

12. Directors' and Supervisors' Rights to Acquire Shares or Debentures

None of the Directors or Supervisors or their respective associates (as defined under the Rule 1.01 of the Listing Rules of the SEHK) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights in 2010.

13. Share Option Scheme

The Company does not have any share option scheme.



VII. Directors' Report

14. Substantial Shareholders and Long Positions in the H Shares

The details are set out section III of this annual report.

15. Directors' Interests in Contracts

There were no contracts of significance to which the Company or any of its subsidiaries was a party and in which any of the Directors had a material interest, whether directly or indirectly, subsisted at the end of 2010 or at any time in 2010.

16. Material Contracts

None of the Company (or any of its subsidiaries) or the controlling Shareholders of the Company (or any of its subsidiaries) has entered into any material contracts between themselves, and none of the controlling Shareholders of the Company (or any of its subsidiaries) has provided any material service contract to the Company (or any of its subsidiaries).

17. Purchase, Sale or Redemption of Securities

None of the Company or any of its subsidiaries has purchased, sold or redeemed any listed securities of the Company in 2010.

18. Pre-emptive Rights

There is no provision for pre-emptive rights under the Articles or the laws of the PRC which would oblige the Company to offer new shares on a pro rata basis to existing Shareholders.

19. Corporate Governance

The principal Code on Corporate Governance adopted by the Company is set out in section V of this annual report.

20. Sufficiency of Public Float

According to information of the Company available to the public and to the knowledge of the Directors, the Directors confirm that the Company has maintained a sufficient public float throughout the current year and up to the date of this report.

VIII. Supervisory Committee's Report



I. Performance of Duties

During the reporting period, all the Supervisors, who are accountable to the shareholders, performed their duties in accordance with Company Law, the Articles of Association, and Procedural Rules for Supervisory Committee's Meetings, and under the principle of diligence. They monitored whether the business activities were lawfully operated, and supervised the financial management and connected transactions of the Company. During the reporting period, they examined and supervised the subsidiaries in terms of accounting, raw materials purchase, sales of goods, connected transactions, and use of proceeds to provide strong protection for the lawful operation and healthy development of the Company.

II. Meetings of the Supervisory Committee

1. The second meeting of the third session of the Supervisory Committee was held on 5 February 2010. Resolutions regarding the work report of the Supervisory Committee of the Company for 2009, audited performance report of the Company for 2009, and the profit distribution plan for 2009, were considered and passed at the meeting.
2. The third meeting of the third session of the Supervisory Committee was held on 23 July 2010. Resolutions regarding the interim performance report of the Company for 2010, and the interim profit distribution plan for 2010, were considered and passed at the meeting.
3. The fourth meeting of the third session of the Supervisory Committee was held on 29 October 2010. Resolution regarding replacement of the self-raised funds put into the proceeds-funded projects in advance with the net proceeds of the A shares Issue were considered and passed at the meeting.
4. The fifth meeting of the third session of the supervisory committee was held on 17 December 2010. Resolution regarding use of surplus net proceeds of the a share issue were considered and passed at the meeting.

III. Independent Opinion of the Supervisory Committee

1. Operation according to the law

- (1) During the reporting period, the Company conducted its businesses according to Company Law, Securities Law, Articles of Association of the Company and the related national laws and regulations under the direction of "lawfulness, supervision, self discipline and regulation" applied in a consistent manner. Information disclosures were conducted under the principles of truthfulness, completeness, accuracy, and timeliness. No false or misleading information was released.
- (2) The Board undertook all of the rights and responsibilities set out by Company Law, Securities Law, and Articles of Association of the Company, and fully implemented the resolutions passed by the general meetings and Board meetings. The decision making processes were lawful with timely consideration and approval of the production targets, sustainable development measures, operation according to the law and standardization operation. A more comprehensive internal control system was established to ensure healthy and continued development of the Company. The management of the Company was able to perform their duties as stipulated in the Articles of Association of the Company and executed the resolutions of the Board. No contravention of laws or regulations or the Articles of Association nor acts detrimental to the interests of the Company were identified.



VIII. Supervisory Committee's Report

2. Financial position inspection

The financial statements of the Company were audited by Deloitte Touche Tohmatsu Certified Public Accountants Ltd. who issued standard auditors' reports with unqualified opinion on them upon auditing. In the opinion of the Supervisory Committee, the auditors' report gave a true and fair view of the financial conditions and operating results of the Company.

3. Use of proceeds

The actual use of the proceeds from the latest fund raising activity was consistent with their intended use without any changes.

4. Material purchase or sales of assets

There was no material purchase or sales of assets in the Company during the reporting period.

5. Connected transactions

The Company had no connected transactions during the reporting period.

IX. Material Matters



- I. The Company had no Material Litigation or Arbitration During the Reporting Period
- II. There Was no Significant Purchase or Sales of Assets and Merger and Acquisition by the Company During the Reporting Period
- III. There Was no Major Connected Transactions During the Reporting Period
- IV. Significant Contracts and their Performance

1. The Company had no external guarantees during the reporting period.
2. The Company had no entrusted loans during the reporting period.

V. Commitments by Holders of Non-Tradable Shares Before the Company's Issuance of A Shares

Zhang En Rong and Zhang Yun San, the controlling shareholders of the Company, committed that shares held by them shall not be transferred or entrusted to others to manage, and not be purchased by the Company within 36 months from the date of listing of the A Shares.

Lin Fu Long, Xie Xin Cang, Liu Yun Long, Cui Huan You, Liang Yong Qiang, and Kaiyuan Oil, the shareholders of the Company, committed that shares held by them shall not be transferred or entrusted to others to manage, and not be purchased by the Company within 12 months from the date of listing of the A Shares.

Meantime, as the directors, supervisors and senior management of the Company, Zhang En Rong, Lin Fu Long, Zhang Yun San, Xie Xin Cang, Cui Huan You and Liu Yun Long committed that, after the expiration of the abovementioned periods, the number of shares transferred by them each year during their terms of office shall not exceed 25% of the total shares of the Company, and they shall not transfer the shares held by them within half a year after leaving.

During the reporting period, the above people (or legal person) strictly performed their commitments.



IX. Material Matters

VI. The Auditors Engaged by the Company During the Reporting Period

At the 2009 annual general meeting of the Company, the resolutions in relation to engagement of domestic and overseas auditors for 2010 were approved to engage Deloitte Touche Tohmatsu Certified Public Accountants Ltd. and Deloitte Touche Tohmatsu as the domestic and overseas auditors of the Company for 2010 respectively. According to the "Consultation Conclusions on Acceptance of Mainland Accounting and Auditing Standards and Mainland Audit Firms for Mainland Incorporated Companies Listed in Hong Kong" which was published by The Stock Exchange of Hong Kong Limited in December 2010, Mainland audit firms approved by the Ministry of Finance of the People's Republic of China and the China Securities Regulatory Commission can apply the accounting policies in the Mainland when providing services to the Mainland incorporated issuers which are listed in Hong Kong for the financial year ending on or after 15 December 2010. The Board proposes to, subject to the approval by the shareholders of the Company at the annual general meeting for the year ended 31 December 2010 to be convened, not to re-appoint its overseas auditor, Deloitte Touche Tohmatsu, whilst Deloitte Touche Tohmatsu Certified Public Accountants Ltd will be the only auditor auditing the Company's financial statements for 2010 in accordance with the China Accounting Standard for Business Enterprises and undertaking the role of overseas auditor in compliance with the Rules Governing the Listing of Securities on the Stock Exchange. The auditor's fees for 2010 aggregated to RMB800,000 (traveling expenses, meals, accommodation and related fees were paid by the company).

VII. During the Reporting Period, the Board and the Directors of the Company Were not Fined by China Securities Regulatory Commission nor Condemned by any Stock Exchange

VIII. Launch of Various Channels to Communicate and Strengthen Investor's Relation Management

The Board of the Company realized that it's important to establish good relationship with investors. During the reporting period, the Board not only promptly disclosed sufficient information in strict compliance with the relevant regulations, but also launched various channels to actively manage investor's relations, and strengthen the direct communications with investors, news media and the public. The Company fully utilized investor's special telephone lines (0536-5100890), strengthened the telephone communication with shareholders, and answered queries from each shareholder patiently. By way of exchanges through the network, special email mailboxes (dsh@molonggroup.com and zhf@molonggroup.com) where dedicated personnel were arranged to be responsible for answering various questions from investors were set up, thereby fully introducing and displaying the outstanding image of the Company, as well as our advantages over other players, our continuous improving results and unlimited development prospects which lead investors to further understand the investment value of the Company in depth.

The Company has appointed a company engaged in financial public relations and adopted its advice periodically. We also listen to professional opinions from overseas investors recommended by this company to ensure good communication with investors.

At the same time, the Company cordially invites Shareholders to express their opinions by filling out the feedback form enclosed with this annual report. Visits to our facilities in the PRC will also be arranged for Shareholders. Opinions from the Shareholders will be forwarded to senior management and the Directors of the Company.

IX. Material Matters



The Board of the Company realized that not every shareholder and relevant person can browse the data from the Internet at any time. If needed, they can write to the office of the Board of Shandong Molong at No. 99 Beihuan Road, Shouguang City, Shandong Province (Postal code: 262700) or send e-mail to dsh@molonggroup.com for the text of information and documents listed in the website.

In 2010, the Company' general headquarters handled more than 20 visits from individual and institutional investors surveys and studies.

Details of reception

| Time of reception | Place of reception | Manner of reception | Parties accommodated | Main topics of discussion and information provided |
|-------------------|---------------------|------------------------------------|---|--|
| October 2010 | Shouguang, Shandong | On-site research and investigation | Vice President from Moon Capital Management, LP | |
| November 2010 | Shouguang, Shandong | On-site research and investigation | Research personnel and fund managers from institutions such as SWS Research Co., Ltd, Merito Capital Management, New China Fund Management Co., Ltd, Quam Asset Management Limited, OCH-ZIFF Capital Management Limited, Shanghai Nengjin Investment Co., Ltd, etc. | Matters including recent development of the industry and development trend in the future, production and operation of the Company, as well as the condition of A Shares proceeds-funded projects |
| December 2010 | Shouguang, Shandong | On-site research and investigation | Research personnel and fund managers from institutions such as Rising Securities Co., Ltd, Huaxi Securities Co., Ltd, GF Securities Co., Ltd, BOC International (China) Limited, Yinhua Fund Management Co., Ltd, Fortis Haitong Investment Management Co., Ltd, Bank of Communications Schroders, Everbright Pramerica Fund, Harvest Fund, SYWG BNP Paribas Asset Management, Hua An Fund, China Asset Management Co., Ltd, TX Investment Consulting Co., Ltd, Yuan Ce Investment Management Co., Ltd, Shanghai Mega Trust Investment Management, etc. | |



IX. Material Matters

IX. Other Material Matters

The independent non-executive Directors of the Company expressed the following opinions on the use of funds by related parties and external guarantee provided during the reporting period:

Under the requirements of the Listing Rules of SZSE in relation to connected transactions, the Company had no material connected transactions during the reporting period; according to the requirements of the Accounting Standards for Business Enterprises, except for the ordinary connected transactions between the Company and its controlling subsidiaries and interested companies of the Company (for details, please refer to PRC Auditors' Report and Financial Statements and Note (IX) thereto prepared in accordance with Accounting Standards for Business Enterprises), there were no use of funds by controlling shareholders and other related parties; while the connected transaction took place were true and accurate reflection of the ordinary connected transactions of the Company that were fair and reasonable and in compliance with the relevant requirements of the Company Law and the Articles of Association, the transaction price was objective and just and without prejudice to the interests of the Company and its shareholders (especially minority shareholders and non-related shareholders).

Upon validation, the Company had provided RMB0 of external guarantee for the period of and accrued up to 2010. The Company strictly followed the relevant requirements of the Notice on Regulation of External Guarantee Provided by Listed Companies (Zheng Jian Fa [2005] No. 120) 《關於規範上市公司對外擔保行為的通知》(證監發) [2005]120號 and the Articles of Association to earnestly perform its information disclosure obligations in respect of external guarantees and honestly provided information concerning all external guarantee matters to the public accountant without prejudice to the interests of the Company and the shareholders of the Company (especially minority shareholders).

IX. Material Matters



X. Index of Information Disclosure in 2010

| Date of announcement | Subject matter | Media for publication |
|-----------------------------|--|---|
| January 4, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| January 25, 2010 | The Date of the Board | http://www.hkex.com.hk |
| February 4, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| February 5, 2010 | Annual Results of the year 2009 | http://www.hkex.com.hk |
| February 9, 2010 | Annual Report of the year 2009 | http://www.hkex.com.hk |
| | Circular of the AGM and Separate Class Meetings | |
| | Notice of the AGM | |
| | Notice of Domestic Shares Class Meeting | |
| | Notice of H shares Class Meeting | |
| | Reply Slip of AGM | |
| | Reply Slip of Domestic Shares Class Meeting | |
| | Reply Slip of AGM | |
| | Proxy Form of AGM | |
| | Proxy Form of Domestic Shares Class Meeting | |
| | Proxy Form of H shares Class Meeting | |
| February 11, 2010 | Announcement | http://www.hkex.com.hk |
| March 2, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| March 28, 2010 | Poll Results of the AGM and Separate Class Meetings | http://www.hkex.com.hk |
| April 1, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| May 4, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| June 1, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| July 2, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| July 13, 2010 | The Date of Board | http://www.hkex.com.hk |



IX. Material Matters

| Date of announcement | Subject matter | Media for publication |
|-----------------------------|---|---|
| July 23, 2010 | Interim Results 2010 | http://www.hkex.com.hk |
| July 26, 2010 | Interim Report 2010 | http://www.hkex.com.hk |
| August 2, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| September 1, 2010 | Monthly Return of Equity Issuer on Movements in Securities | http://www.hkex.com.hk |
| September 21, 2010 | CSRC Approval of IPO Annual financial Statement and Audit Report of 2009, 2008, and 2007 during the period from 1 January,2010 to 30 June, 2010 Commencement of Price Consultation for A Share Issue and marketing announcement the Articles of Association Legal Opinion and Supplementary Legal Opinion regarding Issuing A Shares and Listing Special Statement on Detailed Statement of Extraordinary Items and Audit Report of Internal Control in 2009, 2008, and the period from January 1, 2010 to June 30, 2010 China Merchants Securities Sponsor Work Report regarding Issuing A Shares and Listing China Merchants Securities Sponsor Recommendation Letter of Issuance Regarding Issuing A Shares and Listing Resolution Regarding General Meeting of Shareholders on Issuing A Shares Resolution Regarding the Meeting of the Board on Issuing A Shares A Summary of the A Shares Prospectus A Shares IPO Prospectus | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |
| September 30, 2010 | Announcement of Online Roadshow on A Shares IPO | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |

IX. Material Matters



| Date of announcement | Subject matter | Media for publication |
|----------------------|--|---|
| October 8, 2010 | A Shares IPO Prospectus A Summary of the A Shares Prospectus Special Announcement of Investment Risk on A Shares IPO Completion of A Shares Issue | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |
| October 13, 2010 | Announcement Regarding Online Pricing Issue Subscribe and Success Rate on A Shares IPO Off-line Allotment Announcement regarding A Shares IPO | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |
| October 14, 2010 | Announcement Regarding Online Pricing Ballot Outcome Result of IPO A Shares | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |
| October 20, 2010 | Listed Company Statement Regarding IPO A Shares China Merchants Securities Sponsor Recommendation Letter of Issuance Regarding Issuing A Shares and Listing Legal Opinion Regarding IPO A Shares Applying for Listing On Shenzhen Stock Exchange | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |
| October 29, 2010 | Announcement Regarding Signing Proceeds of A Shares Tripartite Regulation Agreement | http://www.cninfo.com.cn |



IX. Material Matters

| Date of announcement | Subject matter | Media for publication |
|-----------------------------|---|--|
| October, 30, 2010 | <p>Announcement In Respect of the Resolutions Passed at the Fourth Meeting of the Third Session of the Board</p> <p>Announcement Regarding Appointment of the Securities Affairs Representative of the Company</p> <p>Special Opinions of Independent Directors Regarding Using the Net Proceeds of the A Shares Issue to Replace the Self-raised Funds In Advance for Proceeds-funded Projects</p> <p>Announcement In Respect of The Resolutions Passed at the Fourth Meeting of the Third Session of the Supervisory Committee</p> <p>Announcement Regarding Using the Net Proceeds of the A Shares Issue to Replace the Self-raised Funds In Advance for Proceeds-funded Projects</p> <p>Sponsor Opinion of China Merchants Securities Regarding Using the Net Proceeds of the A shares Issue to Replace the Self-raised Funds In Advance for Proceeds-funded Projects</p> <p>Report Regarding Using the Net Proceeds of the A Shares Issue to Replace the Self-raised Funds in Advance for Proceeds-funded Projects by September 30, 2010</p> | <p>http://www.hkex.com.hk</p> |
| December 9, 2010 | <p>Announcement Regarding Accomplishing the Change of Industrial Registration</p> <p>the Articles of Association</p> | <p>http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News</p> |
| December 18, 2010 | <p>Announcement Regarding the Proceeds of the A Shares Issue Use Plan</p> <p>Announcement in Respect of the Resolutions Passed at the Fifth Meeting of the Third Session of the Board</p> <p>Announcement In Respect of the Resolutions Passed at the fifth Meeting of the Third Session of the Supervisory Committee</p> <p>China Merchants Securities Special Verification Report Regarding Using the Surplus Net Proceeds of the A Share Issue to Finance the Petroleum Pipes Processing Project</p> <p>Independent Views of the Independent Directors Regarding Relevance Matters at the Fifth Meeting of the Third Session of the Board</p> <p>Feasibility Study Report Regarding the Petroleum Pipes Processing Project of Weihai Baolong Company Limited</p> | <p>http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News</p> |

IX. Material Matters



| Date of announcement | Subject matter | Media for publication |
|----------------------|---|---|
| December 23, 2010 | Announcement Regarding the Replacement of the Sponsor Representatives | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |
| December 30, 2010 | The Proceeds-funded Project Production Announcement | http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News |



Deloitte.

德勤

De Shi Bao ShenZi (11) No. P0407

TO THE SHAREHOLDERS OF
SHANDONG MOLONG PETROLEUM MACHINERY COMPANY LIMITED
(established in the People's Republic of China with limited liability)

We have audited the accompanying financial statements of Shandong Molong Petroleum Machinery Company Limited (the "Company"), which comprise the Company's and consolidated balance sheets as at 31 December 2010, the Company's and consolidated income statements, the Company's and consolidated statements of changes in shareholders' equity, and the Company's and consolidated cash flow statements for the year then ended, and the notes to the financial statements.

I. Management's Responsibility for the Financial Statements

Management of the Company is responsible for the preparation and fair presentation of these financial statements. This responsibility includes: (1) preparing the financial statements in accordance with Accounting Standards for Business Enterprises to achieve: fair presentation of the financial statements; (2) designing, implementing and maintaining internal control that is necessary to enable that the financial statements are free from material misstatement whether due to fraud or error.

II. Certified Public Accountants' Responsibility

Our responsibility is to express an audit opinion on these financial statements based on our audit. We conducted our audit in accordance with China Standards on Auditing. China Standards on Auditing require that we comply with the Code of Ethics for Chinese Certified Public Accountants and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the certified public accountants' 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 Certified Public Accountants consider the internal control relevant to the preparation 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 internal control. An audit also includes evaluating the appropriateness of the 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.



III. Audit Opinion

In our opinion, the financial statements of the Company present fairly, in all material respects, the Company's and consolidated financial position as of 31 December 2010, and the Company's and consolidated results of operations and cash flows for the year then ended in accordance with Accounting Standards for Business Enterprises.

Deloitte Touche Tohmatsu CPA Ltd.
Shanghai, China

Chinese Certified Public Accountant
29 March 2011



Consolidated Balance Sheets

As at 31 December 2010

| Item | Note | Closing balance RMB | Opening balance RMB |
|---------------------------------|-------|-------------------------|------------------------|
| Current assets: | | | |
| Cash and bank balance | (v)1 | 892,286,589.93 | 305,509,495.54 |
| Bills receivable | (v)2 | 19,120,729.91 | 34,631,397.12 |
| Accounts receivable | (v)3 | 500,867,640.05 | 455,109,180.76 |
| Prepayments | (v)4 | 158,601,512.56 | 54,615,164.00 |
| Dividends receivable | (v)5 | 150,000.00 | — |
| Other receivable | (v)6 | 30,281,650.63 | 24,369,143.50 |
| Intentory | (v)7 | 743,553,547.47 | 713,655,725.39 |
| Other current assets | (v)8 | 41,054,637.00 | — |
| Total current assets | | 2,385,916,307.55 | 1,587,890,106.31 |
| Non-current assets: | | | |
| Long-term equity investment | (v)10 | 12,477,279.82 | 12,436,028.87 |
| Fixed assets | (v)12 | 1,648,583,610.99 | 908,171,388.20 |
| Construction in progress | (v)13 | 131,446,242.52 | 391,594,169.80 |
| Construction materials | | — | 7,540,351.49 |
| Intangible assets | (v)14 | 249,918,129.97 | 165,630,624.75 |
| Goodwill | (v)15 | 142,973,383.21 | 142,973,383.21 |
| Deferred income tax assets | (v)16 | 15,095,861.12 | 17,091,629.15 |
| Other non-current assets | (v)17 | — | 23,279,221.87 |
| Total non-current assets | | 2,200,494,507.63 | 1,668,716,797.34 |
| Total assets | | 4,586,410,815.18 | 3,256,606,903.65 |

Consolidated Balance Sheets



As at 31 December 2010

| Item | Note | Closing balance RMB | Opening balance RMB |
|---|-------|-------------------------|------------------------|
| Current liabilities: | | | |
| Short-term borrowings | (v)19 | 712,866,417.20 | 274,648,512.00 |
| Bills payable | (v)20 | 482,816,088.17 | 373,611,268.50 |
| Accounts payable | (v)21 | 501,771,570.34 | 345,188,404.83 |
| Advance receipts | (v)22 | 34,721,719.22 | 52,528,174.61 |
| Salaries payable | (v)23 | 17,839,689.76 | 15,713,925.78 |
| Taxes payable | (v)24 | 29,428,377.89 | 40,385,354.67 |
| Interests payable | (v)25 | 955,547.63 | 563,315.00 |
| Dividends payable | (v)26 | 23,788,680.00 | 39,591,725.86 |
| Other payables | (v)27 | 25,991,912.66 | 17,271,010.07 |
| Non-current liabilities due within 1 year | (v)28 | — | 193,000,000.00 |
| Total current liabilities | | 1,830,180,002.87 | 1,352,501,691.32 |
| Non-current liabilities: | | | |
| Long-term loans | (v)29 | — | 580,000,000.00 |
| Deferred income tax liabilities | (v)16 | 13,027,452.38 | 10,470,001.64 |
| Total non-current liabilities | | 13,027,452.38 | 590,470,001.64 |
| Total liabilities | | 1,843,207,455.25 | 1,942,971,692.96 |
| Shareholders' equity | | | |
| Share capital | (v)30 | 398,924,200.00 | 328,924,200.00 |
| Capital reserve | (v)31 | 1,248,406,190.92 | 121,667,859.42 |
| Surplus reserve | (v)32 | 140,393,447.06 | 108,376,005.02 |
| Undistributed profit | (v)33 | 898,749,873.79 | 694,089,054.29 |
| Foreign currency translation differences | | (483,325.64) | (736,933.63) |
| Total equity attributable to owners of the Company | | 2,685,990,386.13 | 1,252,320,185.10 |
| Minority interests | (v)34 | 57,212,973.80 | 61,315,025.59 |
| Total shareholders' equity | | 2,743,203,359.93 | 1,313,635,210.69 |
| Total liabilities and shareholders' equity | | 4,586,410,815.18 | 3,256,606,903.65 |

The notes form an integral part of the financial statements

The financial statements as set out from pages 70 to 199 have been signed by :

Legal Representative

Chief Financial Officer

Head of the Finance Section



Balance Sheets of the Company

As at 31 December 2010

| Item | Note | Closing balance RMB | Open balance RMB |
|---------------------------------|-------|-------------------------|---------------------|
| Current assets: | | | |
| Cash and bank balances | (v)1 | 837,167,588.76 | 285,155,767.17 |
| Bills receivable | (v)2 | 11,570,729.91 | 20,261,397.12 |
| Accounts receivable | (v)3 | 495,100,949.64 | 431,711,645.01 |
| Prepayments | (v)4 | 101,572,609.15 | 37,251,027.63 |
| Other receivable | (v)6 | 18,186,384.98 | 11,915,673.11 |
| Intentory | (v)7 | 612,796,033.63 | 589,599,432.97 |
| Other current assets | (v)8 | 27,836,147.66 | — |
| Total current assets | | 2,104,230,443.73 | 1,375,894,943.01 |
| Non-current assets: | | | |
| Long-term equity investment | (v)10 | 435,467,004.23 | 435,467,004.23 |
| Investment properties | (v)11 | 6,189,666.32 | 6,554,606.72 |
| Fixed assets | (v)12 | 1,305,073,564.42 | 544,739,933.68 |
| Construction in progress | (v)13 | 44,383,482.30 | 380,434,033.90 |
| Construction materials | | — | 7,540,351.49 |
| Intangible assets | (v)14 | 170,497,485.42 | 93,089,660.29 |
| Deferred income tax assets | (v)16 | 7,174,248.69 | 3,873,028.96 |
| Other non-current assets | (v)17 | — | 18,279,221.87 |
| Total non-current assets | | 1,968,785,451.38 | 1,489,977,841.14 |
| Total assets | | 4,073,015,895.11 | 2,865,872,784.15 |

Balance Sheets of the Company



As at 31 December 2010

| Item | Note | Closing balance RMB | Open balance RMB |
|---|-------|-------------------------|---------------------|
| Current liabilities: | | | |
| Short-term borrowings | (v)19 | 543,626,227.20 | 239,648,512.00 |
| Bills payable | (v)20 | 446,849,308.17 | 379,207,034.90 |
| Accounts payable | (v)21 | 324,586,612.39 | 342,841,259.03 |
| Advance receipts | (v)22 | 80,810,957.44 | 89,246,325.87 |
| Salaries payable | (v)23 | 11,150,221.53 | 9,199,137.76 |
| Taxes payable | (v)24 | 14,729,859.41 | 12,986,543.85 |
| Interests payable | (v)25 | 751,797.63 | — |
| Dividends payable | (v)26 | 23,788,680.00 | 39,591,725.86 |
| Other payables | (v)27 | 14,243,186.10 | 8,637,246.76 |
| Non-current liabilities due within 1 year | (v)28 | — | 50,000,000.00 |
| Total current liabilities | | 1,460,536,849.87 | 1,171,357,786.03 |
| Non-current liabilities: | | | |
| Long-term loans | (v)29 | — | 560,000,000.00 |
| Deferred income tax liabilities | (v)16 | 522,199.20 | — |
| Total non-current liabilities | | 522,199.20 | 560,000,000.00 |
| Total liabilities | | 1,461,059,049.07 | 1,731,357,786.03 |
| Total liabilities | | | |
| share capital | (v)30 | 398,924,200.00 | 328,924,200.00 |
| Capital reserve | (v)31 | 1,248,406,190.92 | 121,667,859.42 |
| Surplus reserve | (v)32 | 140,393,447.06 | 108,376,005.02 |
| Undistributed profit | (v)33 | 824,233,008.06 | 575,546,933.68 |
| Total shareholders' equity | | 2,611,956,846.04 | 1,134,514,998.12 |
| Total liabilities and shareholders' equity | | 4,073,015,895.11 | 2,865,872,784.15 |



Consolidated Income Statements

As at 31 December 2010

| Item | Note | Amount for the current year RMB | Amount for the previous year RMB |
|---|-------|---------------------------------------|--|
| I. Total revenue from operations | (v)35 | 2,703,906,835.19 | 2,075,551,285.67 |
| Total revenue from operations | | 2,703,906,835.19 | 2,075,551,285.67 |
| II. Total cost of operations | | 2,427,381,354.95 | 1,805,362,399.46 |
| Including: Operating cost | (v)35 | 2,237,506,663.67 | 1,678,634,536.19 |
| Business tax and surcharges | (v)36 | 4,812,307.46 | 3,706,491.83 |
| Selling expenses | (v)37 | 51,360,828.52 | 61,250,637.79 |
| Administrative expenses | (v)38 | 91,383,971.04 | 63,829,412.03 |
| Finance costs | (v)39 | 44,341,872.74 | 10,656,881.54 |
| Asset impairment losses | (v)40 | (2,024,288.48) | (12,715,559.92) |
| Add: Gains from changes in fair value | (v)41 | — | (5,270,000.00) |
| Investment income | (v)42 | 191,250.95 | 5,827,137.15 |
| Including: Income from investment in associates and joint ventures | (v)42 | 191,250.95 | 247,137.15 |
| III. Operating profit | | 276,716,731.19 | 270,746,023.36 |
| Add: Non-operating income | (v)43 | 50,431,757.52 | 54,154,013.57 |
| Less: Non-operating expenses | (v)44 | 2,664,687.26 | 619,598.32 |
| Including: Loss from disposal of non-current assets | (v)44 | 2,123,471.06 | 312,747.82 |
| IV. Total profit | | 324,483,801.45 | 324,280,438.61 |
| Less: Income tax expenses | (v)45 | 47,503,492.81 | 50,458,156.21 |
| V. Net profit | | 276,980,308.64 | 273,822,282.40 |
| Net profit attributable to shareholders of the Company | | 276,149,165.54 | 268,315,157.33 |
| Minority interests | | 831,143.10 | 5,507,125.07 |
| VI. Earnings per share: | | | |
| (1) Basic earnings per share | (v)46 | 0.81 | 0.82 |
| (2) Diluted earnings per share | (v)46 | N/A | N/A |
| VII. Diluted earnings per share | (v)47 | 269,875.82 | 73,998.29 |
| VIII. Total comprehensive income | | 277,250,184.46 | 273,896,280.69 |
| Total comprehensive income attributable to owners of the Company | | 276,402,773.53 | 268,388,521.29 |
| Total comprehensive income attributable to minority interests | | 847,410.93 | 5,507,759.40 |

Income Statements of the Company



As at 31 December 2010

| Item | Note | Amount for the current year RMB | Amount for the previous year RMB |
|--|-------|---------------------------------------|--|
| I. Operating revenue | (v)35 | 2,663,041,641.58 | 1,999,624,351.38 |
| Less: Operating cost | (v)35 | 2,253,227,044.55 | 1,698,338,793.43 |
| Business tax and surcharges | (v)36 | — | 33,124.30 |
| Selling expenses | (v)37 | 50,601,134.39 | 60,055,946.69 |
| Administrative expenses | (v)38 | 70,280,481.44 | 47,619,940.34 |
| Finance costs | (v)39 | 33,816,054.17 | (1,762,124.94) |
| Asset impairment losses | (v)40 | (1,541,277.09) | (9,703,209.91) |
| Add: Gains from changes in fair value | (v)41 | — | 44,380,000.00 |
| Investment income | (v)42 | 85,765,164.48 | 35,410,000.00 |
| Including: Income from investment in associates and joint ventures | (v)42 | — | — |
| II. Operating profit | | 342,423,368.60 | 284,831,881.47 |
| Add: Non-operating income | (v)43 | 14,833,143.22 | 32,184,147.07 |
| Less: Non-operating expense | (v)44 | 2,023,023.19 | 362,450.15 |
| Including: Loss from disposal of non-current assets | (v)44 | 1,717,023.19 | 145,359.56 |
| III. Total profit | | 355,233,488.63 | 316,653,578.39 |
| Less: Income tax expenses | (v)45 | 35,059,068.21 | 33,760,767.50 |
| IV. Net profit | | 320,174,420.42 | 282,892,810.89 |
| V. Earnings per share: | | | |
| (1) Basic earnings per share | | N/A | N/A |
| (2) Diluted earnings per share | | N/A | N/A |
| VI. Other comprehensive income | | — | — |
| VII. Total comprehensive income | | 320,174,420.42 | 282,892,810.89 |



Consolidated Cash Flow Statements

As at 31 December 2010

| Item | Note | Amount for the current year RMB | Amount for the previous year RMB |
|---|----------|---------------------------------------|--|
| I. Cash received from disposal of investments | | | |
| Cash received from selling goods and rendering services | | 2,209,445,846.07 | 2,319,247,440.10 |
| Tax rebate received | | 127,703,832.00 | 71,119,819.64 |
| Other cash received relating to operating activities | (v)48(1) | 40,299,662.90 | 91,102,991.66 |
| Sub-total of cash inflow from operating activities | | 2,377,449,340.97 | 2,481,470,251.40 |
| Cash paid for purchasing goods and receiving services | | 1,616,065,575.62 | 2,092,599,259.17 |
| Cash paid to and on behalf of employees | | 94,388,152.02 | 83,108,112.77 |
| Taxes and surcharges paid | | 129,736,495.73 | 105,563,185.75 |
| Other cash paid relating to operating activities | (v)48(2) | 148,245,602.11 | 105,429,772.39 |
| Sub-total of cash outflow from operating activities | | 1,988,435,825.48 | 2,386,700,330.08 |
| Net cash flows from operating activities | | 389,013,515.49 | 94,769,921.32 |
| II. Cash flows from investing activities: | | | |
| Cash received from disposal of investments | | — | 81,820,000.00 |
| Cash received from return on investments | | — | 150,000.00 |
| Net cash received from disposal of fixed assets, intangible assets and other long-term assets | | 5,094,699.70 | 10,708,300.27 |
| Sub-total of cash inflow from investing activities | | 5,094,699.70 | 92,678,300.27 |
| Cash paid for acquisition of fixed assets, intangible assets and other long-term assets | | 582,952,354.89 | 481,901,472.25 |
| Cash paid for investment | | — | 41,200,000.00 |
| Net cash paid for acquisition of subsidiaries and other business entities | | — | 23,401,120.48 |
| Sub-total of cash outflow from investing activities | | 582,952,354.89 | 546,502,592.73 |
| Net cash flows from investing activities | | (577,857,655.19) | (453,824,292.46) |
| III. Cash flows from financing activities: | | | |
| Cash received from equity investments | | 1,260,000,000.00 | — |
| Including: Cash received by subsidiaries from minority shareholders' investment | | — | — |
| Cash received from borrowings | | 1,226,069,863.92 | 1,399,648,512.00 |
| Other cash received relating to financing activities | (v)48(3) | — | 53,730,000.00 |
| Sub-total of cash inflow from financing activities | | 2,486,069,863.92 | 1,453,378,512.00 |
| Cash paid for repayment of liabilities | | 1,560,851,958.72 | 1,170,522,706.00 |
| Cash paid for dividends, profits distribution or interest repayment | | 125,809,384.16 | 109,891,637.85 |
| Including: Dividend and profit paid by subsidiaries to minority shareholders | | 4,949,462.72 | 4,500,000.00 |
| Other cash paid relating to financing activities | (v)48(4) | 82,643,150.54 | 3,468,517.96 |
| Sub-total of cash outflow from financing activities | | 1,769,304,493.42 | 1,283,882,861.81 |
| Net cash flows from financing activities | | 716,765,370.50 | 169,495,650.19 |
| IV. Effect on cash and cash equivalents due to change in foreign currency exchange rate | | 182,821.83 | 56,770.42 |
| V. Net increase(decrease) in cash and cash equivalents | | 528,104,052.63 | (189,501,950.53) |
| Add: Balance of cash and cash equivalents at the beginning of the period | (v)49(2) | 226,121,078.70 | 415,623,029.23 |
| VI. Balance of cash and cash equivalents at the end of the period | (v)49(2) | 754,225,131.33 | 226,121,078.70 |

Cash Flow Statements of the Company



As at 31 December 2010

| Item | Note | Amount for the current year RMB | Amount for the previous year RMB |
|--|----------|---------------------------------------|--|
| 1. Cash flows from operating activities: | | | |
| Cash received from selling goods and rendering services | | 1,849,365,933.20 | 1,941,990,009.28 |
| Tax rebate received | | 109,953,203.91 | 63,113,916.17 |
| Other cash received relating to operating activities | (v)48(1) | 18,760,804.03 | 77,268,423.95 |
| Sub-total of cash inflow from operating activities | | 1,978,079,941.14 | 2,082,372,349.40 |
| Cash paid for purchasing goods and receiving services | | 1,620,545,441.96 | 1,867,372,941.71 |
| Cash paid to and on behalf of employees | | 59,962,600.08 | 52,893,550.38 |
| Taxes and surcharges paid | | 43,937,397.03 | 27,823,578.81 |
| Other cash paid relating to operating activities | (v)48(2) | 125,600,400.00 | 102,718,893.95 |
| Sub-total of cash outflow from operating activities | | 1,850,045,839.07 | 2,050,808,964.85 |
| Net cash flows from operating activities | | 128,034,102.07 | 31,563,384.55 |
| II. Cash flows from investing activities: | | | |
| Cash received from disposal of investments | | — | 35,040,000.00 |
| Cash received from return on investments | | 85,765,164.48 | 76,610,000.00 |
| Net cash received from disposal of fixed assets, intangible assets and other long-term assets | | 1,960,278.04 | 1,822,901.83 |
| Sub-total of cash inflow from investing activities | | 87,725,442.52 | 113,472,901.83 |
| Cash paid for acquisition of fixed assets, intangible assets and other long-term assets | | 473,705,110.69 | 441,925,761.05 |
| Cash paid for investment | | — | 64,601,120.48 |
| Net cash paid for acquisition of subsidiaries and other business entities | | — | — |
| Sub-total of cash outflow from investing activities | | 473,705,110.69 | 506,526,881.53 |
| Net cash flows from investing activities | | (385,979,668.17) | (393,053,979.70) |
| III. Cash flows from financing activities: | | | |
| Cash received from equity investments | | 1,260,000,000.00 | — |
| Cash received from borrowings | | 1,126,829,673.92 | 1,379,648,512.00 |
| Other cash received relating to financing activities | (v)48(3) | — | 53,730,000.00 |
| Sub-total of cash inflow from financing activities | | 2,386,829,673.92 | 1,433,378,512.00 |
| Cash paid for repayment of liabilities | | 1,432,851,958.72 | 1,110,644,386.00 |
| Cash paid for dividends, profits distribution or interest repayment | | 109,994,378.16 | 92,608,427.37 |
| Other cash paid relating to financing activities | (v)48(4) | 82,643,150.54 | 3,468,517.96 |
| Sub-total of cash outflow from financing activities | | 1,625,489,487.42 | 1,206,721,331.33 |
| Net cash flows from financing activities | | 761,340,186.50 | 226,657,180.67 |



Cash Flow Statements of the Company

As at 31 December 2010

| Item | Note | Amount for the current year RMB | Amount for the previous year RMB |
|--|----------|---------------------------------------|--|
| IV. Effect on cash and cash equivalents due to change in foreign currency exchange rate | | (55,840.57) | (766.82) |
| V. Net increase(decrease) in cash and cash equivalents | | 503,338,779.83 | (134,834,181.30) |
| Add: Balance of cash and cash equivalents at the beginning of the period | (v)49(2) | 205,767,350.33 | 340,601,531.63 |
| VI. Balance of cash and cash equivalents at the end of the period | (v)49(2) | 709,106,130.16 | 205,767,350.33 |

Consolidated Statement of Change in Shareholders' Equity



For the year ended 31 December 2010

| Item | Amount for the current year | | | | Amount for the previous year | | | | Total equity | | | | | |
|---|-----------------------------|------------------|-----------------|----------------------|------------------------------|--------------------|------------------|----------------|----------------|-----------------|-----------------|----------------------|----------------|--------------------|
| | Share capital | Capital reserve | Surplus reserve | Undistributed profit | Others | Minority interests | Total equity | Share capital | | Capital reserve | Surplus reserve | Undistributed profit | Others | Minority interests |
| | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB |
| I. Balance at the end of the previous year | 328,924,200.00 | 121,667,859.42 | 108,376,005.02 | 694,089,054.29 | (736,933.63) | 61,315,025.59 | 1,313,635,210.69 | 328,924,200.00 | 121,667,859.42 | 80,066,723.93 | 519,848,018.05 | (810,297.59) | 60,307,266.19 | 1,110,023,770.00 |
| II. Changes in the current year | | | | | | | | | | | | | | |
| (1) Net profit | — | — | — | 276,149,165.54 | — | 831,143.10 | 276,980,308.64 | — | — | — | 268,315,157.33 | — | 5,507,125.07 | 273,822,282.40 |
| (2) Other comprehensive income | — | — | — | — | 253,607.99 | 16,267.83 | 269,875.82 | — | — | — | — | 73,363.96 | 634.33 | 73,998.29 |
| Sub-total of (1) and (2) | — | — | — | 276,149,165.54 | 253,607.99 | 847,410.93 | 277,250,184.46 | — | — | — | 268,315,157.33 | 73,363.96 | 5,507,759.40 | 273,896,280.69 |
| (3) Shareholder's capital injection and capital reduction | | | | | | | | | | | | | | |
| 1. Capital injection from shareholders | 70,000,000.00 | 1,126,738,331.50 | — | — | — | — | 1,196,738,331.50 | — | — | — | — | — | — | — |
| 2. Equity settled share expenses charged to equity | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| 3. Others | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| (4) Profit distribution | | | | | | | | | | | | | | |
| 1. Transfer to surplus reserves | — | — | 32,017,442.04 | (32,017,442.04) | — | — | — | — | — | 28,289,281.09 | (28,289,281.09) | — | — | — |
| 2. Distribution to shareholders | — | — | — | (39,470,904.00) | — | (4,949,462.72) | (44,420,366.72) | — | — | (65,784,840.00) | — | — | (4,500,000.00) | (70,284,840.00) |
| 3. Others | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| (5) Transfer of shareholders' equity | | | | | | | | | | | | | | |
| 1. Transfer of capital reserve to share capital | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| 2. Transfer of surplus reserves to share capital | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| 3. Surplus reserves making up of losses | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| 4. Others | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| III. Balance at the end of the current year | 398,924,200.00 | 1,248,406,190.92 | 140,393,447.06 | 898,749,873.79 | (483,325.64) | 57,212,973.80 | 2,745,203,559.93 | 328,924,200.00 | 121,667,859.42 | 108,376,005.02 | 694,089,054.29 | (736,933.63) | 61,315,025.59 | 1,313,635,210.69 |



Statement of Change in Shareholders' Equity of the Company

For the year ended 31 December 2010

| Item | Amount for the current year | | | | | Amount for the previous year | | | | |
|---|-----------------------------|------------------|-----------------|----------------------|------------------|------------------------------|-----------------|-----------------|----------------------|------------------|
| | Share capital | Capital reserve | Surplus reserve | Undistributed profit | Total equity | Share capital | Capital reserve | Surplus reserve | Undistributed profit | Total equity |
| | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB | RMB |
| I. Balance at the end of the previous year | 328,924,200.00 | 121,667,859.42 | 108,376,005.02 | 575,546,933.68 | 1,134,514,998.12 | 328,924,200.00 | 121,667,859.42 | 80,086,723.93 | 386,728,243.88 | 917,407,027.23 |
| II. Changes in the current year | | | | | | | | | | |
| (1) Net profit | — | — | — | 320,174,420.42 | 320,174,420.42 | — | — | — | 282,892,810.89 | 282,892,810.89 |
| (2) Other comprehensive income | — | — | — | — | — | — | — | — | — | — |
| Sub-total of (1) and (2) | — | — | — | 320,174,420.42 | 320,174,420.42 | — | — | — | 282,892,810.89 | 282,892,810.89 |
| (3) Shareholders' contributions and decrease in capital | | | | | | | | | | |
| 1. Shareholders' contributions in capital | 70,000,000.00 | 1,126,738,331.50 | — | — | 1,196,738,331.50 | — | — | — | — | — |
| 2. Others | — | — | — | — | — | — | — | — | — | — |
| (4) Profit distribution | | | | | | | | | | |
| 1. Transfer to surplus reserves | — | — | 32,017,442.04 | (32,017,442.04) | — | — | — | 28,289,281.09 | (28,289,281.09) | — |
| 2. Distribution to shareholders | — | — | — | (39,470,904.00) | (39,470,904.00) | — | — | — | (65,784,840.00) | (65,784,840.00) |
| 3. Others | — | — | — | — | — | — | — | — | — | — |
| (5) Transfer of shareholders' equity | | | | | | | | | | |
| 1. Transfer of capital reserve to share capital | — | — | — | — | — | — | — | — | — | — |
| 2. Transfer of surplus reserves to share capital | — | — | — | — | — | — | — | — | — | — |
| 3. Surplus reserves making up of losses | — | — | — | — | — | — | — | — | — | — |
| 4. Others | — | — | — | — | — | — | — | — | — | — |
| III. Balance at the end of the current year | 398,924,200.00 | 1,248,406,190.92 | 140,393,447.06 | 824,233,008.06 | 2,611,956,846.04 | 328,924,200.00 | 121,667,859.42 | 108,376,005.02 | 575,546,933.68 | 1,134,514,998.12 |

Notes to the Financial Statements



For the year ended 31 December 2010

I. General Information

Shandong Molong Petroleum Machinery Company Limited (hereunder the "Company") is a joint stock limited company registered in the People's Republic of China, and its place of registration is No. 99 Beihuan Road, Shouguang City, Shandong Province. The Company's predecessor company is Molong Holdings, which was established jointly by Zhang En Rong, Lin Fu Long, Zhang Yun San, Xie Xin Cang, Liu Yun Long, Cui Huan You, Liang Yong Qiang, Shengli Oil Field Kaiyuan Oil Exploitation Company Limited (勝利油田凱源石油開發有限責任公司) and Gansu Industrial University Alloy Materials Factory (甘肅工業大學合金材料總廠) on 27 December 2001 with the approval from Office for Restructuring the Economic System of Shandong Province (山東省經濟體制改革辦公室) with the letter Lu Ti Gai Han Zi [2001] No.53 (魯體改函字[2001]53號文). On 30 December 2001, the Company obtained the business license for enterprise natural person (registration number : Qi Gu Lu Zong Zi No. 004025 (企股魯總字第004025號)) with a registered capital of RMB40,500,000.00, total number of shares of 40,500,000 shares of RMB1 each.

On 28 February 2003, upon the approval by Office of Ministry of Finance(財政部辦公廳) with Cai Ban Qi [2003] No.30 (財辦企[2003]30號文), Gansu Industrial University Alloy Materials Factory (甘肅工業大學合金材料總廠) transferred 327,800 state-owned legal person shares of the Company to the National Council for Social Security Fund (全國社會保障基金理事會)

On 29 December 2003, upon the approval by China Securities Regulatory Commission with Zheng Jian Guo He Zi [2003] No. 50 (證監國合字[2003]50號文), the Company divided the nominal value per share to RMB0.10, and the change in total number of shares was 405,000,000 shares.

Upon the approval by China Securities Regulatory Commission with Zheng Jian Guo He Zi [2003] No. 50 (證監國合字[2003]50號文), on 15 April 2004, the Company issued 134,998,000 overseas listed foreign shares (H Shares) at the issuing price of HKD 0.70 per share with a nominal value of RMB0.10 each, which were listed in the Growth Enterprise Market of the Stock Exchange of Hong Kong.

Upon the approval by China Securities Regulatory Commission with Zheng Jian Guo He Zi [2005] No. 13 (證監國合字[2005]13號文), on 12 May 2005, the Company issued 108,000,000 additional overseas listed foreign shares (H Shares) at the issuing price of HKD 0.92 per share with a nominal value of RMB0.10 each. The Company's registered capital has changed to RMB64,799,800.00, and the total number of shares has changed to 647,998,000 shares.

Upon the approval by Zheng Jian Guo He Zi [2007] No.2 (證監國合字[2007]2號文) issued and signed by China Securities Regulatory Commission on 26 January 2007 and the approval issued by the Stock Exchange of Hong Kong on 6 February 2007, the listing status of the Company's overseas listed foreign shares (H Shares) in the Growth Enterprise Market of the Stock Exchange of Hong Kong has been cancelled on 7 February 2007, and changed to list on the Main Board of the Stock Exchange of Hong Kong.

Pursuant to the resolutions of 2006 Annual General Meeting convened on 25 May 2007, on the basis of a total of 647,998,000 shares as at 31 December 2006, the Company added its share capital from unallocated profit with bonus issue of 2 shares for every 1 share and added its share capital from capital reserve with the addition of 2 shares for every 1 share, adding 2,591,992,000 shares in aggregate, and the addition date was 18 July 2007. Upon the addition, the Company's registered capital has changed to RMB323,999,000.00, and the total number of shares has changed to 3,239,990,000 shares.



Notes to the Financial Statements

For the year ended 31 December 2010

I. General Information (continued)

Upon the approval by China Securities Regulatory Commission with Zheng Jian Guo He Zi [2007] No. 28 (證監國合字[2007]28號文), on 19 September 2007, the Company added 49,252,000 additional overseas listed foreign shares (H Shares) at the issuing price of HKD 1.70 per share with a nominal value of RMB0.10 each. The Company's registered capital has changed to RMB328,924,200.00, and the total number of shares has changed to 3,289,242,000 shares.

On 29 December 2009, the board of the Company has resolved to implement share consolidation, that is, consolidating every 10 shares in issue with nominal value of RMB0.10 each into 1 share with nominal value of RMB1.00. Such share consolidation has been completed on 7 January 2010.

Upon the approval by China Securities Regulatory Commission with Zheng Jian Guo He Zi [2010] No. 1285 (證監許可[2010]1285號文), on 11 October 2010, the Company offered 70,000,000 Renminbi ordinary shares (A Shares) with nominal value of RMB1 each at an offering price of RMB18 per share. The Company's registered capital has changed to RMB398,924,200.00, and the total number of shares has changed to 398,942,200 shares.

The Company and its subsidiaries (hereunder the "Group") are principally engage in the manufacturing and sales of oil well pumps, oil well sucker rods, oil pumping machinery, oil pumping pipes, petroleum machinery, textile machinery, petroleum equipment and accessories, high pressure isolation switch, high pressure electrical appliances, related electrical equipment, metal material specialized for petroleum use and the acquisition of scrap metal; development of petroleum machinery and its associated products; information service on commodities (excluding agency); import and export within the scope of qualification certificate.

Zhang En Rong, a natural person, is the controlling shareholder and final control person of the Company.

II. Significant Accounting Policies, Estimates and Previous Errors of the Company

1. Basis of preparation

The Group had applied the "Enterprise Accounting Standards" promulgated by the Ministry of Finance in February 15, 2006. In addition, the Group disclosed the relative financial information in accordance with the "Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 15) — General Regulation of Financial Statement" (as amended in 2010)

Basis of preparation and principle of measurement

The Group's financial statements have been prepared on an accrual basis. Except for certain financial instruments which are measured at fair value, the financial statements are prepared under the historical cost convention. In the event that depreciation of assets occurs, a provision for impairment is made accordingly in accordance with the relevant regulations.

2. Statement of compliance

The financial statements truly and completely reflect the financial position of the Group and the Company as at 31 December 2010 and the results of their operations and their cash flows for the year ended 31 December 2010.

3. Financial year

The financial year of the Group is from 1 January to 31 December of each calendar year.

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

4. Reporting currency

Renminbi is the currency of the primary economic environment where the Company and domestic subsidiaries operate, and the Company's and domestic subsidiaries' reporting currencies are both Renminbi. Prior to 1 January 2009, MPM International Limited (hereunder "MPM Company"), the foreign subsidiary of the Company, used Hong Kong Dollar (HKD) as its reporting currency based on the primary economic environment where it operates. Since 1 January 2009, as the currency of the primary economic environment where MPM Company operates has changed to United State Dollar (USD), its reporting currency was changed to USD correspondingly. The Group adopts Renminbi as its currency when preparing for these financial statements.

5. The accounting treatment of business combination under common control and not under common control

Business combination is classified into business combination under common control and not under common control.

5.1 Business combinations involving entities under common control

A business combination involving entities under common control is a business combination in which all of the combining entities are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Assets and liabilities obtained by combining party in the business combination are recognized at their carrying amounts at the combination date as recorded by the party being combined. The difference between the carrying amount of the consideration paid for the combination (or aggregate face values of the shares issued) and the carrying amount of the net assets obtained is adjusted to capital reserves. If the capital reserve is not sufficient to absorb the difference, any excess is adjusted to retained profits.

Any costs directly attributable to the combination are recognized as expenses when incurred by the combining party.

5.2 Business combinations and goodwill involving entities not under common control

A business combination not involving entities under common control is a business combination in which all of the combining entities are not ultimately controlled by the same party or parties both before and after the business combination.

Combination cost represents the assets paid, liabilities incurred or assumed and fair value of issuing equity instruments for obtaining the control of acquiree by the acquirer. Intermediate fees such as audit, legal service, assessment and consultation and other relevant management expenses incurred by the acquirer for business combination are credited to profit or loss for the current period upon occurrence. For business combination not under common control realized via various transactions, the combination cost represents the sum of the consideration paid at the purchase date and the fair value of the equity in acquiree already held before the purchase date at the purchase date. For equity in acquiree already held before the purchase date, it is remeasured at the fair value at the purchase date, and the difference between fair value and its carrying value is credited to the investment gain for the current period. For equity in acquiree already held before the purchase date involving other comprehensive income, other comprehensive income related is transferred to the investment gain for the current period at the purchase date.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

5. The accounting treatment of business combination under common control and not under common control (continued)

5.2 Business combinations and goodwill involving entities not under common control (continued)

Identifiable assets, liabilities and contingent liabilities of acquiree qualifying for the conditions of recognition acquired by the acquirer in combination are measured at fair value on the purchase date. For the difference that the combination cost is larger than the portion of fair value of net identifiable assets of acquiree acquired in combination, it is recognized as goodwill as an asset, and initially measured at cost. For those with combination cost lower than the portion of fair value of net identifiable assets of acquiree acquired in combination, re-verification on the measurement of the fair value of all identifiable assets, liabilities and contingent liabilities as well as the combination cost is first obtained. For those with combination cost still lower than the portion of fair value of net identifiable assets of acquiree acquired in combination after re-verification, they are credited to profit or loss for the current period.

Goodwill arising from business combination is presented in the combined financial statements separately, and measured at the amount of cost less accumulated impairment provision. Goodwill is tested for impairment at least once at the end of the year.

When conducting the impairment test for goodwill, the test is conducted combined with its related asset group or portfolio of asset group. That is, the carrying value of goodwill is allocated to the asset group or portfolio of asset group which could be benefited from the synergy of business combination since the purchase date. If the recoverable amount of asset group or portfolio of asset group containing the allocated goodwill is lower than its carrying value, relative impairment loss is recognized. The amount of impairment loss is first written-down and allocated to the carrying amount of the goodwill of that asset group or portfolio of asset group, and is then written down to the carrying value of all other types of assets proportionally according to the weighting of the carrying value of all other types of assets other than goodwill within asset group or portfolio of asset group

The recoverable amount of an asset is the higher of its fair value less costs of disposal and the present value of the future cash flows expected to be derived from the asset. An asset's fair value is the price in a sale agreement in an arm's length transaction. If there is no sale agreement but the asset is traded in an active market, fair value shall be determined based on the bid price. If there is neither sale agreement nor active market for an asset, fair value shall be based on the best available information. Costs of disposal are expenses attributable to disposal of the asset, including legal fee, relevant tax and surcharges, transportation fee and direct expenses incurred to prepare the asset for its intended sale. The present value of the future cash flows expected to be derived from the asset over the course of continued use and final disposal is determined as the amount discounted using an appropriately selected discount rate.

An impairment loss recognized on goodwill shall not be reversed in a subsequent period.

Notes to the Financial Statements



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

6. Basis for preparation of consolidated financial statements

The scope of consolidated financial statements is determined on the basis of control. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its operating activities.

For disposal of subsidiaries, operating results and cash flows of such subsidiaries from the period beginning to the date of disposal are included into the consolidated income statement and consolidated cash flow statement.

For those subsidiaries acquired through business combination not under common control, the operating results and cash flows after the acquisition date have been properly included in the consolidated income statements and consolidated cash flow statements. No adjustments shall be made to the opening balance of the consolidated balance sheet and the comparative consolidated financial statements amount.

For those subsidiaries acquired through business combination under common control, the operating results and cash flows from the opening of the consolidation period to the consolidation date are also presented in the consolidated income statement and the consolidated cash flow statements.

Major accounting policies and accounting periods adopted by the subsidiaries are defined according to the standardized accounting policies and accounting periods stipulated by the Company.

All significant intra-group accounts and transactions between the parent company and its subsidiaries or between subsidiaries are eliminated on consolidation.

The portion of a subsidiary's equity that is not attributable to the parent is treated as minority interests and presented as "minority interest" in the consolidated balance sheet within owners' equity. The portion of net profits or losses of subsidiaries for the period attributable to minority interests is presented in the consolidated income statement under the "net profit" line item as "minority interests".

If the loss of subsidiaries attributable by minority interests exceeds the portion of ownership shares in that subsidiary attributable to the minority interests, the excess is still used to write down minority shareholder's equity.

For the acquisition of minority interests in subsidiaries or transaction which involves partial disposal of equity investment but no loss in control on that subsidiary, it is computed as equity transaction, and the carrying value of ownership interests attributable to the parent and minority interests are adjusted to reflect changes in relevant equity in subsidiaries. The difference between the amount of adjustment in minority interests and the fair value of consideration paid/received is adjusted for capital reserve, and those capital reserves insufficient to be written-down are adjusted for retained revenue.

For the loss of control on original subsidiaries due to partial disposal of equity investment or other reasons, the remaining equity interests is remeasured at its fair value at the date losing control. The sum of consideration received for the disposal of equity and the fair value of the remaining equity, less the difference in the proportion of net assets of the original subsidiary continuously calculated since the purchase date attributable to the calculation of the original shareholding proportion are credited to the investment gain for the period losing control. Other comprehensive income related to the investment in equity of the original subsidiary is transferred to the investment gain for the current period when losing control.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

7. Cash and cash equivalents

Cash represent the Group's treasury cash and deposit withdrawn on demand. Cash equivalents held by the Group represent short-term and highly liquid investments that are readily convertible to known amounts of cash and which are subject to insignificant risk of value change.

8. Foreign currency and translation of statements denominated in foreign currency

8.1 Foreign currency

On initial recognition, foreign currency transactions are translated into the reporting currency using the spot exchange rate prevailing at the date of transaction.

As at the balance sheet date, monetary items denominated in foreign currency are exchanged to Renminbi by adopting the prevailing exchange rate on that date. Foreign exchange difference arising from the difference between the prevailing exchange rate on that date and the prevailing exchange rate on initial reorganization or on the previous balance sheet date are all credited to profit or loss for the current period, except: (1) foreign exchange differences for specific borrowings denominated in foreign currency and qualifying for conditions of capitalization are capitalized during the capitalization period and credited to the cost of relevant assets; (2) foreign exchange differences of hedging instruments for the purposes of avoiding foreign exchange risk are accounted at hedging; (3) foreign exchange differences arising from available-for-sale non-monetary items (such as stocks) denominated in foreign currency and foreign exchange differences arising from the changes in other remaining carrying amount of available-for-sale monetary items (other than amortized cost) are recognized as other comprehensive income and credited to capital reserve.

Exchange differences arising from change in exchange rate where the preparation of consolidated financial statements relates to overseas operation and foreign currency monetary items materially constitute net investment in overseas operation shall be recorded into "translation reserve" in the shareholders' equity; disposal of overseas operation shall be included into profits and losses on disposal in the current period.

Non-monetary items denominated in foreign currency that are measured at historical cost are still measured at amount denominated in reporting currency exchanged at the prevailing exchange rate at the transaction date. Non-monetary items denominated in foreign currency that are measured at fair value are exchanged at the prevailing exchange rate at the date of determining the fair value. The difference between the exchanged reporting currency amount and the original reporting currency amount is treated as changes in fair value (including change in exchange rate), and is credited to the profit or loss for that period or recognized as other comprehensive income and credited to capital reserve.

8.2 Translation of financial statements denominated in foreign currency

The financial statements denominated in foreign currency of a foreign operation are translated to RMB in comply with the following requirement: assets and liabilities on the balance sheet are translated at the spot exchange rate prevailing at the balance sheet date; all equity items except for unallocated profits are translated at the spot exchange rates at the dates on which such items arose; income and expenses in the income statement are translated at the spot exchange rate at the date of transaction; the unallocated



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

8. Foreign currency and translation of statements denominated in foreign currency (continued)

8.2 Translation of financial statements denominated in foreign currency

profits brought forward are reported at the prior year's closing balance; the unallocated profits carried forward are calculated, based on the translated amounts of profits and other profit appropriation items; and all exchange differences resulting from the translation are recognized separately as "translation reserve" in the shareholders' equity on the balance sheet.

Cash flow dominated in foreign currency or from foreign subsidiaries shall be translated at the spot exchange rate when it incurs. Effects arising from changes of exchange rate of cash and cash equivalents shall be presented separately as "Effect of changes in exchange rates on cash and cash equivalents" in the cash flow statement.

The opening balances and prior year's figures are presented according to the translated amounts of the prior year.

When the control on foreign operation is lost due to the disposal of ownership interests of foreign operation or partial disposal of equity investment by the Group or other reasons, exchange differences of foreign currency statements attributable to shareholder's equity of the parent related to such foreign operation presented under shareholder's equity item in balance sheet are all transferred to profit or loss for the current period.

When the control on foreign operation is not lost due to partial disposal of equity investment or other reasons, exchange differences of foreign currency statements related to that foreign operation are attributable to minority interests, and not transferred to profit or loss for current period. When disposing part of equity interests in foreign operation of associates or joint ventures, exchange differences of foreign currency statements related to that foreign operation are transferred to the profit or loss disposed for the current period in accordance with the proportion of that foreign operation disposed.

9. Financial instruments

When the Group becomes a party of financial instrument contract, a financial asset or financial liability will be recognized. Financial assets and financial liabilities are measured at fair value on initial reorganization. For financial assets and financial liabilities measured at fair value through profit or loss with changes credited to profit or loss for the current period, relevant transaction costs are directly included in profit or loss. For financial assets and financial liabilities of other categories, relevant transaction costs are included in the amount initially recognized.

9.1 Method of determination of the fair value

The fair value refers to the amount, at which both willing parties to a fair transaction who are familiar with the condition exchange their assets or clear off their debts under fair conditions. Financial instruments exist in an active market. While financial instruments do not exist in an active market, the fair value is determined using valuation techniques. Valuation technologies include reference to be familiar with situation and prices reached in recent market transactions entered into by both willing parties, reference to present fair values of similar other financial instruments, cash flow discounting method and option pricing models.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

9. Financial instruments (continued)

9.2 Effective interest method

Effective interest method represents the method for calculating the amortized costs and interest income or expense of each period in accordance with the effective interest rate of financial assets or financial liabilities (inclusive of a set of financial assets or financial liabilities). Effective interest rate represents the rate that discounts the future cash flow over the expected subsisting period or shorter period, if appropriate of the financial asset or financial liability to the current carrying value of such financial asset or financial liability.

When calculating the effective interest rate, the Group will consider the anticipated future cash flow (not considering the future credit loss) on the basis of all contract clauses of financial assets or financial liabilities, as well as consider all kinds of charges, transaction fees and discount or premium paid forming an integral part of the effective interest rate paid or received between both parties of financial asset or financial liability contract.

9.3 Classification, recognition and measurement of the financial assets

Financial assets are divided into financial assets at fair value through profit or loss, held-to-maturity investments, loans and the accounts receivable and available for-sale financial assets when they are initially recognized. Financial assets and financial liabilities are initially recognized at fair value. Financial assets purchased and sold in regular way are recognized and derecognized based on the accounting at transaction date. Financial assets held by the Group are mainly financial assets carried at fair value with its changes included in profit or loss for the current period as well as loans and receivables.

9.3.1 Financial assets carried at fair value through profit or loss for the current period

They include financial assets held for trading and financial assets designated as at fair value through profit or loss for the current period.

Financial assets may be classified as financial assets held for trading if one of the following conditions is met: (1) the financial assets is acquired or incurred principally for the purpose of selling or repurchasing it in the near term; (2) the financial assets is part of a portfolio of identified financial instruments that are managed together and for which there is objective evidence of a recent pattern of short-term profit-taking; or (3) the financial assets is a derivative, excluding the derivatives designated as effective hedging instruments, the derivatives classified as financial guarantee contract, and the derivatives linked to an equity instrument investment which has no quoted price in an active market nor a reliably measured fair value and are required to be settled through that equity instrument.

Financial assets which satisfy one of the following conditions could be designated as financial assets measured at fair value with its change included in profit of loss for the current period upon initial reorganization: (1) such designation could eliminate or clearly reduce the inconsistency in recognition or measurement of relevant gain or loss resulting from different measurement basis of such financial assets; (2) Duly written documents of the Group's risk management or investment strategy has stated that the financial asset portfolio or financial asset and financial liability portfolio which such financial assets are located is managed with the basis of fair value, and is assessed and reported to key management personnel.

Financial assets held for trading are subsequently measured at fair value. The gain or loss arising from changes in fair value and dividends and interest income related to such financial assets are charged to profit or loss for the current period.

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

9. Financial instruments (continued)

9.3 Classification, recognition and measurement of the financial assets (continued)

9.3.2 Loans and accounts receivable

Loans and accounts receivable are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Financial assets, including entrusted loans, bills receivables, accounts receivable and other receivables, are classified as loans and accounts receivable by the Group.

Trust loans and accounts receivable adopt the actual interest rate method to carry out the ongoing measure based on amortized costs. On derecognition, profit or loss arising from impairment or amortization is carried at profit or loss for the current period.

9.4 Impairment of financial assets

In addition to financial assets at fair value through profit or loss for the current period, the Group reviews the book value of other financial assets at each balance sheet date and provide for impairment where there is objective evidence that financial assets are impaired. Objective evidences indicating the impairment of financial assets represent events which actually occur after initial reorganization of financial assets and has impact on the anticipated future cash flow of such financial assets, and that the enterprise could make reliable measurement on such impact.

Objective evidence of impairment on financial asset includes those observable matters listed as follows:

- (1) issuers or debtors encounter severe financial difficulties;
- (2) debtors violate terms of contract, such as a breach of rules or delay during settlement of interests or principal;
- (3) the Group gives way to those under financial difficulty accounting on economic or legal reasons;
- (4) debtors may go into liquidation or conduct other financial reorganization;
- (5) transaction of the financial assets ceases in the active market as the issuer encounters great financial difficulties;
- (6) any reduction in cash flow of certain assets among a group of financial assets cannot be identified, while it is discovered that the estimated future cash flow of the financial assets has been reduced and can be measured since initial recognition after an overall evaluation based on disclosed information, including that:
 - the repayment capability of the debtor of the group of financial assets gradually deteriorates;
 - economy difficulties of the country or region where the debtor is staying appear a situation where this group of financial assets cannot be paid;
- (7) significant and adverse changes have taken place in the technological, market, economic or legal environments in which the debtor operates, making investors of equity instruments difficult to recover the investment cost;



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

9. Financial instruments (continued)

9.4 Impairment of financial assets (continued)

- (8) substantial or non-temporary reduction of the fair value of investment on equity instruments; and
 - (9) other objective evidence showing signs of impairment on financial assets.
- Impairment on financial assets measured at amortized cost

When financial assets measured at amortized cost are impaired, their carrying amounts are written down to the present value of anticipated future cash flow (excluding future credit loss not yet incurred) discounted at the original effective interest rate of such financial assets. The written down amount is recognized as impairment loss and included in profit or loss for the current period. Upon the recognition of impairment loss of financial assets, if objective evidences indicate that the value of such financial assets has been recovered, and could be objectively related to events after the occurrence of such loss, the impairment loss originally recognized is written back, to the extent that the carrying amount of financial assets written back after impairment loss shall not exceed the amortization cost of such financial assets at the write-back date assuming that no impairment allowance has been provided.

For a financial asset that is individually significant, the Group assesses the asset individually for impairment. For a financial asset that is not individually significant, the Group assess the asset individually for impairment or include the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. If it is determined that no impairment exists for an individually assessed financial asset, whether the financial asset is individually significant or not, the financial asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment again. Financial assets for which an impairment loss is individually recognized are not included in the collective assessment for impairment for a group of financial assets with similar credit risk characteristics.

9.5 Transfers of financial asset

Financial asset that satisfied any of the following criteria shall be derecognized: (1) the contract right to recover the cash flows of the financial asset has terminated; (2) the financial asset, along with substantially all the risk and return arising from the ownership of the financial asset, has been transferred to the transferee; and (3) the financial asset has been transferred to the transferee, and the transferor has given up the control on such financial asset, though it does not assign maintain substantially all the risk and return arising from the ownership of the financial asset.

When the entity does not either assign or maintain substantially all the risk and return arising from the ownership of the financial asset and does not give up the control on such financial asset, to the extent of its continuous involvement in the financial asset, the entity recognizes it as a related financial asset and recognizes the relevant liability accordingly. The extent of the continuous involvement is the extent to which the entity exposes to changes in the value of such financial assets.

On derecognition of a financial asset, the difference between the following amounts is recognized in profit or loss for the current period: the carrying amount and the sum of the consideration received and any accumulated gain or loss that had been recognized directly in equity.

If a part of the financial assets qualifies for derecognition, the carrying amount of the financial asset is allocated between the part that continues to be recognized and the part that qualifies for derecognition, based on the fair values of the respective parts. The difference between the following amounts is recognized in profit or loss for the period: the sum of the consideration received and the carrying amount of the part that qualifies for derecognition and the aforementioned carrying amount.



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

9. Financial instruments (continued)

9.6 Classification, affirmation and measurement of financial liabilities

Financial liabilities to be issued by the Group will be recognized as financial liabilities or equity instruments according to the actual contractual arrangement of such financial instruments and the definition of financial liabilities and equity instruments.

At initial recognition, financial liabilities are classified either as “financial liabilities at fair value through profit or loss” or “other financial liabilities”. Financial liabilities are initially recognized at fair value.

9.6.1 *Financial liabilities at fair value through profit or loss for the period*

Financial liabilities measured at fair value with its changes included in the profit or loss for the current period include tradable financial liabilities and financial liabilities designated to be measured at fair value with its changes included in profit or loss for the current period.

Financial liabilities which satisfy one of the following conditions are classified as tradable financial liabilities: (1) the purposes for commitment to such financial liabilities is mainly for repurchase in short term; (2) for those belong to a part of the identifiable financial instrument portfolio managed in a centralized manner upon initial reorganization, and objective evidences show that the Group has recently adopted short-term profitability approach to manage such portfolio; ; (3) for those belong to derivatives, but are designated and act as derivatives of effective hedging, except for derivatives which belong to financial guarantee contract and linked with equity instrument and settled via delivery of such equity instruments without quotation in active market and no reliable measurement of fair value, subsequent measurement is made according to cost.

Financial liabilities which satisfy one of the following conditions are financial liabilities designated to be carried at fair value through profit or loss for the current period upon initial reorganization: (1) such designation could eliminate or clearly reduce the inconsistency in recognition and measurement of relevant gain or loss resulting from different measurement basis of such financial liabilities; (2) Duly written documents of the Group’s risk management or investment strategy has stated that the financial liability portfolio or financial asset and financial liability portfolio which such financial liabilities are located is managed with the basis of fair value, and is assessed and reported to key management personnel.

Financial liabilities at fair value through profit or loss for the period are subsequently measured at fair value. The gain or loss arising from changes in fair value and dividends and interest income related to such financial liabilities are included into the current profit or loss.

9.6.2 *Other financial liabilities*

For derivative financial liability linked with equity instrument and settled via delivery of such equity instruments without quotation in active market and no reliable measurement of fair value, subsequent measurement is made according to cost. The financial liabilities of the Group are mainly other financial liabilities such as accounts payable, borrowings and bonds payables. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Gains or losses arising from derecognition or amortization is recognized in profit or loss for the current period.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

9. Financial instruments (continued)

9.7 Derecognition of financial liabilities

Financial liabilities are derecognized in full or in part only when the present obligation is discharged in full or in part. An agreement is entered between the Group (debtor) and a creditor to replace the original financial liabilities with new financial liabilities with substantially different terms, derecognize the original financial liabilities as well as recognize the new financial liabilities.

When financial liabilities is derecognized in full or in part, the difference between the carrying amount of the financial liabilities derecognized and the consideration paid (including transferred non-cash assets or new financial liability) is recognized in profit or loss for the current period.

9.8 Offset of financial assets and financial liabilities

If the Group owns the legitimate rights of offsetting the recognized financial assets and financial liabilities, which are enforceable currently, and the Group plans to realize the financial assets or to clear off the financial liabilities by net amount method, the amount of the offsetting financial assets and financial liabilities shall be reported in the balance sheet. Otherwise, financial assets and financial liabilities are presented separately in the balance sheet without offsetting.

9.9 Equity instruments

Equity instruments are any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. For equity instruments, the price received during the issue shall be added to shareholder's equity after reducing the transaction fees.

The distribution (excluding the dividends) to the equity instrument holders by the Group shall reduce the shareholder's equity. The Group shall not recognize the changes of the equity instruments' fair value.

10. Accounts receivable

10.1 Single item with significant accounts receivable and provided for bad debts in single item.

Judgment basis or amount standard for single item with significant amount The Group recognizes accounts receivable of over RMB300 million and other receivables of over RMB200 million as single item with significant accounts receivable.

Provision method for single item with significant amount and provided for bad debts in single item The Group conducts impairment test for single item with significant accounts receivable separately, and tests financial assets without impairment separately, including conducting impairment test on financial asset groups with similar credit risk characteristics. For accounts receivable with impairment loss recognized in single item test, they ceased to be included in accounts receivable portfolio with similar risk characteristics for impairment test.

Notes to the Financial Statements



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

10. Accounts receivable (continued)

10.2 Accounts receivable provided for bad debts by group

Basis for determining portfolio

| | |
|--|--|
| Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item. | The Group considers the credit risk for single items with insignificant accounts receivable and single item with significant accounts receivable but not impaired under single item test is relatively low, and no bad debt provision is required, unless there is evidence showing that credit risk of certain accounts receivable is relatively large. |
|--|--|

10.3 Single item with insignificant accounts receivable but provided for bad debts separately

| | |
|--|---|
| Reasons for bad debts provision by single item | The Group conducts impairment test for single item with insignificant accounts receivable, and recognizes the amount of present value of future cash flow lower than the carrying value as impairment loss. |
|--|---|

| | |
|--|---------------------------------|
| Provision method for bad debts provision | Individual determination method |
|--|---------------------------------|

11. Inventory

11.1 Classification and initial measure of inventories

Inventories of the Group mainly include raw materials, products and finished products. Inventories are initially measured at cost. Cost of inventories include purchasing cost, processing cost and other expenses that help deliver the inventories to the current location and situation.

11.2 Method for calculating value of inventories delivered

When inventories are delivered, weighed average method is adopted to determine the actual cost of inventories delivered.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

11. Inventory (continued)

11.3 Recognition of net realizable value of inventory and provision for inventory impairment

At the balance sheet date, inventories are calculated at the lower of cost and net realizable value. Provision for inventory impairment is made when the net realizable value is lower than the cost. Net realizable value represents the estimated selling price of inventories minus cost estimated to incur upon completion, estimated selling costs and relevant post-tax amounts during normal course of business. When determining the net realizable value of inventory, basis is relied on the actual evidences obtained while the objectives of inventories holding and the impact of post balance sheet date event are also considered.

For inventories with tremendous number and relatively low unit price, inventory impairment loss is provided according to the type of inventory. For other inventories, inventory impairment provision is provided at the difference of cost of a single item of inventory exceeding its net realizable value.

After making the provision for inventory impairment, in case the factors causing inventory impairment no longer exists, and the net realizable value of an inventory is higher than its book-value, the original provision for inventory impairment shall be transferred back and incorporated into the profit or loss for the current period.

11.4 Inventory taking system

The inventory taking system shall be on a perpetual basis.

11.5 Amortization of low-value consumable and packaging materials

Packaging materials and low-value consumable are amortized by one-time write-off.

12. Long-term equity investments

12.1 Determination of initial investment cost

For a long-term equity investment acquired through a business combination involving enterprises under common control, the initial investment cost of the long-term equity investment shall be the absorbing party's share of the carrying amount of the owner's equity of the party being absorbed at the date of combination. For a long-term equity investment acquired through business combination not involving enterprises under common control, the initial investment cost of the long-term equity investment acquired shall be the cost of acquisition. The long-term equity investment acquired through means other than a business combination shall be initially measured at its cost.

12.2 Method for subsequent measurement and profit or loss recognition

12.2.1 Long-term equity investments accounted for using the cost method

For investees which the Group does not have any common control or significant influence and without quotation in an active market, and with long-term equity investment with fair value which could not be reliably measured, they are computed by adopting cost approach. In addition, the Company's financial statements adopt cost approach to compute the long-term equity investment in subsidiaries. Subsidiaries are investees for which the Group could impose control.

Under the cost method, a long-term equity investment is measured at its initial investment cost. Except receiving the actual consideration paid for the investment or the declared but not yet distributed cash dividends or profits which is included in the consideration, investment gains for the period is recognized as the cash dividends or profits declared by the investee.



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

12. Long-term equity investments (continued)

12.2 Long-term equity investments accounted for using the equity method (continued)

12.2.2 Long-term equity investments accounted for using the equity method

The Group's investment in associates and joint ventures are computed by adopting equity approach. Associates are investees for which the Group could impose significant influence. Joint ventures are investees for which the Group and other investors could impose common control.

Under the equity method, where the initial investment cost of a long-term equity investment exceeds the investor's interest in the fair value of the investee's identifiable net assets at the acquisition date, no adjustment shall be made to the initial investment cost. Where the initial investment cost is less than the investor's interest in the fair value of the investee's identifiable net assets at the acquisition date, the difference shall be charged to profit or loss for the current period, and the cost of the long term equity investment shall be adjusted accordingly.

Under the equity method, investment gain or loss represents the Group's share of the net profits or losses made by the investee for the current period. The Group shall recognize its share of the investee's net profits or losses based on the fair values of the investee's individual separately identifiable assets at the time of acquisition, after making appropriate adjustments thereto in conformity with the accounting policies and accounting periods of the Group. The unrealized gain or loss from internal transactions entered into between the Group and its associated enterprises and joint ventures is set off according to the shareholding attributable to the Group and accounted for as investment income and loss based such basis. However, the unrealized gain or loss from internal transactions entered into between the Group and its investee is not set up if belonging to impairment loss from assets transferred according to regulations such as Accounting Standards for Business Enterprises No. 8 "Assets impairment". For changes in other shareholder's equity in investee other than net profit or loss, the carrying amount of the correspondingly adjusted long-term equity investment is recognized as other comprehensive income and included in capital reserve

The Group's share of net losses of the investee shall be recognized to the extent that the carrying amount of the long-term equity investment together with any long-term interests that in substance form part of the investor's net investment in the investee are reduced to zero. If the Group has to assume additional obligations, the estimated obligation assumed shall be provided for and charged to the profit or loss as investment loss for the period. Where the investee is making profits in subsequent periods, the Group shall resume recognizing its share of profits after setting off against the share of unrecognized losses.

For the Group's long-term equity investment in associates and joint ventures already held prior to the first implementation of new accounting standards on 1 January 2007, if there exists borrower's difference on equity investment related to such investment, amounts amortized over the original remaining period on straight line basis are included in profit or loss of the current period.

12.2.3 Disposal of long-term equity investments

On disposal of a long-term investment, the difference between the carrying amount of the investment and the actual consideration paid is recognized in current profit or loss. Where the equity method is adopted, the amount attributable to the long-term equity investments previously included shareholders' equity shall be transferred to current profit or loss on a pro-rata basis.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

12. Long-term equity investments (continued)

12.3 Recognition of having joint control or significant influence over the investee

The term "Control" means that the Group has the power to decide an enterprise's financial and operating policy, pursuant to which, the Group can get the power to obtain benefits from its operating activities. Joint control is the contractually agreed sharing of control over an economic activity, which only exists when relevant and important financial affairs and management decisions related to such economic activity require sharing of control by investors who unanimously agree upon. Significant influence is the power to participate in the financial and operating policy decisions of an enterprise, but to fail to control or joint control the formulation of such policies together with other parties. In determining whether there is control or significance influence over the investee, potential voting right factors (such as the convertible corporate bonds for the period and the exercisable stock warrants for the period of the investee and other invested units held) were taken into account.

12.4 Impairment test method and impairment provision

The Group assesses at each balance sheet date whether there is any indication that any long-term equity investments may be impaired. If there is any evidence indicating that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If the recoverable amount of an asset is less than its carrying amount, the reduction is recognized as an impairment loss and charged to profit or loss for the current period. A provision for impairment loss of the asset is recognized accordingly.

An impairment loss recognized on long-term equity investments shall not be reversed in a subsequent period.

13. Investment property

Investment property refer to real estate held to earn rentals or for capital appreciation, or both, including leased land use rights, land use rights held and provided for transfer after appreciation and leased construction, etc.

Investment property is initially measured at cost. Subsequent expenditures related to an investment property shall be included in cost of investment property only when the economic benefits associated with the asset will likely flow to the Group and its cost can be measured reliably. All other expenditures on investment property shall be included in profit or loss for the current period when incurred.

The Group adopts cost method for subsequent measurement of investment property, which is depreciated or amortized using the same policy as that for buildings and land use rights.

The Group assesses at each balance sheet date whether there is any indication that any investment properties may be impaired. If there is any evidence indicating that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Group shall determine the recoverable amount of the asset group to which the asset belongs. If the recoverable amount of an asset is less than its carrying amount, the reduction is recognized as an impairment loss and charged to profit or loss for the current period.

An impairment loss recognized on investment properties shall not be reversed in a subsequent accounting period.

When an investment property is sold, transferred, retired or damaged, the amount of proceeds on disposal of the property net of the carrying amount and related tax and surcharges is recognized in profit or loss for the current period.

Notes to the Financial Statements



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

14. Fixed assets

14.1 Conditions for recognition of fixed assets

Fixed assets are tangible assets that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and have a useful life of more than one accounting year. Fixed assets are only recognized when its related economic benefits are likely to flow to the Group and its cost could be reliably measured. Fixed assets are initially measured at cost.

For subsequent expenses related to fixed assets, if the economic benefits related to such fixed assets is likely to inflow and its cost could be reliably measured, they are capitalised to fixed assets cost and the carrying amount of replacement will be derecognized. Other subsequent expenses other than the above are charged to profit or loss for the current period upon occurrence.

14.2 Method for depreciation of different fixed assets

Depreciation is provided over their estimated useful lives from the month after they have reached the working condition for their intended use using the straight-line method. The useful life, estimated residual value and annual depreciation rate of each category of fixed assets are as follows:

| Category | Depreciable life (year) | Estimated residual value (%) | Annual depreciation rate (%) |
|--------------------------|-------------------------|------------------------------|------------------------------|
| Buildings and structures | 20 years | 5 | 4.75 |
| Machinery and equipment | 2 years–20 years | 5 | 47.50–4.75 |
| Electronic equipment | 3 years–5 years | 5 | 31.67–19.00 |
| Vehicles | 5 years | 5 | 19.00 |
| Other | 5 years | 5 | 19.00 |

Estimated net residual value of a fixed asset is the estimated amount that the Group would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the stage and in the condition expected at the end of its useful life.

14.3 Impairment testing methods and provision for impairment methods on fixed assets

The Group assesses at each balance sheet date whether there is any indication that any fixed assets may be impaired. If there is any evidence indicating that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Group shall determine the recoverable amount of the asset group to which the asset belongs. If the recoverable amount of an asset is less than its carrying amount, the reduction is recognized as an impairment loss and charged to profit or loss for the current period. A provision for impairment loss of the asset is recognized accordingly.

An impairment loss recognized on the assets mentioned above shall not be reversed in a subsequent period.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

14. Fixed assets

14.4 Explanation on other matters

The Group reviews the useful life and estimated net residual value of a fixed asset and the depreciation method applied at least at each financial year-end. A change in the useful life or estimated net residual value of a fixed asset or the depreciation method used shall be accounted for as a change in accounting estimate.

When fixed asset is disposed or no economic benefit is expected to incur upon usage or disposal, such fixed asset will be derecognized. When a fixed asset is sold, transferred, retired or damaged, the Group shall recognize the amount of any proceeds on disposal of the asset net of the carrying amount and related taxes in profit or loss for the current period.

15. Construction in progress

Construction in progress is recognized based on the actual construction cost, including all expenditures incurred for construction projects, capitalized borrowing costs for the construction in progress before it has reached the working condition for its intended use, and other related expenses during the construction period. A construction in progress is transferred to fixed assets when it has reached the working condition for its intended use.

The Group assesses at each balance sheet date whether there is any indication that any construction in progress may be impaired. If there is any evidence indicating that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Group shall determine the recoverable amount of the asset group to which the asset belongs. If the recoverable amount of an asset is less than its carrying amount, the reduction is recognized as an impairment loss and charged to profit or loss for the current period. A provision for impairment loss of the asset is recognized accordingly.

An impairment loss recognized on the assets mentioned above shall not be reversed in a subsequent period.

16. Borrowing costs

For borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, when expenditures for the asset and borrowing costs are being incurred, activities relating to the acquisition, construction or production of the asset that are necessary to prepare the asset for its intended use or sale have commenced, such borrowing costs shall be capitalized as part of the cost of that asset; and capitalization shall discontinue when the qualifying asset is ready for its intended use or sale. Capitalization of borrowing costs shall be suspended during periods in which the acquisition, construction or production of a qualifying asset is interrupted abnormally, when the interruption is for a continuous period of more than 3 months, until the acquisition, construction or production of the qualifying asset is resumed. Other borrowing costs shall be recognized as expense in the period in which they are incurred.

Where funds are borrowed for a specific purpose, the amount of interest to be capitalized shall be the actual interest expense incurred on that borrowing for the period less any bank interest earned from depositing the borrowed funds before being used into banks or any investment income on the temporary investment of those funds. Where funds are borrowed for general purpose, the Group shall determine the amount of interest to be



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

16. Borrowing costs (continued)

capitalized on such borrowings by applying a capitalization rate to the weighted average of the excess amounts of cumulative expenditures on the asset over and above the amounts of specific-purpose borrowings. The capitalization rate shall be the weighted average of the interest rates applicable to the general-purpose borrowings.

During the capitalization period, exchange differences related to the principal and interest on a specific purpose borrowing denominated in foreign currency shall be capitalized. Exchange differences related to general-purpose borrowings denominated in foreign currency shall be included in profit or loss for the current period.

17. Intangible assets

17.1 Intangible assets

Intangible assets include land-use right, patent right, and so on.

An intangible asset shall be initially measured at cost. An intangible asset with an infinite useful life shall be stated at cost less estimated net residual value and any accumulated impairment loss provision and amortized using the straight-line method over its useful life when the asset is available for use. No amortization is made for intangible assets with undeterminable certain useful lives.

The Group shall review the useful life of intangible asset with an infinite useful life and the amortization method applied at least at each period end and make adjustments when necessary.

17.2 Research and development expenditure

Expenditure arising from the research phase is recognized as profit or loss in the current period.

Expenses incurred during the development stage that satisfy the following conditions are recognized as intangible assets, while those that do not satisfy the following conditions are accounted for in the profit or loss for the current period:

- (1) it is technically feasible that the intangible asset can be used or sold upon completion;
- (2) there is intention to complete the intangible asset for use or sale;
- (3) the intangible asset can produce economic benefits, including there is evidence that the products produced using the intangible asset has a market or the intangible asset itself has a market; if the intangible asset is for internal use, there is evidence that there exists usage for the intangible asset;
- (4) there is sufficient support in terms of technology, financial resources and other resources in order to complete the development of the intangible asset, and there is capability to use or sell the intangible asset;
- (5) the expenses attributable to the development stage of the intangible asset can be measured reliably.

If the expenses incurred during the research stage and the development stage cannot be distinguished separately, all development expenses incurred are accounted for in the profit or loss for the current period.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

17. Intangible assets (continued)

17.3 Intangible assets impairment test method and their impairment provision

The Group assesses at each balance sheet date whether there is any indication that any intangible assets with a finite useful life may be impaired. If there is any evidence indicating that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Group shall determine the recoverable amount of the asset group to which the asset belongs. If the recoverable amount of an asset is less than its carrying amount, the reduction is recognized as an impairment loss and charged to profit or loss for the current period.

For intangible assets with undetermined useful lives and intangible assets not ready for use, impairment test is conducted every year no matter indications for impairment exist or not.

An impairment loss recognized on the assets mentioned above shall not be reversed in a subsequent period.

18. Long-term deferred expenses

Long-term deferred expenses are expenditures and other expenses which have incurred but that shall be amortized over the current period and subsequent periods of more than one year. Long-term deferred expenses are amortized evenly over the estimated benefit period.

19. Contingent liabilities

When related obligations of contingencies are the obligations currently assumed by the Group, and that such obligation is likely to result in outflow of economic benefits and the amount of such obligations could be reliably measured, contingent liabilities will be recognized.

As at the balance sheet date, after considering factors such as the risks related to contingencies, uncertainties and time value of currency, contingent liabilities are measured at the best estimate on the expenses necessary for the performance of the related existing obligations. If the impact of the time value of currency is material, best estimate is determined by the amount after discounting the anticipated future cash outflow.

If all or part of the cost necessary for the contingent liabilities is expected to be settled by third party, the amount of settlement, when it is basically certain to be received, is recognized as an asset separately, and the settlement amount recognized shall not be more than the carrying amount of contingent liabilities.

20. Revenue recognition

20.1 Revenue from sales of goods

Revenue is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, will receive the economic benefits associated with the transaction, and can reliably measure the relevant amount of revenue and costs.

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

20. Revenue (continued)

20.2 Revenue from provision of services

When the amount of revenue from provision of services could be measured reliably, the related economic benefits are likely to inflow to the enterprise, the progress of completion of transaction could be reliably determined and costs incurred and to be incurred during the transaction could be reliably measured, realization of revenue from provision of services will be recognized. The Group recognizes related revenue from services in accordance with the percentage of completion as at the balance sheet date. The completion level of service transaction is recognized by the percentage of estimated total cost represented by service cost incurred.

If the result of provision of service transaction cannot be reliably estimated, revenue from provision of service is recognized at the service cost incurred and estimated to receive as compensation, and service cost incurred will be regarded as the current cost. If service cost incurred is compensated as anticipated, no revenue will be recognized.

21. Government grant

Government grants are transfer of monetary assets or non-monetary assets from the government to the Group at no consideration. Government grant shall be recognized when, and only when the related criteria are met.

If a government grant is in the form of a transfer of 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 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 and recognized immediately in profit or loss for the current period.

A government grant related to an asset shall be recognized as deferred income, and evenly amortized to profit or loss over the useful life of the asset.

For a government grant related to income, if the grant is a compensation for related expenses or losses to be incurred 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, the grant shall be recognized immediately in profit or loss for the current period.

For the repayment of a government grant already recognized, if there is any related deferred income, the repayment shall be off set against the carrying amount of the deferred income, and any excess shall be recognized in profit or loss for the current period; if there is no related deferred income, the repayment shall be recognized immediately in profit or loss for the current period.

22. Deferred income tax assets/deferred income tax liabilities

Income tax expense comprises current income tax expense and deferred income tax expense.

22.1 Current income tax

At the balance sheet date, current income tax liabilities (or assets) for the current and prior periods shall be measured at the amount expected to be paid (or recovered) according to the requirements of tax laws.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

22. Deferred income tax assets/deferred income tax liabilities(continued)

22.2 Deferred income tax assets and deferred income tax liabilities

Temporary differences arising from the difference between the carrying amount of an asset or liability and its tax base, and the difference between the tax base and the carrying amount of those items that are not recognized as assets or liabilities but have a tax base that can be determined according to tax laws, shall be recognized as deferred income tax assets and deferred income tax liabilities using the balance sheet liability method.

All temporary differences are generally recognized for relevant deferred income tax. However, for deductible temporary difference, the Group recognizes relevant deferred income tax assets to the extent of income tax payable available for deducting deductible temporary difference. In addition, for those related to the initial recognition of goodwill and does not belong to business combination, and neither affect the accounting profit nor the temporary difference related to the initial recognition of assets or liabilities incurred in transaction of income tax payable (or deductible loss), related deferred income tax assets or liabilities will not be recognized.

The Company recognizes a deferred income tax asset for the carry forward of deductible losses and tax credits to subsequent periods, to the extent that it is probable that future taxable profits will be available against which the deductible losses and tax credits can be utilized.

The Group recognizes deferred income tax liabilities arising from the temporary difference on tax payable related to investment in subsidiaries, associates and joint ventures, unless the Group could control the timing of write back of the temporary difference, and such temporary difference is unlikely to be written back in foreseeable future. For the deductible temporary difference related to investment in subsidiaries, associates and joint ventures, the Group will only recognize deferred income tax assets when temporary difference is likely to be written back in the foreseeable future and income tax payable could be utilized to deduct the deductible temporary difference.

At the balance sheet date, deferred income tax assets and deferred income tax liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, according to the requirements of tax laws.

Current income tax expense (current income tax income) and deferred income tax expense (deferred income tax income) are included in profit or loss for the current period, except for: current income tax and deferred income tax related to transactions or events that are directly recognized in owners' equity, which are recognized directly in owners' equity, and deferred income tax arising from a business combination, which is adjusted against the carrying amount of goodwill.



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

22. Deferred income tax assets/deferred income tax liabilities (continued)

22.2 Deferred income tax assets and deferred income tax liabilities (continued)

At the balance sheet date, the Company shall review the carrying amount of a deferred income tax asset. If it is probable that sufficient taxable profits will not be available in future periods to allow the benefit of the deferred income tax asset to be utilized, the carrying amount of the deferred income tax asset shall be reduced. Any such reduction in amount shall be reversed when it becomes probable that sufficient taxable profits will be available.

After granted the legal rights of net settlement and with the intention to use net settlement or obtain assets, repay debt, the Group, at the same time, records the net amount after offsetting its current income tax assets and current income tax liabilities.

The Group was granted the legal rights of net settlement of current income tax assets and current income tax liabilities. Deferred income tax assets and deferred income tax liabilities are related to income tax to be paid by the same entity liable to pay tax to the same tax collection and management authority or related to different entities liable to pay tax, but the relevant entity liable to pay tax is intended to apply net settlement of current income tax assets and liabilities or, at the same time, obtain assets, repay debt whenever every deferred income tax assets and liabilities with importance would be reversed in the future, the Group records the net amount after offsetting its current income tax assets and current income tax liabilities.

23. Lease

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

23.1 Operating lease business with the Group recorded as lessee

Lease payment for operating lease is recognized as related asset cost or profits and losses for the current period using the straight-line method over the lease term. The initial direct cost is directly accounted in profit or loss for the current period. Contingent rent is recognized as profit or loss for the current period upon occurrence.

23.2 Operating lease business with the Group recorded as lessor

Rental income is recognized in profit or loss for the current period using the straight-line method over the lease term. The initial direct cost where the amount is larger is capitalized when incurred, and accounted for as profit or loss for the current period on the same basis as recognition of rental income over the entire lease period. Contingent rental is accounted for as profit or loss for the period in which it is incurred.



Notes to the Financial Statements

For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

24. Changes in Accounting Policies for Business Combination not under Common Control

| Content and reasons for changes in accounting policies | Name of statement | |
|--|-------------------|------------------|
| | —items affected | Amounts affected |
| <p>24.1 Costs directly related to all items of the occurrence of —business combination</p> <p>Prior to 1 January 2010, for business combination not under common control, costs directly attributable to all items of occurrence of business combination are credited to the combined financial statements as business combination costs, and are recognized as the initial investment costs for long-term equity investment in the company financial statements.</p> <p>According to the requirements under “Business Accounting Standards Explanation No. 4”, since 1 January 2010, in business combination not under common control, intermediate fees such as audit, legal services, assessment and consultation as well as other relevant management fees incurred for business combination are both credited to profit or loss for the current period in the combined financial statements and company financial statements upon occurrence.</p> <p>The Group adopts future appropriate method to compute the above change in accounting policy.</p> | No | Nil |

Notes to the Financial Statements



For the year ended 31 December 2010

II. Significant Accounting Policies, Estimates and Previous Errors of the Company (continued)

25. Other significant accounting policies and estimates of the Company and basis for Preparation of Financial Statements

25.1 Employee Benefits

Except for the compensation for terminating the relationship with employees, in the accounting period in which an employee has rendered services, the Group shall recognize the employee benefits payable as a liability.

The Group participates in social security systems operated by the government. Payments of social security contributions for employees, such as premiums or contributions on pensions, medical insurance, payments of housing funds and other social welfare contributions shall be included in the cost of related assets or profit or loss for the period in which they are incurred.

When the Group terminates the employment relationship with employees before the expiry of the employment contracts or provides compensation as an offer to encourage employees to accept voluntary redundancy, if the Group has a formal plan for termination of employment relationship or has made an offer for voluntary redundancy, which will be implemented immediately, and the Group cannot unilaterally withdraw from the termination plan or the redundancy offer, a compensation liability arising from the termination of employment relationship with employees should be charged to the profit or loss for the current period.

III. Taxation

1. Main tax types and tax rates

| Tax type | Basis of taxing | Tax rate (%) |
|--|--|------------------------------------|
| Value-added Tax | (Note 1) | 17 |
| Business tax | Operation Revenue | 5 |
| Building tax | (Note 2) | (Note 2) |
| Urban maintenance and construction tax | Paid-in value-added tax and business tax | 7 |
| Education surtax | Paid-in value-added tax and business tax | 3 |
| Education surcharge | Paid-in value-added tax and business tax | 1 |
| Deed tax | Transfer price for housing and land use rights | 3–5 |
| Land value increment tax | Increment on transfer of state-owned land use rights, construction on land and its ancillaries | 4-level ultra progressive tax rate |
| Enterprise Income Tax (Note 3) | Taxable income | 15 –25 |



Notes to the Financial Statements

For the year ended 31 December 2010

III. Taxation (continued)

1. Main tax types and tax rates (continued)

Note 1: Value-added tax payable is the balance after output tax minus deductible input. Output tax is calculated at 17% of sales volume calculated under requirements of relevant tax laws. Export commodities are subject to taxation method of "exemption, reduction and rebate".

Note 2: Real estate tax is subject to the tax base of the remaining value of real estate after a one-off reduction of 30% of consumption of the original real estate value, and is subject to a tax rate of 1.2% per annum. For leased housing, the tax base is the rental income for the year, and is subject to a tax rate of 12% per annum.

Note 3: Rate of income tax of the Company and subsidiaries are as follows:

| Names of the Company and subsidiaries | | Rate of income tax |
|--|------------|-----------------------|
| The Company | Note III.2 | 15 |
| Weifang Molong Drilling Equipment Limited (“Molong Drilling Equipment”) | Note III.2 | 25 |
| MPM International Limited | | 16.50 |
| Shouguang Baolong Petroleum Material Company Limited (“Shouguang Baolong”) | | 25 |
| Shouguang Maolong Machinery Company Limited (“Maolong Machinery”) | | 25 |
| Shouguang Molong Electro-mechanical Equipment Company Limited (“Molong Electro-mechanical Equipment”) | | 25 |
| Shouguang Maolong Old Metals Recycle Company Limited (“Maolong Recycle”) | Note III.2 | 25 |
| Weihai Baolong Company Limited (“Weihai Baolong”) | | 25 |
| Wendeng Baolong Recyclable Resource Company Limited (“Baolong Recyclable Resource”) | | 25 |

Notes to the Financial Statements



For the year ended 31 December 2010

III. Taxation (continued)

2. Tax incentives and approvals

| Name | Type of tax | Basis of relevant regulations and policies | Approval authorities | Approval No. | Level of reduction and exemption | Valid period |
|---|------------------------------|---|--|---------------------------|---|------------------------|
| The Company | Business income tax (Note 1) | "Enterprise Income Tax Law of the People's Republic of China" | Technology Office of Shandong Province, Finance Office of Shandong Province, State Administration of Taxation of Shandong Province, Local Taxation Bureau of Shandong Province | Lu Ke Gao Zi [2009] No.12 | Implement the income tax rate of 15% | 2008.01.01 -2010.12.31 |
| Molong Drilling Equipment | Business income tax (Note 2) | "Notice Regarding the Business Taxation Concessionary Policies on Disabled People" | Ministry of Finance, State Administration on Taxation | Cai Shui [2007] No. 92 | When computing the enterprise income tax, the actual salary paid to the disabled would be deducted, and would be deducted additionally according to 100% of the actual salary paid to the disabled | Since 2007.01.01 |
| | Value-added tax (Note 3) | "Notice Regarding Taxation Concessionary Policies on Fostering Employment of Disabled People" | Ministry of Finance, State Administration on Taxation | Cai Shui [2007] No. 92 | Entitled to the limited real-time levy and rebate policy by taxation authorities according to the actual number of disabled people settled with the specific limit on value-added tax refund for each actually settled disabled person up to RMB35,000 per person each year | Since 2007.07.01 |
| Maolong Old Metals Recycle Company Limited | Value-added tax (Note 4) | "Notice Regarding the Policies on Value-added Tax for Recyclable Resources" | Ministry of Finance, State Administration on Taxation | Cai Shui [2008] No. 157 | Entitled to the value-added tax policy of first levy and later refund, realizing a rebate of 70% of value-added tax in 2009 and a rebate of 50% of value-added tax in 2010. After 2010, value-added tax is no longer levied | 2009.01.01 -2010.12.31 |
| Baolong Recyclable Resource Company Limited | Value-added tax (Note 4) | "Notice Regarding the Policies on Value-added Tax for Recyclable Resources" | Ministry of Finance, State Administration on Taxation | Cai Shui [2008] No. 157 | Entitled to the value-added tax policy of first levy and later refund, realizing a rebate of 70% of value-added tax in 2009 and a rebate of 50% of value-added tax in 2010. After 2010, value-added tax is no longer levied | 2009.01.01 -2010.12.31 |



Notes to the Financial Statements

For the year ended 31 December 2010

III. Taxation (continued)

2. Tax incentives and approvals (continued)

- Note 1:* On 16 January 2009, upon the approval and reply of Technology Office of Shandong Province, Finance Office of Shandong Province, State Administration of Taxation of Shandong Province and Local Taxation Bureau of Shandong Province on Lu Ke Gao Zi [2009] No. 12(科高字[2009]12號文), the Company was awarded the Advanced Technology Enterprise Certificate (No.: GR200837000307). According to the requirements under "Enterprise Income Tax Law of People's Republic of China" (《中華人民共和國企業所得法》), the Company was subject to an enterprise income tax rate of 15% since 1 January 2008.
- Note 2:* According to the requirements under "Cai Shui [2007] No. 92 Notice Regarding Taxation Concessionary Policies on Fostering Employment of Disabled People" ([2007]92號文《於促疾人就業收優惠政策的通知》) issued by the Ministry of Finance and State Administration of Taxation, since 1 July 2007, when computing the enterprise income tax of Molong Drilling Company, the actual salary paid to the disabled would be deducted, and would be deducted additionally according to 100% of the actual salary paid to the disabled, while the resulting value-added tax rebates or the income after business tax reduction were exempted from enterprise income tax. °
- Note 3:* Molong Drilling Company is a social welfare enterprise. According to the requirements under "Cai Shui [2007] No. 92 Notice Regarding Taxation Concessionary Policies on Fostering Employment of Disabled People" ([2007]92號文《於促疾人就業收優惠政策的通知》) issued by the Ministry of Finance and State Administration of Taxation, since 1 July 2007, Molong Drilling Company was entitled to the limited real-time levy and rebate policy by taxation authorities according to the actual number of disabled people settled as "the income gained from production and sales of commodities or the service of processing, repair and maintenance accounted for 50% of the sum of income from value-added-tax business and business-tax business", with the specific limit on value-added tax refund for each actually settled disabled person up to RMB35,000 per person each year.
- Note 4:* According to the requirements under "Cai Shui [2008] No. 157 "Notice Regarding the Policies on Value-added Tax for Recyclable Resources" ([2008]157號《於再生源增值政策的通知》) issued by the Ministry of Finance and State Administration of Taxation, since 1 January 2009 to the end of 2010, Maolong Reycle Company and Baolong Resources Company were entitled to the value-added tax policy of first levy and later refund, realizing a rebate of 70% of value-added tax in 2009 and a rebate of 50% of value-added tax in 2010. After 2010, value-added tax is no longer levied.

Notes to the Financial Statements



For the year ended 31 December 2010

IV. Merger of Companies and Consolidated Financial Statement

1. Subsidiaries

(1) Subsidiaries acquired through establishment or investment

| Full Name of Subsidiaries (Note 3) | Type | Registered Address | Business Nature | Registered Capital | Scope of Business | Actual capital contribution at the year | Other balance items which constitute net investment in subsidiaries | Proportion of Shareholding (%) | Proportion of Voting Right (%) | Whether consolidated | Minority interest | RMB | |
|------------------------------------|---------------------------------|-----------------------------------|-----------------|--------------------|--|---|---|--------------------------------|--------------------------------|----------------------|-------------------|--|-----|
| | | | | | | | | | | | | Amount in minority interests used to write down the losses of minority interests | |
| Molong Drilling Equipment (Note 1) | LLC (Legal entity wholly-owned) | Shouguang City, Shandong Province | Manufacture | 6,000,000.00 | Manufacture and sales of oil-well pump, petroleum extraction machinery and spare parts | 6,397,082.50 | — | 100 | 100 | Yes | Nil | Nil | Nil |
| Shouguang Baolong (Note 2) | LLC | Shouguang City, Shandong Province | Manufacture | 150,000,000.00 | Manufacture and sales of petroleum equipment | 105,000,000.00 | — | 70 | 70 | Yes | 56,099,071.75 | Nil | Nil |

Note 1: Molong Drilling Company was established as a social welfare enterprise on 29 September 2004, of which the Company contributed a capital of RMB5,400,000.00, accounting for 90% of its equity capital; People's Government of Shangkou Town, Shouguang City, Shandong Province contributed a capital of RMB600,000.00, accounting for 10% of its equity capital.

On 30 June 2007, according to the equity transfer agreement signed by the Company and People's Government of Shangkou Town, Shouguang City, Shandong Province, the Company acquired 10% of equity interests in Molong Drilling Company at RMB7,340,000.00. Molong Drilling Company convened a general meeting in August 2007 and resolved to allocate all accumulated and unallocated profit as at 31 December 2006 to the Company, and the Company has written down the long-term equity investment at 10% proportion. As at 31 December 2010, the Company held 100% equity interests in Molong Drilling Company.

Note 2: On 28 April 2007, the Company and Weifang Shengcheng Investment and Management Company Limited (hereunder "Shengcheng Investment Company") signed the "promoter agreement" to jointly invest and establish Shouguang Baolong, of which the Company contributed cash of RMB105,000,000.00, representing 70% of its equity capital, and Shengcheng Investment Company contributed cash of RMB12,600,000.00 and land use rights valued RMB32,400,000.00 (area of 120,105sq. m), representing 30% of its equity capital. The land use rights contributed by Shengcheng Investment Company to Shouguang Baolong was transferred from Maolong Machinery Company (Maolong Machinery Company became the subsidiary of the Company since 31 December 2007), the related party of the Company to Shengcheng Investment Company on 5 January 2007 at RMB9,000,000.00. According to Shou Lu Hui Ping Zi [2007] No. 56 "Assets Valuation Report" (壽魯會評字[2007]第56號《資產評估報告》), the land use rights were revalued on 15 September 2007 as RMB32,400,000.00. As at 25 September 2007, the above contributions have been imputed, and verified by 壽光魯東有限責任會計師事務所, which issued Shou Lu Hui Yan [2007] No. 105 Assets Examination Report (壽魯會驗[2007]第105號驗資報告)。

Note 3: Subsidiaries of the Company have not issued any security during the current year.



Notes to the Financial Statements

For the year ended 31 December 2010

IV. Merger of Companies and Consolidated Financial Statement (continued)

1. Subsidiaries (continued)

(2) Subsidiaries acquired through business consolidation not under common control

| Full Name of Subsidiaries (Note 7) | Type | Registered Address | Business Nature | Registered Capital | Scope of business | Actual capital contribution at the end of the year | Other balance items which actually constitute net investment in subsidiaries | Proportion of Shareholding (%) | Proportion of Voting Right (%) | Whether consolidated | Minority interests | Amount in minority interests used to write down the losses of minority interests |
|---|----------------------------------|------------------------------|-----------------|--------------------|--|--|--|--------------------------------|--------------------------------|----------------------|--------------------|--|
| Shouguang Maolong Machinery Company Limited (Note 1) | LLC (Legal entity wholly-owned) | Shouguang, Shandong Province | Manufacture | RMB12,380,000.00 | Manufacture and sales of petroleum equipment and accessories, high-voltage isolating switch, voltage electrical appliances and complete equipment, processing and sales of alloy accessories | RMB3267,43,681.73 | — | 100 | 100 | Yes | Nil | Nil |
| Molong Electromechanical Equipment Company Limited (Note 2) | LLC (Sino-foreign joint venture) | Shouguang, Shandong Province | Manufacture | USD 1,000,000.00 | Manufacture and sales of outer thickening oil well tubing and electrical complete equipment | RMB15,011,813.88 | — | 100 | 100 | Yes | Nil | Nil |
| Shouguang Maolong Old Metals Recycle Company Limited (Note 3) | LLC | Shouguang, Shandong Province | Trade | RMB500,000.00 | Trading of scrap metals | RMB500,000.00 | — | 100 | 100 | Yes | Nil | Nil |
| Weihai Baogong Company Limited (Note 4) | LLC | Weihai, Shandong Province | Manufacture | RMB10,000,000.00 | Manufacture and sales of special petroleum metal materials | RMB59,602,708.10 | — | 100 | 100 | Yes | Nil | Nil |
| Baogong Recyclable Resource Company Limited (Note 5) | LLC | Weihai, Shandong Province | Manufacture | RMB300,000.00 | Purchase and sales of scrap metals | RMB271,156.08 | — | 100 | 100 | Yes | Nil | Nil |
| MPM International Limited (Note 6) | LLC | Hong Kong, PRC | Trade | USD 1,000,000.00 | Acquisition and sales of petroleum extraction and chemical machinery electric equipment | RMB7,276,230.00 | — | 90 | 90 | Yes | 1,113,302.05 | Nil |

Notes to the Financial Statements



For the year ended 31 December 2010

IV. Merger of Companies and Consolidated Financial Statement (continued)

1. Subsidiaries (continued)

(2) Subsidiaries acquired through business consolidation not under common control (continued)

Note 1: Maolong Machinery Company was invested and established by Molong Holdings and 12 natural persons (including some shareholders of the Company) on 1 August 2000. On 2 March 2001, Molong Holdings signed an agreement with Mr. Zhang Yun Qi to transfer all of its equity interests in Maolong Machinery Company to Mr. Zhang Yun Qi. On 25 September 2007, according to the equity transfer agreement signed by the Company and all shareholders of Maolong Machinery Company, the Company acquired 100% equity interests in Maolong Machinery Company at a consideration of RMB305,000,000.00.

Note 2: Molong Electro-mechanical Equipment Company is a sino-foreign equity joint venture jointly invested and established by Maolong Machinery Company and Mr. Luke Fang, an independent third party, of which Mr. Luke Fang held 45% of its equity capital and Maolong Machinery Company held 55% of its equity capital. On 2 August 2006, according to the equity transfer agreement signed by Maolong Machinery Company and Mr. Luke Fang, Maolong Machinery Company acquired 20% equity interests in Molong Electro-mechanical Equipment Company at RMB2,225,848.00. On 30 December 2006, according to the equity transfer agreement signed by MPM Company and Mr. Luke Fang, MPM Company acquired 25% equity interests in Molong Electro-mechanical Equipment Company at RMB8,240,711.00.

Note 3: Maolong Recycle Company was established on 13 December 2002 with limited liability, of which Maolong Machinery Company holds 90% of its equity capital and the Company holds 10% of its equity capital.

Note 4: Weihai Baolong Company was jointly invested and established with limited liability by 4 natural person shareholders on 26 November 2003. According to the equity transfer agreement signed by Maolong Machinery Company, Molong Electro-mechanical Equipment Company and 4 natural person shareholders of Weihai Baolong Company on 28 July 2005, Maolong Machinery Company and Molong Electro-mechanical Equipment Company jointly acquired all equity interests in Weihai Baolong Company, of which Maolong Machinery Company holds 95% of its equity interests and Molong Electro-mechanical Equipment Company holds 5% of its equity interests.

Note 5: Baolong Resources Company was jointly invested and established with limited liability by 2 natural person shareholders on 2 August 2004. According to the equity transfer agreement signed by Maolong Machinery Company, Weihai Baolong Company and 2 natural person shareholders of Baolong Resources Company on 4 August 2005, Maolong Machinery Company and Weihai Baolong Company jointly acquired all equity interests in Baolong Resources Company, of which Maolong Machinery Company holds 95% of its equity interests and Weihai Baolong Company holds 5% of its equity interests.

Note 6: On 24 May 2004, Jade Nominees Limited established Molong (Asia) Holding Limited in Hong Kong with an authorized capital of HKD 10,000, issued capital of HKD 1 and 1 share in issue.

On 28 March 2005, upon approval by Office for Foreign Trading and Economic Co-operation of Shandong Province (山東省對外貿易經濟合作廳) with Lu Wai Jing Mao Jing Wai [2005] No. 125 (魯外經貿境外[2005]125號文), it was intended to transfer the shares in Molong (Asia) Holding Limited held by Jade Nominees Limited to the Company.

On 15 May 2005, Molong (Asia) Holding Limited convened its first Board meeting and passed the following resolutions: Jade Nominees Limited would transfer its shares in Molong (Asia) Holding Limited to the Company; authorized number of shares would be increased to 7,990,000 shares of HKD 1 each and the authorized capital would be increased to HKD8,000,000; number of shares in issue would be increased to 7,799,999 shares of HKD 1 each and share capital in issue would be increased to HKD 7,800,000. Under which, the Company subscribed for 90% of the share capital, and Maolong Machinery Company, the related party of the Company, subscribed for the remaining 10% of the share capital.

On 12 May 2006, special resolution was passed on the board meeting of Molong (Asia) Holdings Limited, in which the name of the Company was changed into MPM International Limited.

On 26 January 2007, according to the equity transfer agreement between Molong Machinery Company and Shengcheng Investment Company, Molong Machinery Company sold 10% of stock rights of MPM which was held by it to Shengcheng Investment Limited with HK\$780,000,000.



Notes to the Financial Statements

For the year ended 31 December 2010

IV. Merger of Companies and Consolidated Financial Statement (*continued*)

1. Subsidiaries (*continued*)

(2) Subsidiaries acquired through business consolidation not under common control (*continued*)

On 12 May 2006, the board of directors of Molong (Asia) Holding Limited passed a special resolution to change the name of Molong (Asia) Holding Limited to MPM INTERNATIONAL LIMITED.

On 26 January 2007, according to the equity transfer agreement signed by Maolong Machinery Company and Shengcheng Investment Company, Maolong Machinery Company sold its 10% equity interests in MPM Company to Shengcheng Investment Company at HKD 780,000.00.

Note 7: Subsidiaries of the Company have not issued any securities during the year.

2. Exchange Rate for Major Statement Items of Foreign Operating Entities

When the Company prepared these combined financial statements, all assets and liabilities items within MPM Company's (operated overseas) balance sheet were exchanged at the rate of USD1: RMB6.6227; all items within income statement and items that reflect the amount incurred by profit allocation were exchanged at the rate of USD1: RMB6.7255.

V. Notes to the Financial Statements

1. Cash & cash equivalents

Consolidation

| Item | Closing balance | | | Opening balance | | |
|--|-------------------------|---------------|-----------------------|-------------------------|---------------|-----------------------|
| | Foreign currency amount | Exchange Rate | Amount in RMB | Foreign currency amount | Exchange Rate | Amount in RMB |
| Cash: | | | | | | |
| RMB | 353,112.99 | 1.0000 | 353,112.99 | 199,283.81 | 1.0000 | 199,283.81 |
| Cash in Bank: | | | | | | |
| RMB | 629,524,833.01 | 1.0000 | 629,524,833.01 | 118,662,572.49 | 1.0000 | 118,662,572.49 |
| USD | 813,920.62 | 6.6227 | 5,385,617.68 | 397,060.54 | 6.8282 | 2,711,208.79 |
| HKD | 17,368.05 | 0.8509 | 14,788.49 | 19,805.67 | 0.8805 | 17,418.09 |
| EURO | 100.32 | 8.8065 | 883.47 | 117.32 | 9.7971 | 1,149.40 |
| Other cash and cash equivalents (<i>note</i>): | | | | | | |
| RMB | 257,007,354.29 | 1.0000 | 257,007,354.29 | 183,917,862.96 | 1.0000 | 183,917,862.96 |
| Total | | | 892,286,589.93 | | | 305,509,495.54 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

1. Cash & cash equivalents (continued)

The Company

| Item | Closing balance | | | Opening balance | | |
|--|-------------------------------|---------------|-----------------------|-------------------------------|---------------|-----------------------|
| | Foreign currency amount | Exchange Rate | Amount in RMB | Foreign currency amount | Exchange Rate | Amount in RMB |
| Cash: | | | | | | |
| RMB | 248,496.92 | 1.0000 | 248,496.92 | 57,140.39 | 1.0000 | 57,140.39 |
| Cash in Bank: | | | | | | |
| RMB | 596,980,452.13 | 1.0000 | 596,980,452.13 | 99,488,413.72 | 1.0000 | 99,488,413.72 |
| USD | 668,180.25 | 6.6227 | 4,420,422.93 | 246,166.96 | 6.8282 | 1,680,877.24 |
| HKD | 11,727.19 | 0.8509 | 9,979.02 | 11,724.81 | 0.8805 | 10,323.46 |
| EURO | 100.32 | 8.8065 | 883.47 | 117.32 | 9.7971 | 1,149.40 |
| Other cash and cash equivalents (note): | | | | | | |
| RMB | 235,507,354.29 | 1.0000 | 235,507,354.29 | 183,917,862.96 | 1.0000 | 183,917,862.96 |
| Total | | | 837,167,588.76 | | | 285,155,767.17 |

Note 1: As at 31 December 2010, other monetary capital of the Group and the Company represented guarantee on bank promissory notes and guarantee on loans. As at 31 December 2009, other monetary capital of the Group and the Company represented guarantee on bank's promissory notes.

As at 31 December 2010, the Group and the Company had restricted bank promissory notes with maturity over 3 months of RMB112,341,458.60 and RMB102,341,458.60 respectively. Both the Group and the Company had guarantee on loans with maturity over 3 months of RMB25,720,000.00. As at 31 December 2009, both of the Group and the Company had restricted bank promissory notes with maturity over 3 months of RMB79,388,416.84.

2. Bills receivable

(1) Classification of bills receivable

| Item | Consolidated | | The Company | |
|-----------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Bank acceptance | 19,120,729.91 | 34,631,397.12 | 11,570,729.91 | 20,261,397.12 |

RMB



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

2. Bills receivable (continued)

- (2) As at 31 December 2010, the breakdown for bills endorsed to other parties but undue were as follows:
Consolidation and the Company

| Name of Ticket Units | Date of draft | Due date | RMB Amount |
|---|---------------|------------|---------------|
| Liaohu oil survey materials company | 2010-10-22 | 2011-04-20 | 6,120,000.00 |
| Liaocheng Shandong Zhong Ganglian Steel Metal Manufacturing Co., Ltd | 2010-08-03 | 2011-02-03 | 6,000,000.00 |
| Shanxi Yanchang Petroleum Co., Ltd | 2010-11-24 | 2011-05-24 | 5,000,000.00 |
| Shandong huaxia group Co., LTD | 2010-09-17 | 2011-03-17 | 5,000,000.00 |
| Ordos city Xinhe industry and trade Co., LTD | 2010-07-29 | 2011-01-29 | 5,000,000.00 |
| Total | | | 27,120,000.00 |

- (3) Balance of bills payable in the current reporting period does not have any amount due to bill of shareholders with over 5% (inclusive) voting rights in the Company.
- (4) During the current year, the Group has accumulatively discounted promissory notes of RMB68,244,972.00 to the bank (previous year: the Group and the Company have accumulatively discounted promissory notes of RMB594,463,200.83 and RMB191,331,454.17 to the bank respectively). The Group derecognized the discounted bills receivable of RMB68,244,972.00 (previous year: the Group and the Company have derecognized the discounted bills receivable of RMB594,463,200.83 and RMB191,331,454.17 to the bank respectively). Discounting fees incurred amounted to RMB1,034,174.46 (previous year: discounting fees incurred by the Group and the Company amounted to RMB4,427,064.52 and RMB1,558,811.18 respectively).

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

3. Accounts receivable

Consolidation

(1) The breakdown of accounts receivable according to classification is as follows:

| Category | Closing balance | | | | Opening balance | | | | RMB |
|---|-----------------------|---------------|---------------------|-------------|-----------------------|---------------|---------------------|-------------|-----|
| | Book balance | | Bad debt provision | | Book balance | | Bad debt provision | | |
| | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) | |
| Single item with significant accounts receivables and provided for bad debt by single item | 8,553,843.19 | 1.68 | 6,499,598.96 | 75.98 | 25,001,963.23 | 5.41 | 6,499,598.96 | 26.00 | |
| Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item | 498,813,395.82 | 98.26 | — | — | 436,606,816.49 | 94.42 | — | — | |
| Single item with insignificant accounts receivables but provided for bad debt by single item | 289,713.72 | 0.06 | 289,713.72 | 100.00 | 803,480.53 | 0.17 | 803,480.53 | 100.00 | |
| Total | 507,656,952.73 | 100.00 | 6,789,312.68 | 1.34 | 462,412,260.25 | 100.00 | 7,303,079.49 | 1.58 | |

The Group recognized the accounts receivable over RMB3,000,000.00 (including RMB3,000,000.00) as single item with significant accounts receivable.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

Consolidation (continued)

- (1) Prior to the acceptance of new customers, the Group applies internal credit assessment policies to assess the credit quality of potential customers and formulates credit limit. Apart from requiring new customers to pay in advance, the Group formulates different credit policies according to different customers. The credit period is generally three months, and can be extended to six months for major customers. Aging analysis of accounts receivable is as follows:

| Aging | Closing balance | | | | Opening balance | | | | RMB |
|---------------|-----------------------|---------------|---------------------|-----------------------|-----------------------|---------------|---------------------|-----------------------|-----|
| | Amount | Ratio (%) | Bad debt | | Amount | Ratio (%) | Bad debt | | |
| | | | provision | Book value | | | provision | Book value | |
| Within 1 year | 469,500,329.21 | 92.48 | — | 469,500,329.21 | 404,034,545.67 | 87.38 | — | 404,034,545.67 | |
| 1 to 2 years | 16,100,799.42 | 3.17 | — | 16,100,799.42 | 56,260,257.91 | 12.17 | 6,499,137.99 | 49,761,119.92 | |
| 2 to 3 years | 20,708,830.99 | 4.08 | 6,576,638.96 | 14,132,192.03 | 1,290,392.13 | 0.28 | 527.90 | 1,289,864.23 | |
| Over 3 years | 1,346,993.11 | 0.27 | 212,673.72 | 1,134,319.39 | 827,064.54 | 0.17 | 803,413.60 | 23,650.94 | |
| Total | 507,656,952.73 | 100.00 | 6,789,312.68 | 500,867,640.05 | 462,412,260.25 | 100.00 | 7,303,079.49 | 455,109,180.76 | |

The Group judges whether the above accounts receivable with credit term past but no impairment provision made are recoverable according to historical payment record and creditability.

As at 31 December 2010, single item with insignificant accounts receivable but provided for bad debt in single item is as follows:

| Accounts receivable | Book balance | Bad debt balance | Provision ratio (%) | Reason | RMB |
|---------------------|--------------|------------------|---------------------|---|-----|
| Trade receivable | 289,713.72 | -289,713.72 | 100.00 | Aged over two years, difficult to recover | |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

Consolidation (continued)

(2) Situation of write-back or recovery during the current year

| RMB | | | | |
|---------------------|--|--|--|----------------------------------|
| Accounts receivable | Reason for write-back or recovery | Basis for determination of original bad debt provision | Accumulated amount of bad debt provision before write-back or recovery | Amount written-back or recovered |
| Trade receivable | Amount recovered or repayment agreement signed | Relatively long aged, difficult to recover | 803,480.53 | 513,766.81 |

(3) The Group and the Company did not have other receivables from shareholder units holding 5% (including 5%) or more shares in the Company.

(4) Top 5 accounts receivable are set out as follows:

| RMB | | | | |
|--|-------------------------------|----------------|---------------|--|
| Name | Relationship with the Company | Amount | Aging | Percentage of the total balance of accounts receivable (%) |
| SB International Inc | customer | 80,255,861.71 | Within 1 year | 15.81 |
| China National Petroleum Corporation — Changqing Oil Field | customer | 34,540,017.82 | Within 1 year | 6.80 |
| Campex Inc | customer | 31,467,324.14 | Within 1 year | 6.20 |
| Mitsui & CO.,LTD. | customer | 24,032,252.10 | Within 1 year | 4.73 |
| Daqing Oil Field Petroleum Materials Group | customer | 21,873,370.80 | Within 1 year | 4.31 |
| Total | | 192,168,826.57 | | 37.85 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

Consolidation (continued)

(5) Situation on accounts due from related parties:

| Name | Relationship with the Company | Amount | RMB Proportion of the total accounts receivables (%) |
|---|-------------------------------|--------------|---|
| Kelamayi Ya Long Oil Pump Company Limited ("Yalong Oil Pump") | Related company | 2,576,611.00 | 0.51 |

(6) Pledge on accounts receivable:

As at 31 December 2010, RMB14,719,160.20 and RMB21,452,067.00 of accounts receivable were pledged as borrowings of RMB14,719,160.20 and RMB21,452,067.00 of the Company from China Merchants Bank Co., Ltd. and China Construction Bank Corporation (outward documentary bill). These pledges will expire between 13 January 2011 and 21 February 2011 respectively. RMB100,000,000.00 of accounts receivable was pledged as a borrowing of RMB100,000,000.00 of the Company from China Construction Bank Corporation (factoring agreement). These pledges will expire between 4 March 2011 and 18 May 2011 respectively.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

The Company

(1) The breakdown of accounts receivable according to classification is as follows:

| Category | Closing balance | | | | Opening balance | | | | RMB |
|---|-----------------|-----------|--------------------|-----------|-----------------|-----------|--------------------|-----------|-----|
| | Book balance | | Bad debt provision | | Book balance | | Bad debt provision | | |
| | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) | |
| Single item with significant accounts receivable and provided for bad debt by single item | 8,553,843.19 | 1.71 | 6,499,598.96 | 75.98 | 25,001,963.23 | 5.70 | 6,499,598.96 | 26.00 | |
| Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item | 493,046,705.41 | 98.28 | — | — | 413,209,280.74 | 94.17 | — | — | |
| Single item with insignificant accounts receivables but provided for bad debt in single item | 69,255.56 | 0.01 | 69,255.56 | 100.00 | 583,022.37 | 0.13 | 583,022.37 | 100.00 | |
| Total | 501,669,804.16 | 100.00 | 6,568,854.52 | 1.31 | 438,794,266.34 | 100.00 | 7,082,621.33 | 1.61 | |

The Group recognized the accounts receivable over RMB3,000,000.00 (including RMB3,000,000.00) as single item with significant accounts receivable.

Prior to the acceptance of new customers, the Group applies internal credit assessment policies to assess the credit quality of potential customers and formulates credit limit. Apart from requiring new customers to pay in advance, the Group formulates different credit policies according to different customers. The credit period is generally three months, and can be extended to six months for major customers. Aging analysis of accounts receivable is as follows:

| Aging | Closing balance | | | | Opening balance | | | | RMB |
|---------------|-----------------|-----------|--------------------|----------------|-----------------|-----------|--------------------|----------------|-----|
| | Amount | | Bad debt provision | | Amount | | Bad debt provision | | |
| | Amount | Ratio (%) | provision | Book value | Amount | Ratio (%) | provision | Book value | |
| Within 1 year | 466,102,190.11 | 92.91 | — | 466,102,190.11 | 388,349,766.78 | 88.50 | — | 388,349,766.78 | |
| 1 to 2 years | 14,760,879.44 | 2.94 | — | 14,760,879.44 | 48,751,132.95 | 11.11 | 6,499,137.99 | 42,251,994.96 | |
| 2 to 3 years | 19,603,159.66 | 3.91 | 6,499,548.96 | 13,103,560.70 | 1,086,760.23 | 0.25 | 527.90 | 1,086,232.33 | |
| Over 3 years | 1,203,574.95 | 0.24 | 69,255.56 | 1,134,319.39 | 606,606.38 | 0.14 | 582,955.44 | 23,650.94 | |
| Total | 501,669,804.16 | 100.00 | 6,568,854.52 | 495,100,949.64 | 438,794,266.34 | 100.00 | 7,082,621.33 | 431,711,645.01 | |

The Group judges whether the above accounts receivable with credit term past but no impairment provision made are recoverable according to historical payment record and creditability.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

The Company (continued)

As at 31 December 2010, single item with insignificant accounts receivable but provided for bad debt in single item is as follows:

| Accounts receivable | Book balance | Bad debt balance | Provision ratio (%) | Reason for provision |
|----------------------------|---------------------|-------------------------|----------------------------|---|
| Trade receivable | 69,255.56 | 69,255.56 | 100.00 | Aged over three years, difficult to recover |

RMB

(2) Situation of write-back or recovery during the current year

| Accounts receivable | Reason for write-back or recovery | Basis for determination of original bad debt provision | Accumulated amount of bad debt provision before write-back or recovery | Amount written-back or recovered |
|----------------------------|--|---|---|---|
| Trade receivable | Amount recovered or repayment agreement signed | Relatively long aged, difficult to recover | 803,480.53 | 513,766.81 |

RMB

(3) The Group and the Company did not have other receivables from shareholder units holding 5% (including 5%) or more shares in the Company.

(4) Amounts of top five accounts receivable are the same as notes to combined financial statements.

(5) Amounts due from related parties are the same as notes to combined financial statements

(6) Pledge on accounts receivable are the same as notes to combined financial statements.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

4. Advance payment

Consolidation

(1) Advance to suppliers stated according to aging:

| Aging | Closing balance | | Opening balance | |
|---------------|-----------------|-----------|-----------------|-----------|
| | Amount | Ratio (%) | Amount | Ratio (%) |
| Within 1 year | 158,298,872.41 | 99.81 | 53,980,492.35 | 98.84 |
| 1 to 2 years | 201,885.93 | 0.13 | 345,755.09 | 0.63 |
| 2 to 3 years | — | — | 136.00 | — |
| Over 3 years | 100,754.22 | 0.06 | 288,780.56 | 0.53 |
| Total | 158,601,512.56 | 100.00 | 54,615,164.00 | 100.00 |

(2) Top 5 advance to suppliers are set out as follows:

| Name | Relationship with the Company | Amount | Aging | Reasons |
|--|-------------------------------|----------------|---------------|--------------------------|
| | | | | |
| Zibo Iron Eagle Steel Co., LTD | Supplier | 8,684,827.34 | Within 1 year | hasn't received material |
| Shouguang Shandong Xinyude Industry and Trade Co., Ltd | Supplier | 8,630,000.00 | Within 1 year | hasn't received material |
| Linqu Chengye Steel Trade Co., LTD | Supplier | 6,029,501.00 | Within 1 year | hasn't accepted labour |
| Shouguang Shihua Natural Gas Company Limited | Supplier | 1,604,115.94 | Within 1 year | hasn't received material |
| Total | | 143,761,074.12 | | |

(3) The Group and the Company had no outstanding amount within the advance to suppliers due from shareholders holding 5% or more (including 5%) in the shares of the Company at the end of the year.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

4. Advance payment (continued)

Consolidation (continued)

(4) The breakdown of advance to suppliers according to customer's classification is as follows:

| Category | Closing balance | | Opening balance | |
|--|-----------------|-----------|-----------------|-----------|
| | Amount | Ratio (%) | Amount | Ratio (%) |
| Single item with significant other Advance payment | 142,156,958.18 | 89.63 | 20,516,302.03 | 37.57 |
| Single item without significant Advance payment but considered to be greater risks after arrived at by credit risk characteristics | 302,640.15 | 0.19 | 634,671.65 | 1.16 |
| Other items without significant other | 16,141,914.23 | 10.18 | 33,464,190.32 | 61.27 |
| Total | 158,601,512.56 | 100.00 | 54,615,164.00 | 100.00 |

The Group recognized the other receivables over RMB3,000,000.00 (including RMB3,000,000.00) as single item with significant other receivables.

Single item with insignificant repayment but considered to have significant risk after arrived at by credit risk characteristics is single item with insignificant prepayment but aged over one year.

(5) Balance of prepayment does not have any prepayment to related parties.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

4. Advance payment (continued)

The Company

(1) Advance to suppliers stated according to aging:

| Aging | Closing balance | | Opening balance | | RMB |
|---------------|-----------------------|---------------|----------------------|---------------|-----|
| | Amount | Ratio (%) | Amount | Ratio (%) | |
| Within 1 year | 101,360,039.61 | 99.79 | 36,892,142.65 | 99.04 | |
| 1 to 2 years | 201,885.93 | 0.20 | 331,043.37 | 0.89 | |
| 2 to 3 years | — | — | 132.00 | — | |
| Over 3 years | 10,683.61 | 0.01 | 27,709.61 | 0.07 | |
| Total | 101,572,609.15 | 100.00 | 37,251,027.63 | 100.00 | |

(2) Top 5 advance to suppliers are set out as follows:

| Name | Relationship with the Company | Amount | Aging | Reasons | RMB |
|--|-------------------------------|----------------------|---------------|--------------------------|-----|
| | | | | | |
| Shouguang Baolong Company Limited | Subsidiary | 49,077,015.70 | Within 1 year | hasn't received material | |
| Weihai Baolong Company Limited | Subsidiary | 42,880,150.69 | Within 1 year | hasn't received material | |
| Shouguang Shihua Natural Gas Company Limited | Supplier | 1,604,115.94 | Within 1 year | hasn't received material | |
| Weifang Gangtong Customs Brokers Co., Ltd | Supplier | 1,564,310.54 | Within 1 year | hasn't accepted labour | |
| THERMO MONITORING & ANALYSIS GROUP LIMITED | Supplier | 1,158,099.50 | Within 1 year | hasn't received material | |
| Total | | 96,283,692.37 | | | |

(3) The Group and the Company had no outstanding amount within the advance to suppliers due from shareholders holding 5% or more (including 5%) in the shares of the Company at the end of the year.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

4. Advance Payment (continued)

The Company (continued)

(4) The breakdown of advance to suppliers according to customer's classification is as follows:

| Category | Closing balance | | Opening balance | |
|--|-----------------------|---------------|----------------------|---------------|
| | Amount | Ratio (%) | Amount | RMB Amount |
| Single item with significant other Advance payment | 91,957,166.39 | 90.53 | 12,513,000.60 | 33.59 |
| Single item without significant Advance payment but considered to be greater risks after arrived at by credit risk characteristics | 212,569.54 | 0.21 | 358,884.98 | 0.96 |
| Other items without significant other | 9,402,873.22 | 9.26 | 24,379,142.05 | 65.45 |
| Total | 101,572,609.15 | 100.00 | 37,251,027.63 | 100.00 |

The Group recognized the other receivables over RMB3,000,000.00 (including RMB3,000,000.00) as single item with significant other receivables.

Single item with insignificant prepayment but considered to have significant risk after arrived at by credit risk characteristics is single item with insignificant prepayment but aged over one year.

(5) Prepayments to related parties are as follows:

| Name | Relationship with the Company | Amount | RMB |
|-------------------|-------------------------------|----------------------|---|
| | | | Proportion of the total advance payment (%) |
| Shouguang Baolong | Subsidiary | 49,077,015.70 | 48.32 |
| Weihai Baolong | Subsidiary | 42,880,150.69 | 42.21 |
| Total | | 91,957,166.39 | 90.53 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

5. Dividends receivable

Consolidation

| Item | Opening balance | Additions for the period | Deductions for the period | Closing balance | Reason for no recovery | RMB |
|--|-----------------|--------------------------|---------------------------|-----------------|--|--------------------------------------|
| | | | | | | Whether relevant amount has impaired |
| Dividends receivable whit aging within 1 year including: Kelamayi Ya Long Oil Pump Company Limited ("Yalong Oil Pump") | — | 150,000.00 | — | 150,000.00 | | |
| | — | 150,000.00 | — | 150,000.00 | Dividends declared but not distributed | No |
| Total | — | 150,000.00 | — | 150,000.00 | | |

6. Other receivables

Consolidation

(1) The breakdown of accounts receivable according to classification is as follows:

| Category | Closing balance | | | | Opening balance | | | |
|---|-----------------|-----------|--------------------|-----------|-----------------|-----------|--------------------|-----------|
| | Book balance | | Bad debt provision | | Book balance | | Bad debt provision | |
| | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) |
| Single item with significant other receivables and provided for bad debt in single item | — | — | — | — | — | — | — | — |
| Single item with insignificant other receivables and single item with significant other receivables but not impaired after separate impairment test | 30,281,650.63 | 99.61 | — | — | 24,369,143.50 | 99.51 | — | — |
| Single item with insignificant other receivables but provided for bad debt in single item | 119,119.25 | 0.39 | 119,119.25 | 100.00 | 119,119.25 | 0.49 | 119,119.25 | 100.00 |
| Total | 30,400,769.88 | 100.00 | 119,119.25 | 0.39 | 24,488,262.75 | 100.00 | 119,119.25 | 0.49 |

The Group recognized the other receivables over RMB2,000,000.00 (including RMB2,000,000.00) as single item with significant other receivables.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

6. Other receivables

Consolidation (continued)

Aging analysis of accounts receivable is as follows:

| Aging | Amount | Closing balance | | | Opening balance | | | | RMB |
|---------------|----------------------|-----------------|-------------------|----------------------|----------------------|---------------|-------------------|----------------------|-----|
| | | Ratio (%) | Bad debt | | Amount | Ratio (%) | Bad debt | | |
| | | | balance | Book Value | | | balance | Book Value | |
| Within 1 year | 23,434,196.12 | 77.08 | — | 23,434,196.12 | 21,263,148.55 | 86.83 | — | 21,263,148.55 | |
| 1 to 2 years | 4,322,190.74 | 14.22 | — | 4,322,190.74 | 2,179,318.88 | 8.90 | — | 2,179,318.88 | |
| 2 to 3 years | 2,149,853.50 | 7.07 | — | 2,149,853.50 | 275,722.27 | 1.13 | — | 275,722.27 | |
| Over 3 years | 494,529.52 | 1.63 | 119,119.25 | 375,410.27 | 770,073.05 | 3.14 | 119,119.25 | 650,953.80 | |
| Total | 30,400,769.88 | 100.00 | 119,119.25 | 30,281,650.63 | 24,488,262.75 | 100.00 | 119,119.25 | 24,369,143.50 | |

As at 31 December 2010, single item with insignificant other receivables but provided for bad debt in single item is the same as follows:

| Other receivables | Book balance | Bad debt balance | Provision ratio (%) | Reason | RMB |
|-------------------|--------------|------------------|---------------------|--------|-----|
| | | | | | |

- (2) During the current reporting period, there is no amount due from the balance of other receivables from shareholder units holding 5% (including 5%) or more shares in the Company.
- (3) Other receivable of relatively material amount of the Group mainly comprises of rebates on value-added tax in relation to scrap metal enterprise due from Finance Bureau of Shouguang City, land removal advance due from Gucheng Street Offices, rebates on valued-added tax paid for exported commodities due from National Tax Bureau of Shouguang, tendering guarantee due from China Petroleum Materials Corporation and interests receivable from Bank of China Shouguang Branch.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

6. Other receivables

Consolidation (continued)

(4) Top 5 accounts receivable are set out as follows

| Name | Relationship with the Company | Amount | Aging | RMB |
|--|-------------------------------|---------------|---------------|--|
| | | | | Percentage of the total balance of accounts receivable |
| Shouguang Finance Bureau | Non-related party | 7,804,984.16 | Within 1 year | 25.67 |
| Gucheng Street Offices | Non-related party | 6,891,320.00 | Within 3 year | 22.67 |
| Bureau of State Taxation of Shouguang City | Non-related party | 3,036,727.83 | Within 1 year | 9.99 |
| China Petroleum Materials Corporation | Non-related party | 3,000,000.00 | Within 1 year | 9.87 |
| Bank of China, Shouguang Branch | Non-related party | 1,088,318.64 | Within 1 year | 3.58 |
| Total | | 21,821,350.63 | | 71.78 |

(5) Balance of other receivables does not include any amount due from related parties.

The Company

(1) The breakdown of other receivables according to classification is as follows:

| Category | Closing balance | | | | Opening balance | | | |
|--|-----------------|-----------|------------------|-----------|-----------------|-----------|------------------|-----------|
| | Book balance | | Bad debt balance | | Book balance | | Bad debt balance | |
| | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) | Amount | Ratio (%) |
| Single item with significant other receivables and provided for bad debt by single item | — | — | — | — | — | — | — | — |
| Single item with insignificant other receivables and single item with significant other receivables but is not impaired after separate impairment test | 18,186,384.98 | 99.35 | — | — | 11,915,673.11 | 99.01 | — | — |
| Single item with insignificant other receivables but provided for bad debt by single item | 119,119.25 | 0.65 | 119,119.25 | 100.00 | 119,119.25 | 0.99 | 119,119.25 | 100.00 |
| Total | 18,305,504.23 | 100.00 | 119,119.25 | 0.65 | 12,034,792.36 | 100.00 | 119,119.25 | 0.99 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

6. Other receivables (continued)

The Company (continued)

The Group recognized the other receivables over RMB2,000,000.00 (including RMB2,000,000.00) as single item with significant other receivables.

Aging analysis of other receivables is as follows:

| Aging | Closing balance | | | | Opening balance | | | | RMB |
|---------------|----------------------|---------------|-------------------|----------------------|----------------------|---------------|-------------------|----------------------|-----|
| | Amount | Ratio (%) | Bad debt | | Amount | Ratio (%) | Bad debt | | |
| | | | balance | Book Value | | | balance | Book Value | |
| Within 1 year | 13,082,720.87 | 71.46 | — | 13,082,720.87 | 9,632,548.34 | 80.04 | — | 9,632,548.34 | |
| 1 to 2 years | 2,851,739.34 | 15.58 | — | 2,851,739.34 | 2,148,221.50 | 17.85 | — | 2,148,221.50 | |
| 2 to 3 years | 2,148,221.50 | 11.74 | — | 2,148,221.50 | 3,703.27 | 0.03 | — | 3,703.27 | |
| Over 3 years | 222,822.52 | 1.22 | 119,119.25 | 103,703.27 | 250,319.25 | 2.08 | 119,119.25 | 131,200.00 | |
| Total | 18,305,504.23 | 100.00 | 119,119.25 | 18,186,384.98 | 12,034,792.36 | 100.00 | 119,119.25 | 11,915,673.11 | |

As at 31 December 2010, single item with insignificant other receivables but provided for bad debt in single item is the same as noted to financial statements.

- (2) The Group and the Company did not have other receivables from shareholder units holding 5% (including 5%) or more shares in the Company.
- (3) Other receivable of relatively material amount of the Company mainly comprises of land removal advances due from Gucheng Street Offices, rebates on valued-added tax paid for exported commodities due from National Tax Bureau of Shouguang, tendering guarantee due from China Petroleum Materials Corporation, interests receivable from Bank of China Shouguang Branch and rent due from Molong Electro-Mechanical Equipment Company Limited.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

6. Other receivables (continued)

The Company (continued)

(4) Top 5 other receivables are set out as follows

| Name | Relationship with the Company | Amount | Aging | RMB Percentage of the total balance of Accounts receivable |
|--|-------------------------------|---------------------|---------------|---|
| Gucheng Street Offices | Non-related party | 6,891,320.00 | within 3 year | 37.65 |
| National Tax Bureau of Shouguang | Non-related party | 3,036,727.83 | within 1 year | 16.59 |
| China Petroleum Materials Corporation | Non-related party | 3,000,000.00 | within 1 year | 16.39 |
| Bank of China, Shouguang Branch | Non-related party | 1,088,318.64 | within 1 year | 5.95 |
| Electro-mechanical Equipment Company Limited | Subsidiary | 690,000.00 | within 1 year | 3.76 |
| Total | | 14,706,366.4 | | 80.34 |

(5) Of the balance of other receivables during the current reporting period, amount due from related parties represents the above amount due from Molong Electro-Mechanical Equipment Company Limited.

7. Inventory

Consolidation

(1) Inventory categories:

| Item | Closing balance | | | Opening balance | | |
|--------------------------------|-----------------------|---------------------------|-----------------------|-----------------------|---------------------------|-----------------------|
| | Book balance | Allowance for inventories | Book value | Book balance | Allowance for inventories | Book value |
| Raw materials | 244,146,298.70 | 916,732.12 | 243,229,566.58 | 180,207,968.76 | 2,443,469.90 | 177,764,498.86 |
| Work-in-progress | 265,326,710.41 | 872,825.06 | 264,453,885.35 | 284,323,068.14 | 1,190,035.14 | 283,133,033.00 |
| Entrusted processing materials | 15,619,636.34 | — | 15,619,636.34 | 25,086,295.12 | — | 25,086,295.12 |
| Finished product | 221,921,817.72 | 1,671,358.52 | 220,250,459.20 | 229,882,101.11 | 2,210,202.70 | 227,671,898.41 |
| Total | 747,014,463.17 | 3,460,915.70 | 743,553,547.47 | 719,499,433.13 | 5,843,707.74 | 713,655,725.39 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

7. Inventory (continued)

Consolidation (continued)

(2) Allowance for inventories is as follows:

| Inventory categories | Opening book balance | Provision for the current period | Decrease for the period | | Closing book balance |
|----------------------|----------------------|----------------------------------|-------------------------|-------------------|----------------------|
| | | | Reversals | Write-offs | |
| Raw materials | 2,443,469.90 | 742,929.64 | 2,138,046.49 | 131,620.93 | 916,732.12 |
| Work-in-progress | 1,190,035.14 | 609,420.63 | 766,067.58 | 160,563.13 | 872,825.06 |
| Finished product | 2,210,202.70 | 1,195,784.52 | 1,154,542.39 | 580,086.31 | 1,671,358.52 |
| Total | 5,843,707.74 | 2,548,134.79 | 4,058,656.46 | 872,270.37 | 3,460,915.70 |

RMB

(3) Allowance for inventories:

| Item | Basis of allowance for inventories | Reason of reversal of allowance for inventories for the current period | Percentage of the reversal in the current period to the closing balance of such inventory (%) |
|------------------|--|--|---|
| Raw materials | Relatively long inventory age | Value has rebounded and is higher than cost | 0.88 |
| Work-in-progress | Cost is higher than net realizable value | Value has rebounded and is higher than cost | 0.29 |
| finished product | Cost is higher than net realizable value | Value has rebounded and is higher than cost | 0.52 |

RMB

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

7. Inventory (continued)

The Company

(1) Inventory categories

| Item | Closing balance | | | Opening balance | | | RMB |
|-------------------------------|-----------------------|---------------------------|-----------------------|-----------------------|---------------------------|-----------------------|-----|
| | Book balance | Allowance for inventories | Book value | Book balance | Allowance for inventories | Book value | |
| Raw materials | 181,513,472.81 | 478,729.14 | 181,034,743.67 | 118,877,126.92 | 1,402,054.40 | 117,475,072.52 | |
| Work-in-progress | 256,072,176.42 | 650,512.06 | 255,421,664.36 | 273,490,617.45 | 1,052,831.23 | 272,437,786.22 | |
| Consigned processing material | 15,083,226.29 | — | 15,083,226.29 | 23,907,151.10 | — | 23,907,151.10 | |
| Finished product | 162,641,708.88 | 1,385,309.57 | 161,256,399.31 | 177,580,488.89 | 1,801,065.76 | 175,779,423.13 | |
| Total | 615,310,584.40 | 2,514,550.77 | 612,796,033.63 | 593,855,384.36 | 4,255,951.39 | 589,599,432.97 | |

(2) Allowance for inventories:

| Inventory categories | Opening book balance | Provision for the current period | Decrease for the period | | Closing book balance | RMB |
|----------------------|----------------------|----------------------------------|-------------------------|-------------------|----------------------|-----|
| | | | Reversals | Write-offs | | |
| Raw materials | 1,402,054.40 | 575,718.20 | 1,453,977.28 | 45,066.18 | 478,729.14 | |
| Work-in-progress | 1,052,831.23 | 474,906.85 | 729,464.66 | 147,761.36 | 650,512.06 | |
| Finished product | 1,801,065.76 | 1,130,800.98 | 1,025,494.37 | 521,062.80 | 1,385,309.57 | |
| Total | 4,255,951.39 | 2,181,426.03 | 3,208,936.31 | 713,890.34 | 2,514,550.77 | |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

7. Inventory (continued)

The Company (continued)

(3) Movement in allowance for inventories is as follows:

| Item | Basis of allowance for inventories | Reason of reversal of allowance for inventories for the current period | Percentage of the reversal in the current period to the closing balance of such inventory (%) |
|------------------|--|--|---|
| Raw materials | Relatively long inventory age | Value has rebounded and is higher than cost | 0.80 |
| Work-in-progress | Cost is higher than net realizable value | Value has rebounded and is higher than cost | 0.28 |
| Finished product | Cost is higher than net realizable value | Value has rebounded and is higher than cost | 0.63 |

8. Other current assets

Other current assets of consolidation and the Company are as follows:

| Item | Closing balance | | Opening balance | | RMB |
|------------------------------|-----------------|---------------|-----------------|-------------|-----|
| | consolidation | the Company | consolidation | the Company | |
| Import tax pending deduction | 36,978,684.73 | 25,599,842.89 | — | — | |
| Prepaid land usage tax | 2,185,679.28 | 2,185,679.28 | — | — | |
| Prepaid income tax | 995,000.00 | — | — | — | |
| Other prepaid tax | 895,272.99 | 50,625.49 | — | — | |
| Total | 41,054,637.00 | 27,836,147.66 | — | — | |

9. Investment in equity joint ventures and investment in associates

Consolidation

| Name of investee entity | Percentage of the shareholding of the investee entity (%) | Percentage of the shareholding of the investee entity (%) | Total assets at the end of period | Total liabilities at the end of period | Total net asset value at the end of period | Operating income for the current period | Net profit from the Current period | RMB |
|-------------------------|---|---|-----------------------------------|--|--|---|------------------------------------|-----|
| | | | | | | | | |
| Consortium | | | | | | | | |
| Yalong Oil Pump | 30.00 | 30.00 | 12,183,485.46 | 3,976,677.73 | 8,206,807.73 | 12,620,399.41 | 637,503.16 | |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

10. Long-term equity investment

Consolidation

(1) The details of long-term equity investments are as follows:

| Investee entity | Accounting method | Investment | Opening balance | Change | Closing balance | Percentage of shareholding in the investee entity (%) | Percentage of voting right in the investee entity (%) | Explanation of the inconsistent of shareholding percentage and voting right in the investee entity | Impairment provision | Provision of impairment for the current period | Cash bonuses for the current period | RMB |
|---|-------------------|----------------------|----------------------|------------------|----------------------|---|---|--|----------------------|--|-------------------------------------|-----|
| | | | | | | | | | | | | |
| Yalong Oil Pump | Equity method | 1,888,500.00 | 2,436,028.87 | 41,250.95 | 2,477,279.82 | 30.00 | 30.00 | N/A | — | — | 150,000.00 | |
| Shouguang Mihe Water Company Limited ("Mihe Water") | Cost method | 10,000,000.00 | 10,000,000.00 | — | 10,000,000.00 | 9.73 | 9.73 | N/A | — | — | — | |
| Total | | 11,888,500.00 | 12,436,028.87 | 41,250.95 | 12,477,279.82 | | | | — | — | 150,000.00 | |

(2) There is no restriction on the ability of the investee in which the long-term equity investments are held by the Group and the Company as at 31 December 2010 to transfer capital to the Group.

The Company

(1) The details of long-term equity investments are as follows:

| Investee entity | Accounting method | Investment | Opening balance | Change | Closing balance | Percentage of shareholding in the investee entity (%) | Percentage of voting right in the investee entity (%) | Explanation of the inconsistent of shareholding percentage and voting right in the investee entity | Impairment provision | Provision of impairment for the current period | Cash bonuses for the current period | RMB |
|--|-------------------|-----------------------|-----------------------|----------|-----------------------|---|---|--|----------------------|--|-------------------------------------|-----|
| | | | | | | | | | | | | |
| Molong Drilling Equipment | Cost method | 6,397,082.50 | 6,397,082.50 | — | 6,397,082.50 | 100.00 | 100.00 | N/A | — | — | — | |
| MPM International Limited | Cost method | 7,276,230.00 | 7,276,230.00 | — | 7,276,230.00 | 90.00 | 90.00 | N/A | — | — | 44,545,164.48 | |
| Shouguangh Baolong Company Limited | Cost method | 105,000,000.00 | 105,000,000.00 | — | 105,000,000.00 | 70.00 | 70.00 | N/A | — | — | — | |
| Shouguang Maolong Machinery Company Limited | Cost method | 306,743,691.73 | 306,743,691.73 | — | 306,743,691.73 | 100.00 | 100.00 | N/A | — | — | 41,220,000.00 | |
| Shouguang Maolong Old Metals Recycle Company Limited | Cost method | 50,000.00 | 50,000.00 | — | 50,000.00 | 10.00 | 10.00 | N/A | — | — | — | |
| Mihe Water | Cost method | 10,000,000.00 | 10,000,000.00 | — | 10,000,000.00 | 9.73 | 9.73 | N/A | — | — | — | |
| Total | | 435,467,004.23 | 435,467,004.23 | — | 435,467,004.23 | | | | — | — | 85,765,164.48 | |

(2) There is no restriction on the ability of the investee in which the long-term equity investments are held by the Group and the Company as at 31 December 2010 to transfer capital to the Group.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

11. Investment Properties

The Company

| Item | Opening book balance | Additions for the current period | Deductions for the current period | RMB |
|--|-------------------------|-------------------------------------|---|-------------------------|
| | | | | Closing book balance |
| I. Total original book value: | 8,069,389.56 | — | — | 8,069,389.56 |
| Buildings | 8,069,389.56 | — | — | 8,069,389.56 |
| II. Total accumulated depreciation: | 1,514,782.84 | 364,940.40 | — | 1,879,723.24 |
| Buildings | 1,514,782.84 | 364,940.40 | — | 1,879,723.24 |
| III. Total net book value of investment properties | 6,554,606.72 | — | — | 6,189,666.32 |
| Buildings | 6,554,606.72 | — | — | 6,189,666.32 |
| IV. Accumulated value of provision of depreciation of investment properties | — | — | — | — |
| Buildings | — | — | — | — |
| V. Total net book value of investment properties | 6,554,606.72 | — | — | 6,189,666.32 |
| Buildings | 6,554,606.72 | — | — | 6,189,666.32 |

The depreciation for the current period amounted to RMB364,940.40. The surplus amortized deadline of its land-use right was 45.33 years.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

12. Fixed Assets

Consolidation

(1) Overview of fixed assets

| Item | Opening book balance | Additions for the current period | | Deductions for the current period | Closing book balance |
|--|----------------------|----------------------------------|--------------------------------|-----------------------------------|----------------------|
| | | | | | |
| | | | | | RMB |
| I. Total original book value: | 1,214,746,429.49 | 854,946,268.13 | | 56,517,771.08 | 2,013,174,926.54 |
| Of which: Buildings | 224,124,253.80 | 113,086,196.50 | | 628,790.00 | 336,581,660.30 |
| Machinery and equipment | 929,461,374.95 | 728,675,515.95 | | 52,951,817.55 | 1,605,185,073.35 |
| Electronic equipment and others | 49,545,671.58 | 12,233,367.96 | | 863,942.73 | 60,915,096.81 |
| Vehicles | 11,615,129.16 | 951,187.72 | | 2,073,220.80 | 10,493,096.08 |
| II. Total accumulated depreciation: | 263,997,810.38 | Additions for the current year | Provision for the current year | 17,322,143.59 | 345,357,993.89 |
| Of which: Buildings | 32,637,786.65 | — | 10,665,288.46 | 178,583.49 | 43,124,491.62 |
| Machinery and equipment | 208,846,912.00 | — | 76,875,500.11 | 14,712,565.54 | 271,009,846.57 |
| Electronic equipment and others | 17,045,620.74 | — | 9,177,052.17 | 474,122.56 | 25,748,550.35 |
| Vehicles | 5,467,490.99 | — | 1,964,486.36 | 1,956,872.00 | 5,475,105.35 |
| III. Total fixed assets – net book value | 950,748,619.11 | | | | 1,667,816,932.65 |
| Of which: Buildings | 191,486,467.15 | | | | 293,457,168.68 |
| Machinery and equipment | 720,614,462.95 | | | | 1,334,175,226.78 |
| Electronic equipment and others | 32,500,050.84 | | | | 35,166,546.46 |
| Vehicles | 6,147,638.17 | | | | 5,017,990.73 |
| IV. Total Impairment provision | 42,577,230.91 | | — | 23,343,909.25 | 19,233,321.66 |
| Of which: Buildings | 4,986,478.28 | | — | — | 4,986,478.28 |
| Machinery and equipment | 37,590,752.63 | | — | 23,343,909.25 | 14,246,843.38 |
| Electronic equipment and others | — | | — | — | — |
| Vehicles | — | | — | — | — |
| V. Total fixed assets – net book value | 908,171,388.20 | | | | 1,648,583,610.99 |
| Of which: Buildings | 186,499,988.87 | | | | 288,470,690.40 |
| Machinery and equipment | 683,023,710.32 | | | | 1,319,928,383.40 |
| Electronic equipment and others | 32,500,050.84 | | | | 35,166,546.46 |
| Vehicles | 6,147,638.17 | | | | 5,017,990.73 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

12. Fixed Assets

Consolidation

(1) Overview of fixed assets (continued)

Note 1: The original book value over the current year increased as acquisition increased by RMB27,350,437.19, while the transfer in of construction in progress increased by RMB827,595,830.94.

Note 2: The original book value over the current year decreased as the disposal led to a decrease of RMB56,517,771.08.

Note 3: The accumulated depreciation increased over the current year as the provision over the current year amounted to RMB98,682,327.10.

Note 4: The accumulated depreciation decreased over the current year as the disposal led to decrease of RMB17,322,143.59.

Note 5: The impairment provision decreased over the current year as the disposal led to a decrease of RMB23,343,909.25.

Note 6: The surplus amortized deadline of land-use right of the above buildings were 40.75 years to 49.83 years.

(2) Overview of fixed assets without duly prepared title certificates

| Item | Amount | Reason for title certificate not duly prepared | RMB |
|---|---------------|--|--|
| | | | Estimate time for preparing title certificates |
| Steel structure major hot roll plant zone | 68,431,662.82 | New Construction | 2011 |
| Office Building | 1,231,239.29 | New Construction | 2011 |
| 180 electric rooms | 2,345,130.32 | New Construction | 2011 |
| Major electricity room | 3,311,410.87 | New Construction | 2011 |
| Steel pipes storage | 2,982,953.13 | New Construction | 2011 |
| Bathroom, Gatehouse, washroom, and so on | 1,131,561.49 | New Construction | 2011 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

12. Fixed Assets (continued)

The Company

(1) Overview of fixed assets

| Item | Opening book balance | Additions for the current period | Deductions for the current period | RMB | |
|-------------------------------------|----------------------|----------------------------------|-----------------------------------|----------------------|------------------|
| | | | | Closing book balance | |
| I. Total original book value: | 714,883,197.48 | 824,930,628.73 | 20,925,066.47 | 1,518,888,759.74 | |
| Of which: Buildings | 130,650,084.26 | 106,365,303.50 | 515,600.00 | 236,499,787.76 | |
| Machinery and equipment | 560,751,570.58 | 708,662,087.77 | 17,790,281.74 | 1,251,623,376.61 | |
| Electronic equipment and others | 14,132,706.97 | 9,634,861.39 | 723,587.73 | 23,043,980.63 | |
| Vehicles | 9,348,835.67 | 268,376.07 | 1,895,597.00 | 7,721,614.74 | |
| II. Total accumulated depreciation: | 170,143,263.80 | Additions for the current year | Provision for the current year | 13,565,906.50 | 213,815,195.32 |
| Of which: Buildings | 22,031,811.03 | — | 6,342,144.31 | 156,997.99 | 28,216,957.35 |
| Machinery and equipment | 137,073,058.84 | — | 47,025,120.72 | 11,211,476.53 | 172,886,703.03 |
| Electronic equipment and others | 6,627,992.88 | — | 2,393,206.89 | 401,482.06 | 8,619,717.71 |
| Vehicles | 4,410,401.05 | — | 1,477,366.10 | 1,795,949.92 | 4,091,817.23 |
| III. Total fixed assets | 544,739,933.68 | | | | 1,305,073,564.42 |
| – net book value | | | | | |
| Of which: Buildings | 108,618,273.23 | | | | 208,282,830.41 |
| Machinery and equipment | 423,678,511.74 | | | | 1,078,736,673.58 |
| Electronic equipment and others | 7,504,714.09 | | | | 14,424,262.92 |
| Vehicles | 4,938,434.62 | | | | 3,629,797.51 |
| IV. Total Impairment provision | — | — | — | — | — |
| Of which: Buildings | — | — | — | — | — |
| Machinery and equipment | — | — | — | — | — |
| Electronic equipment and others | — | — | — | — | — |
| Vehicles | — | — | — | — | — |
| V. Total fixed assets | 544,739,933.68 | | | | 1,305,073,564.42 |
| – net book value | | | | | |
| Of which: Buildings | 108,618,273.23 | | | | 208,282,830.41 |
| Machinery and equipment | 423,678,511.74 | | | | 1,078,736,673.58 |
| Electronic equipment and others | 7,504,714.09 | | | | 14,424,262.92 |
| Vehicles | 4,938,434.62 | | | | 3,629,797.51 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

12. Fixed Assets (continued)

The Company

Note 1: Original book value for the period increased, an increase of RMB21,777,839.05 was due to acquisition, an increase of RMB803,152,789.68 was due to construction in progress transferred to fixed assets.

Note 2: Original book value for the year decreased, a decreased of RMB20,925,066.47 was due to disposal of fixed assets.

Note 3: Accumulated depreciation for the year increased, an amount of RMB57,237,838.02 was provided for during the period.

Note 4: Accumulated depreciation for the year decreased, a decrease of RMB13,565,906.50 was due to disposal

Note 5: The surplus amortized deadline of land-use right of above buildings were 40.75 years to 49.83 years.

(2) Fixed assets without duly prepared title certificates are the same as those in notes to combined financial statements.

13. Construction in progress

Consolidation

(1) The breakdown of constructions in progress is as follows

| Items | Closing balance | | | Opening balance | | | RMB |
|--|--|----------------------|-----------------------|-----------------------|----------------------|-----------------------|----------------|
| | Book balance | Impairment provision | Net book value | Book balance | Impairment provision | Net book value | |
| | 180mm Special Petroleum Pipes Technical Reconstruction Project | — | — | — | 363,262,888.88 | — | 363,262,888.88 |
| 250,000-tonne oil casing production line | — | — | — | 344,000.00 | — | 344,000.00 | |
| Dormitory Building, Restaurant | — | — | — | 4,927,600.00 | — | 4,927,600.00 | |
| 140mm Petroleum pipes processing project | 84,332,699.43 | — | 84,332,699.43 | 5,500,000.00 | — | 5,500,000.00 | |
| High-end Petroleum Equipment | 34,213,238.46 | — | 34,213,238.46 | — | — | — | |
| Others | 12,900,304.63 | — | 12,900,304.63 | 17,559,680.92 | — | 17,559,680.92 | |
| Total | 131,446,242.52 | — | 131,446,242.52 | 391,594,169.80 | — | 391,594,169.80 | |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

13. Construction in progress (continued)

Consolidation (continued)

(2) Change in material constructions in progress projects

| Project name | Budget amount | Opening balance | Additions for the current period | Transfer to fixed assets | Investment to budgeted costs (%) | Progress (%) | Accumulated capitalized interest amount | Of which: capitalized interest amount for the current period | Capitalized interest amount for the current period (%) | Sources of Fund | Closing balance | RMB |
|--|----------------|-----------------|----------------------------------|--------------------------|----------------------------------|--------------|---|--|--|--|-----------------|-----|
| | | | | | | | | | | | | |
| 180mm Special Petroleum Pipes Technical Reconstruction Project | 615,000,000.00 | 363,262,888.88 | 405,828,196.12 | 769,091,085.00 | 125 | 100 | 38,258,625.33 | 20,655,782.69 | 5.07%-5.76% | Loan from financial institution and proceeds of A Shares Issue | — | |
| 250,000-tonne oil casing production line | 52,000,000.00 | 344,000.00 | 476,572.51 | 820,572.51 | 101 | 100 | — | — | — | Self-raised | — | |
| Dormitory Building, Restaurant | 5,390,000.00 | 4,927,600.00 | 760,400.00 | 5,688,000.00 | 106 | 100 | — | — | — | Self-raised | — | |
| 140mm Petroleum pipes processing project | 250,000,000.00 | 5,500,000.00 | 96,650,692.47 | 17,817,993.04 | 41 | 41 | 831,179.98 | 831,179.98 | 5.07%-5.76% | Loan from financial institution and Self-raised | 84,332,699.43 | |
| High-end Petroleum Equipment | 168,510,000.00 | — | 60,527,953.71 | 26,314,715.25 | 36 | 36 | 1,482,528.67 | 1,482,528.67 | 5.07%-5.76% | Loan from financial institution and Self-raised | 34,213,238.46 | |
| Others | — | 17,559,680.92 | 3,204,088.85 | 7,863,465.14 | — | — | — | — | — | Self-raised | 12,900,304.63 | |
| Total | | 391,594,169.80 | 567,447,903.66 | 827,595,830.94 | | | 40,572,333.98 | 22,969,491.34 | | | 131,446,242.52 | |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

13. Construction in progress (continued)

The Company

(1) The breakdown of constructions in progress is as follows

| Items | Closing balance | | | Opening balance | | | RMB |
|--|----------------------|------------|----------------------|-----------------------|------------|----------------|-----------------------|
| | Book balance | Impairment | | Book balance | Impairment | | |
| | | provision | Net book value | | provision | Net book value | |
| 180mm Special Petroleum Pipes Technical Reconstruction Project | — | — | — | 363,262,888.88 | — | — | 363,262,888.88 |
| 250,000-tonne oil casing production line | — | — | — | 344,000.00 | — | — | 344,000.00 |
| High-end Petroleum Equipment | 34,213,238.46 | — | 34,213,238.46 | — | — | — | — |
| Others | 10,170,243.84 | — | 10,170,243.84 | 16,827,145.02 | — | — | 16,827,145.02 |
| Total | 44,383,482.30 | — | 44,383,482.30 | 380,434,033.90 | — | — | 380,434,033.90 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

13. Construction in progress (continued)

The Company (continued)

(2) Change in material constructions in progress projects

| Project name | Budget amount | Opening balance | Additions for the current period | Transfer to fixed assets | Investment to budgeted costs (%) | Progress (%) | Accumulated capitalized interest amount | Of which: capitalized interest amount for the current period | Capitalized interest amount for the current period (%) | Sources of Fund | Closing balance | RMB |
|--|----------------|-----------------|----------------------------------|--------------------------|----------------------------------|--------------|---|--|--|--|-----------------|-----|
| | | | | | | | | | | | | |
| 180mm Special Petroleum Pipes Technical Reconstruction Project | 615,000,000.00 | 363,262,888.88 | 405,828,196.12 | 769,091,085.00 | 125 | 100 | 38,258,625.33 | 20,655,782.69 | 5.07%-5.76% | Loan from financial institution and proceeds of A Shares Issue | — | |
| 250,000-tonne oil casing production line | 52,000,000.00 | 344,000.00 | 476,572.51 | 820,572.51 | 101 | 100 | — | — | — | Self-raised | — | |
| High-end Petroleum Equipment | 168,510,000.00 | — | 60,527,953.71 | 26,314,715.25 | 36 | 36 | 1,482,528.67 | 1,482,528.67 | 5.07%-5.76% | Loan from financial institution and proceeds of A Shares Issue | 34,213,238.46 | |
| Others | — | 16,827,145.02 | 269,515.74 | 6,926,416.92 | — | — | — | — | — | Self-raised | 10,170,243.84 | |
| Total | | 380,434,033.90 | 467,102,238.08 | 803,152,789.68 | | | 39,741,154.00 | 22,138,311.36 | | | 44,383,482.30 | |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

14. Intangible assets

Consolidation

(1) Intangible assets

| Item | Opening book balance | Additions for the current period | Deductions for the current period | RMB Closing book balance |
|---|----------------------|----------------------------------|-----------------------------------|--------------------------|
| I. Total original book value: | 178,910,167.78 | 97,802,079.10 | — | 276,712,246.88 |
| Land use rights | 136,476,832.47 | 51,059,762.99 | — | 187,536,595.46 |
| Software | 702,088.00 | — | — | 702,088.00 |
| non-patent technology | 41,715,847.31 | 46,739,066.11 | — | 88,454,913.42 |
| patent technology | 15,400.00 | 3,250.00 | — | 18,650.00 |
| II. Total accumulated amortization | 13,279,543.03 | 13,514,573.88 | — | 26,794,116.91 |
| Land use rights | 6,381,034.08 | 3,017,344.15 | — | 9,398,378.23 |
| Software | 702,088.00 | — | — | 702,088.00 |
| non-patent technology | 6,196,035.96 | 10,492,461.45 | — | 16,688,497.41 |
| patent technology | 384.99 | 4,768.28 | — | 5,153.27 |
| III. Total intangible assets net book value | 165,630,624.75 | — | — | 249,918,129.97 |
| Land use rights | 130,095,798.39 | — | — | 178,138,217.23 |
| Software | — | — | — | — |
| non-patent technology | 35,519,811.35 | — | — | 71,766,416.01 |
| patent technology | 15,015.01 | — | — | 13,496.73 |
| IV. Total impairment provision | — | — | — | — |
| Land use rights | — | — | — | — |
| Software | — | — | — | — |
| non-patent technology | — | — | — | — |
| patent technology | — | — | — | — |
| V. Total intangible assets book value | 165,630,624.75 | — | — | 249,918,129.97 |
| Land use rights | 130,095,798.39 | — | — | 178,138,217.23 |
| Software | — | — | — | — |
| non-patent technology | 35,519,811.35 | — | — | 71,766,416.01 |
| patent technology | 15,015.01 | — | — | 13,496.73 |

Note 1: Of the increase of original carrying amount during the current year, the transfer from other non-current assets to intangible assets led to an increase by RMB23,279,221.87 due to the acquisition of land use right certificates, acquisition led to an increase by RMB27,780,541.12, self-development led to an increase by RMB46,739,066.11, purchasing patent technology led to an increase by RMB3,250.00.

Note 2: Accumulated amortization for the current period increased, provision for the current year amounted to RMB13,514,573.88

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

14. Intangible assets

Consolidation (continued)

(2) Research project expenditure of the Company

| Item | Opening book balance | Additions for the current period | Deductions for the current period | | Closing book balance |
|-------------------------|----------------------|----------------------------------|---|---------------------------------|----------------------|
| | | | Credited to profit or loss of previous year | Recognized as intangible assets | |
| Research expenditure | — | 21,334,895.56 | 21,334,895.56 | — | — |
| Development expenditure | — | 46,739,066.11 | — | 46,739,066.11 | — |
| Total | — | 68,073,961.67 | 21,334,895.56 | 46,739,066.11 | — |

Note 1: During the year, development expenditure represented 68.66% of the total research and development project expenditure.

Intangible assets formed from internal research and development of the Company represented 28.31% of the carrying amount of intangible assets at the end of the year.

The Company

(1) Intangible assets

| Item | Opening book balance | Additions for the current period | Deductions for the current period | Closing book balance |
|------------------------------------|----------------------|----------------------------------|-----------------------------------|----------------------|
| I. Total original book value: | 102,088,883.57 | 89,390,373.10 | — | 191,479,256.67 |
| Land use rights | 59,655,548.26 | 42,648,056.99 | — | 102,303,605.25 |
| Software | 702,088.00 | — | — | 702,088.00 |
| non-patent technology | 41,715,847.31 | 46,739,066.11 | — | 88,454,913.42 |
| patent technology | 15,400.00 | 3,250.00 | — | 18,650.00 |
| II. Total accumulated amortization | 8,999,223.28 | 11,982,547.97 | — | 20,981,771.25 |
| Land use rights | 2,100,714.33 | 1,485,318.24 | — | 3,586,032.57 |
| Software | 702,088.00 | — | — | 702,088.00 |
| non-patent technology | 6,196,035.96 | 10,492,461.45 | — | 16,688,497.41 |
| patent technology | 384.99 | 4,768.28 | — | 5,153.27 |
| III. Total intangible assets | | | | |
| net book value | 93,089,660.29 | | | 170,497,485.42 |
| Land use rights | 57,554,833.93 | | | 98,717,572.68 |
| Software | — | | | — |
| non-patent technology | 35,519,811.35 | | | 71,766,416.01 |
| patent technology | 15,015.01 | | | 13,496.73 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

14. Consolidation (continued)

The Company (continued)

(1) Intangible assets (continued)

| Item | Opening book balance | Additions for the current period | Deductions for the current period | Closing book balance |
|---------------------------------------|----------------------|----------------------------------|-----------------------------------|----------------------|
| IV. Total impairment provision | — | — | — | — |
| Land use rights | — | — | — | — |
| Software | — | — | — | — |
| non-patent technology | — | — | — | — |
| patent technology | — | — | — | — |
| V. Total intangible assets book value | 93,089,660.29 | | | 170,497,485.42 |
| Land use rights | 57,554,833.93 | | | 98,717,572.68 |
| Software | — | | | — |
| non-patent technology | 35,519,811.35 | | | 71,766,416.01 |
| patent technology | 15,015.01 | | | 13,496.73 |

Note 1: Of the increase of original carrying amount during the year, the transfer from other non-current assets to land use rights to intangible assets led to an increase by RMB18,279,221.87 due to the acquisition of land use right certificates, acquisition led to an increase by RMB24,368,835.12, self-development led to an increase by RMB46,739,066.11, purchasing patent technology led on an increase by RMB3,250.00.

Note 2: Of the increase in accumulated amortization during the year, the provision for the period amounted to RMB11,982,547.97.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

14. Consolidation (continued)

The Company (continued)

(2) Research project expenditure of the Company

| Item | Opening balance | Additions for the current period | Deductions for the current period | | Closing balance |
|-------------------------|-----------------|----------------------------------|---|---------------------------------|-----------------|
| | | | Credited to profit or loss of previous year | Recognized as intangible assets | |
| Research expenditure | — | 21,334,895.56 | 21,334,895.56 | — | — |
| Development expenditure | — | 46,739,066.11 | — | 46,739,066.11 | — |
| Total | — | 68,073,961.67 | 21,334,895.56 | 46,739,066.11 | — |

RMB

Note 1: During the year, development expenditure represented 68.66% of the total research and development project expenditure.

Intangible assets formed from internal research and development of the Company represented 41.22% of the carrying amount of intangible assets at the end of the year.

15. Goodwill

According to an equity transfer agreement signed by the Company and all shareholders of Maolong Machinery Company on 25 September 2007, the Company acquired Maolong Machinery Company on 31 December 2007, resulting in goodwill of RMB142,973,383.21.

Consolidation

| Matters generating goodwill | Opening balance | Additions for the current period | Deductions | RMB | |
|---|-----------------|----------------------------------|------------|-----------------|---|
| | | | | Closing balance | Impairment provision at the end of the period |
| Business consolidation not under common control | 142,973,383.21 | — | — | 142,973,383.21 | — |

The management of the Company judged, via impairment test on goodwill, that goodwill formed by investment in Maolong Machinery Company would not require any impairment provision.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

16. Deferred income tax assets and deferred income tax liabilities

(1) Confirmed deferred income tax assets and deferred income tax liabilities

| Items | Consolidation | | The Company | |
|---|----------------------|----------------------|---------------------|---------------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| RMB | | | | |
| Deferred income tax assets: | | | | |
| Bad debt balance | 1,727,107.98 | 1,135,375.63 | 1,671,993.44 | 1,080,261.09 |
| Including: Accounts receivable | 1,697,328.17 | 1,117,507.74 | 1,642,213.63 | 1,062,393.20 |
| Other receivables | 29,779.81 | 17,867.89 | 29,779.81 | 17,867.89 |
| Allowance for inventories | 865,228.92 | 1,035,331.80 | 628,637.69 | 638,392.71 |
| Salaries payable | 4,459,922.44 | 3,000,708.38 | 2,787,555.38 | 1,379,870.66 |
| Intangible assets amortization | 2,086,062.18 | 774,504.50 | 2,086,062.18 | 774,504.50 |
| Fixed assets Impairment provision | 3,240,420.59 | 9,194,361.78 | — | — |
| Deductible losses | 2,717,119.01 | — | — | — |
| Unrealized profit of intragroup transaction | — | 1,951,347.06 | — | — |
| Total | 15,095,861.12 | 17,091,629.15 | 7,174,248.69 | 3,873,028.96 |
| Deferred income tax liabilities: | | | | |
| Adjustment of fair value (Note 1) | 9,668,877.75 | 10,203,134.42 | — | — |
| Including: inventory | — | 24,261.31 | — | — |
| Long-term equity investments | 3,809.38 | 3,809.38 | — | — |
| Fixed assets | 1,406,955.76 | 1,823,980.61 | — | — |
| Intangible assets | 8,258,112.61 | 8,351,083.12 | — | — |
| Others | — | — | — | — |
| Others | — | 266,867.22 | — | — |
| Balance of value-added tax rebates | | | | |
| due from government | 2,359,336.73 | — | — | — |
| Interest receivable on guarantee deposits | 522,199.20 | — | 522,199.20 | — |
| Unrealized loss of intragroup transaction | | | | |
| | 477,038.70 | — | — | — |
| Total | 13,027,452.38 | 10,470,001.64 | 522,199.20 | — |

Note 1: As at 31 December 2007, the Company acquired all equity interests in Maolong Machinery Company. Under the accounting of consolidation of enterprises not under common control, the Company will acquire identifiable assets, liabilities and contingent liabilities qualifying for conditions for recognition from Maolong Machinery Company upon the preparation of combined financial statements, which were measured at fair value on the acquisition date, and the temporary difference between its fair value and original carrying value (on the basis of taxation) formed was recognized as deferred income tax liabilities.

Note 2: According to the estimate on the Group's future profitability, the Group considers that it is likely to have adequate income tax payables to eliminate deductible temporary differences and deductible losses, and hence relevant deferred income tax assets are recognized.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

16. Deferred income tax assets and deferred income tax liabilities

(2) Breakdown of temporary difference of tax payables and deductible temporary difference items

| Items | Consolidation | | The Company | |
|--|----------------------|----------------------|----------------------|----------------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| | | | | RMB |
| Deferred income tax assets: | | | | |
| Bad debt balance | 6,908,431.93 | 7,422,198.74 | 6,687,973.77 | 7,201,740.58 |
| Including: Accounts receivable | 6,789,312.68 | 7,303,079.49 | 6,568,854.52 | 7,082,621.33 |
| Other receivables | 119,119.25 | 119,119.25 | 119,119.25 | 119,119.25 |
| Allowance for inventories | 3,460,915.70 | 5,843,707.74 | 2,514,550.77 | 4,255,951.39 |
| Salaries payable | 17,839,689.76 | 15,713,925.78 | 11,150,221.53 | 9,199,137.76 |
| Intangible assets amortization | 8,344,248.71 | 3,098,017.98 | 8,344,248.71 | 3,098,017.98 |
| Fixed assets Impairment provision | 12,961,682.35 | 36,777,447.10 | — | — |
| Deductible losses | 10,868,476.02 | — | — | — |
| Unrealized profit of intragroup transaction | — | 13,008,980.43 | — | — |
| Total | 60,383,444.47 | 81,864,277.77 | 28,696,994.78 | 23,754,847.71 |
| Deferred income tax liabilities: | | | | |
| Adjustment of fair value | 38,675,510.96 | 40,812,537.64 | — | — |
| Including: inventory | — | 97,045.22 | — | — |
| Long-term equity investments | 15,237.51 | 15,237.51 | — | — |
| Fixed assets | 5,627,823.02 | 7,295,922.42 | — | — |
| Intangible assets | 33,032,450.43 | 33,404,332.49 | — | — |
| Others | — | — | — | — |
| Others | — | 1,067,468.88 | — | — |
| Balance of value-added tax rebates due from government | 9,437,346.91 | — | — | — |
| Interest receivable on guarantee deposits | 2,088,796.81 | — | 2,088,796.81 | — |
| Unrealized loss of intragroup transaction | 3,180,257.98 | — | — | — |
| Total | 53,381,912.66 | 41,880,006.52 | 2,088,796.81 | — |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

17. Other non-current assets

| Items | Consolidation | | RMB The Company | |
|-----------------------|-----------------|-----------------|--------------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Land use Right (Note) | — | 23,279,221.87 | — | 18,279,221.87 |

Note : It represents land use right prepayment and land premium. During the year, the Company and Weihai Baolong Company have signed land grant contract with Land Reserve Center of Shouguang City and Land Resources Bureau of Wen Deng City respectively and acquired the relevant land use right certificates, which were also transferred to intangible assets.

18. Provision for impairment of assets

| Item | Opening balance | Additions for the current period | Deductions | | Closing balance |
|-------------------------------------|-----------------|----------------------------------|--------------|---------------|-----------------|
| | | | Reversals | Write-offs | |
| Provisions for bad debts | 7,422,198.74 | — | 513,766.81 | — | 6,908,431.93 |
| Of which: trade receivables | 7,303,079.49 | — | 513,766.81 | — | 6,789,312.68 |
| Other receivables | 119,119.25 | — | — | — | 119,119.25 |
| Provisions for inventory impairment | 5,843,707.74 | 2,548,134.79 | 4,058,656.46 | 872,270.37 | 3,460,915.70 |
| Including: Raw materials | 2,443,469.90 | 742,929.64 | 2,138,046.49 | 131,620.93 | 916,732.12 |
| Work-in-progress | 1,190,035.14 | 609,420.63 | 766,067.58 | 160,563.13 | 872,825.06 |
| Finished product | 2,210,202.70 | 1,195,784.52 | 1,154,542.39 | 580,086.31 | 1,671,358.52 |
| Fixed assets Impairment provision | 42,577,230.91 | — | — | 23,343,909.25 | 19,233,321.66 |
| Including: Building | 4,986,478.28 | — | — | — | 4,986,478.28 |
| Building Machinery and equipment | 37,590,752.63 | — | — | 23,343,909.25 | 14,246,843.38 |
| Total | 55,843,137.39 | 2,548,134.79 | 4,572,423.27 | 24,216,179.62 | 29,602,669.29 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

18. Provision for impairment of assets (continued)

The Company

| Item | Opening balance | Additions for the current period | Reversals | Deductions | | Closing balance |
|-------------------------------------|-----------------|----------------------------------|--------------|------------|--|-----------------|
| | | | | Write-offs | | |
| Provisions for bad debts | 7,201,740.58 | — | 513,766.81 | — | | 6,687,973.77 |
| Of which: trade receivables | 7,082,621.33 | — | 513,766.81 | — | | 6,568,854.52 |
| Other receivables | 119,119.25 | — | — | — | | 119,119.25 |
| Provisions for inventory impairment | 4,255,951.39 | 2,181,426.03 | 3,208,936.31 | 713,890.34 | | 2,514,550.77 |
| Including: Raw materials | 1,402,054.40 | 575,718.20 | 1,453,977.28 | 45,066.18 | | 478,729.14 |
| Work-in-progress | 1,052,831.23 | 474,906.85 | 729,464.66 | 147,761.36 | | 650,512.06 |
| Finished product | 1,801,065.76 | 1,130,800.98 | 1,025,494.37 | 521,062.80 | | 1,385,309.57 |
| Total | 11,457,691.97 | 2,181,426.03 | 3,722,703.12 | 713,890.34 | | 9,202,524.54 |

19. Short-term borrowings

| Items | Consolidation | | The Company | |
|--------------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Credit loans | 559,240,190.00 | 220,000,000.00 | 390,000,000.00 | 220,000,000.00 |
| Guarantee loans | 17,455,000.00 | 35,000,000.00 | 17,455,000.00 | — |
| Secured borrowings | 136,171,227.20 | 19,648,512.00 | 136,171,227.20 | 19,648,512.00 |
| Total | 712,866,417.20 | 274,648,512.00 | 543,626,227.20 | 239,648,512.00 |

Note: The Group and the Company do not have any due but non-repaid short-term borrowings.

Guarantee loans represent the guarantee of RMB17,455,000.00 deposited into the bank by the Company in advance to secure a foreign currency loan of USD2,551,470.86. Upon the expiry of the financing period, the Company will repay such foreign currency loan with the Renminbi guarantee deposited.

Secured borrowings represent the Group's borrowing obtained from banks by pledging its accounts receivable, please refer to note (V) 3 for the amount of relevant pledge.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

20. Bills payable

(1) The breakdown of bills payable is as follows:

| Items | Consolidation | | The Company | | RMB |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----|
| | Closing balance | Opening balance | Closing balance | Opening balance | |
| Bank acceptance | 482,816,088.17 | 373,611,268.50 | 446,849,308.17 | 379,207,034.90 | |

Notes payable of the Group and the Company as at 31 December 2010 will be fully due by 29 June 2011.

(2) Balance of bills payable in the current reporting period does not have any amount due to bill of shareholder unit with over 5% (5% inclusive) voting rights in the Company.

(3) The Group does not have bills payable to related parties. The Company has bills payable to other related parties in its bills payable as follows:

| Items | RMB | |
|---|-----------------|-----------------|
| | Closing balance | Opening balance |
| Molong Electro-mechanical Equipment Company Limited | 18,805,654.37 | 7,060,525.19 |
| Weihai Baolong | 13,830,000.00 | 30,157,885.20 |
| Shouguang Baolong | 257,400,000.00 | 106,160,666.63 |
| Molong Drilling Equipment | 1,048,000.00 | 1,879,161.46 |
| Total | 291,083,654.37 | 145,258,238.48 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

21. Accounts payable

- (1) Breakdown of accounts payable is set out as follows:

| Items | Consolidation | | The Company | |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Material fees payable | 390,316,585.54 | 298,084,665.00 | 222,340,794.46 | 317,095,720.13 |
| Project equipment fees payable | 111,454,984.80 | 47,103,739.83 | 102,245,817.93 | 25,745,538.90 |
| Total | 501,771,570.34 | 345,188,404.83 | 324,586,612.39 | 342,841,259.03 |

- (2) Aging analysis of accounts receivable is as follows:

| Age | Consolidation | | The Company | |
|---------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Within 1 year | 464,598,177.18 | 295,450,059.49 | 310,628,796.75 | 328,632,092.59 |
| 1 to 2 year | 16,068,602.25 | 34,856,100.52 | 8,623,173.45 | 11,019,878.43 |
| 2 to 3 year | 10,926,875.98 | 4,320,296.22 | 2,932,613.80 | 851,888.56 |
| Over 3 year | 10,177,914.93 | 10,561,948.60 | 2,402,028.39 | 2,337,399.45 |
| Total | 501,771,570.34 | 345,188,404.83 | 324,586,612.39 | 342,841,259.03 |

As at 31 December 2010, significant accounts receivable of the Group aged over 1 year amounting to over RMB2,000,000.00 in a single amount was RMB2,503,300.00. This represented the acquisition fees for equipment, which such amounts are not paid as the credit period is over 1 year.

- (3) At the end of the current period, the balance of the accounts payable of the Group and the Company was not due to any shareholders holding over 5% (5% inclusive) of the Company's shares.
- (4) The Group does not have any amount due to related parties. The Company has amount due to other related parties in its accounts payable as follows:

| Name | Closing balance | Opening balance |
|---|-----------------|-----------------|
| Molong Drilling Equipment | 20,194,138.58 | 13,259,789.17 |
| Shouguang Baolong | — | 78,381,361.29 |
| Weihai Baolong | — | 56,420,012.58 |
| Molong Electro-mechanical Equipment Company Limited | 7,415,268.46 | 11,601,146.77 |
| Maolong Old Metals Recycle Company Limited | 360,215.00 | — |
| Total | 27,969,622.04 | 159,662,309.81 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

22. Advance receipts

- (1) Breakdown of advance receipts is set out as follows:

| Item | Consolidation | | The Company | |
|---------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Advance sales | 34,721,719.22 | 52,528,174.61 | 80,810,957.44 | 89,246,325.87 |

RMB

As at 31 December 2010, the Group does not have any single material advance receipt of over RMB2,000,000.00 aged over 1 year. The balance of advance receipt aged over 1 year of the Company amounted to RMB41,447,939.80, which was the advance receipt for product sales from MPM Company. As sales of relevant product have not been realized, no amount has been carried forward as income at the end of the year. As at the approval date of the financial statements, the above amount has not been carried forward as income.

- (2) At the end of the current period, the advance receipts of the Group and the Company were not received from any shareholders holding over 5% (5% inclusive) of the Company's shares.
- (3) The Group does not have any advance receipts from related parties. The Company has advance receipts from related parties as follows:

| Name | RMB | |
|---------------------------|-----------------|-----------------|
| | Closing balance | Opening balance |
| MPM International Limited | 58,889,120.06 | 44,915,955.73 |

23. Employee benefits payable

Consolidation

| Items | RMB | | | |
|--|-----------------|---------------------------|------------------------|-----------------|
| | Opening balance | Accrued during the period | Paid during the period | Closing balance |
| Salaries, bonuses, allowance and subsidies | 14,666,889.95 | 84,820,347.58 | 82,001,268.03 | 17,485,969.50 |
| Staff welfare | 789,105.39 | 1,929,702.91 | 2,617,572.48 | 101,235.82 |
| Social insurance premiums | | 6,420,449.11 | 6,420,449.11 | — |
| Housing provident funds | | 2,155,927.16 | 2,155,927.16 | — |
| Others | 257,930.44 | 1,187,489.24 | 1,192,935.24 | 252,484.44 |
| Total | 15,713,925.78 | 96,513,916.00 | 94,388,152.02 | 17,839,689.76 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

23. Employee benefits payable

The Company

| Items | RMB | | | |
|--|---------------------|---------------------------|------------------------|----------------------|
| | Opening balance | Accrued during the period | Paid during the period | Closing balance |
| Salaries, bonuses, allowance and subsidies | 9,199,137.76 | 53,277,042.68 | 51,325,958.91 | 11,150,221.53 |
| Staff welfare | — | 1,262,167.28 | 1,262,167.28 | — |
| Social insurance premiums | — | 5,448,227.42 | 5,448,227.42 | — |
| Housing provident funds | — | 1,598,746.32 | 1,598,746.32 | — |
| Others | — | 327,500.15 | 327,500.15 | — |
| Total | 9,199,137.76 | 61,913,683.85 | 59,962,600.08 | 11,150,221.53 |

24. Tax payables

| Items | RMB | | | |
|-----------------------|----------------------|----------------------|----------------------|----------------------|
| | Consolidation | | The Company | |
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Income tax | 24,042,381.60 | 30,397,775.82 | 14,139,491.74 | 12,178,964.50 |
| Value added tax | 3,134,259.26 | 8,318,334.28 | — | 902,438.50 |
| Business tax | 413,200.00 | 351,784.55 | — | (61,315.45) |
| Individual income tax | 132,074.96 | 5,389.12 | 66,662.06 | — |
| Others | 1,706,462.07 | 1,312,070.90 | 523,705.61 | (33,543.70) |
| Total | 29,428,377.89 | 40,385,354.67 | 14,729,859.41 | 12,986,543.85 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

25. Interest payables

| Item | Consolidation | | The Company | |
|--------------------------------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Interest of Bank loan | 751,797.63 | 563,315.00 | 751,797.63 | — |
| Interest of loan from Finance Bureau | 203,750.00 | — | — | — |
| Total | 955,547.63 | 563,315.00 | 751,797.63 | — |

26. Dividends payable

Consolidation and the Company

| Name | RMB | |
|-------------------------|-----------------|-----------------|
| | Closing balance | Opening balance |
| Domestic Natural person | 23,788,680.00 | 39,591,725.86 |

Balance of dividends payable amounted to RMB23,788,680.00, which represents the dividends not taken up by investors and will be paid before June 2011.

27. Other payables

(1) Breakdown of other payables is set out as follows:

| Items | Consolidation | | The Company | |
|---|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Advance in electricity fees and delivery expenses | 10,640,796.42 | 8,849,638.71 | 4,826,422.70 | 2,926,262.11 |
| A Shares listing expenses | 2,680,000.00 | — | 2,680,000.00 | — |
| Cash pledge | 5,876,238.62 | 4,982,680.59 | 4,664,738.62 | 4,199,180.59 |
| Others | 6,794,877.62 | 3,438,690.77 | 2,072,024.78 | 1,511,804.06 |
| Total | 25,991,912.66 | 17,271,010.07 | 14,243,186.10 | 8,637,246.76 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

- (2) The other payables of the Group and the Company at the end of the year were not due to any shareholders who holding over 5% (5% inclusive) of the Company's shares.
- (3) The Group does not have amounts due to other related parties in its other payables. The Company has amounts due to other related parties in its other payables as follows:

| Items | RMB | |
|--|-----------------|-----------------|
| | Closing balance | Opening balance |
| Maolong Old Metals Recycle Company Limited | 622,553.06 | — |

Long-term borrowings due within one year

| Items | Consolidation | | The Company | |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Long-term loans due within one year | — | 193,000,000.00 | — | 50,000,000.00 |

29. Long-term borrowings

Consolidation

- (1) Types of long-term borrowings

| Items | RMB | |
|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance |
| Credit loans | 430,000,000.00 | |
| Guarantee loans | — | 150,000,000.00 |
| Total | 580,000,000.00 | |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

29. Long-term borrowings (continued)

Consolidation (continued)

(2) The borrowings from the above banks repaid by following ways:

| Items | Closing balance | RMB Opening balance |
|---|-----------------|---------------------------|
| At sight or within 1 year | — | 193,000,000.00 |
| Over 1 year but not more than 2 years | — | 380,000,000.00 |
| Over 2 year but not more than 5 years | — | 50,000,000.00 |
| Over 5 years | — | 150,000,000.00 |
| Less:long-term borrowings due within 1 year | — | 193,000,000.00 |
| Total | — | 580,000,000.00 |

(3) Top five long-term borrowings

| Borrowing units | Starting date | Expiry date | Currency | Interest rate (%) | Closing balance | |
|--|---------------|-------------|----------|-------------------|------------------|---------------------|
| | | | | | Foreign currency | Functional currency |
| Agricultural Bank of China, Shouguang Branch, Eastern Office | 2009.03.19 | 2011. 12.14 | RMB | 5.31-5.40 | — | 260,000,000.00 |
| Bank of China, Shouguang Branch | 2009.09.18 | 2012.09.18 | RMB | 5.31-5.40 | — | 150,000,000.00 |
| China Construction Bank, Shouguang Branch | 2009.02.23 | 2013.11.22 | RMB | 5.76 | — | 150,000,000.00 |
| Weifang Commercial Bank, Zaochunyuan Branch | 2009.12.28 | 2011.12.28 | RMB | 5.31 | — | 20,000,000.00 |
| Total | | | | | | 580,000,000.00 |

Note : The above long-term loans of the Group at the beginning of the year has been repaid early in the current year.

The Company

(1) Types of long-term borrowings

| Items | Closing balance | RMB Opening balance |
|-----------------|-----------------|---------------------------|
| Credit loans | — | 410,000,000.00 |
| Guarantee loans | — | 150,000,000.00 |
| Total | — | 560,000,000.00 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

29. Long-term borrowings (continued)

The Company (continued)

(2) The borrowings from the above banks repaid by following ways:

| Items | Closing balance | RMB Opening balance |
|--|-----------------|---------------------------|
| At sight or within 1 year | — | 50,000,000.00 |
| Over 1 year but not more than 2 years | — | 360,000,000.00 |
| Over 2 year but not more than 5 years | — | 50,000,000.00 |
| Over 5 years | — | 150,000,000.00 |
| Less: long-term borrowings due within 1 year | — | 50,000,000.00 |
| Total | — | 560,000,000.00 |

(3) Top five long-term borrowings

| Borrowing units | Starting date | Expiry date | Currency | Interest rate (%) | Foreign currency | Closing balance Functional currency |
|--|---------------|-------------|----------|-------------------|------------------|---|
| Agricultural Bank of China, Shouguang Branch, Eastern Office | 2009.03.19 | 2011. 12.14 | RMB | 5.31-5.40 | — | 260,000,000.00 |
| Bank of China, Shouguang Branch | 2009.09.18 | 2012.09.18 | RMB | 5.31-5.40 | — | 150,000,000.00 |
| China Construction Bank, Shouguang Branch | 2009.02.23 | 2013.11.22 | RMB | 5.76 | — | 150,000,000.00 |
| Total | | | | | | 560,000,000.00 |

Note : The above long-term borrowing of the Company at the beginning of the year have been repaid early in the current year.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

30. Share capital

Consolidation and the Company

| | Opening balance | Change for the period | | | | Sub-total | Closing balance |
|---|-----------------|-----------------------|--------------|------------------------------|--------|---------------|-----------------|
| | | New issue | Bonus shares | Shares transfer from reserve | Others | | |
| 2010: | | | | | | | |
| I. <i>Restricted shares outstanding</i> | | | | | | | |
| 1. Other domestic shares | 2,622,000.00 | — | — | — | — | — | 2,622,000.00 |
| 2. Natural person shares | 198,239,000.00 | — | — | — | — | — | 198,239,000.00 |
| 3. RMB ordinary shares | — | 14,000,000.00 | — | — | — | 14,000,000.00 | 14,000,000.00 |
| Total number of restricted shares outstanding | 200,861,000.00 | 14,000,000.00 | — | — | — | 14,000,000.00 | 214,861,000.00 |
| II. <i>Non-restricted shares</i> | | | | | | | |
| 1. RMB ordinary shares | — | 56,000,000.00 | — | — | — | 56,000,000.00 | 56,000,000.00 |
| 2. Overseas listed foreign shares | 128,063,200.00 | — | — | — | — | — | 128,063,200.00 |
| Total number of non-restricted shares | 128,063,200.00 | 56,000,000.00 | — | — | — | 56,000,000.00 | 184,063,200.00 |
| Total shares | 328,924,200.00 | 70,000,000.00 | — | — | — | 70,000,000.00 | 398,924,200.00 |
| 2009 : | | | | | | | |
| I. <i>Restricted shares</i> | | | | | | | |
| 1. Other domestic shares | 2,622,000.00 | — | — | — | — | — | 2,622,000.00 |
| 2. Natural person shares | 198,239,000.00 | — | — | — | — | — | 198,239,000.00 |
| Total number of restricted shares outstanding | 200,861,000.00 | — | — | — | — | — | 200,861,000.00 |
| II. <i>Non-restricted shares</i> | | | | | | | |
| 1. Overseas listed foreign shares | 128,063,200.00 | — | — | — | — | — | 128,063,200.00 |
| Total number of non-restricted shares | 128,063,200.00 | — | — | — | — | — | 128,063,200.00 |
| Total shares | 328,924,200.00 | — | — | — | — | — | 328,924,200.00 |

On 29 December 2009, the Board of the Company resolved to implement share consolidation, that every 10 shares in issue of RMB0.10 each would be consolidated into 1 share of RMB1.00. The share consolidation has completed on 7 January 2010. Upon such share consolidation, the total number of shares of the Company has changed to 328,924,200 shares of RMB1.00 each.

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

30. Share capital (continued)

Consolidation and the Company (continued)

Upon the approval of CSRC with "Approval and Reply Regarding the Initial Public Offering of Shares of Shandong Molong Petroleum Machinery Company Limited" (Zheng Jian Xu Ke [2010] No. 1285) (《關於核准山東墨龍石油機械股份有限公司首次公開發行股票的批復》(證監許可[2010]1285號文)), on 11 October 2010, the Company offered 70,000,000 Renminbi shares (A Shares) of RMB1 each at an offering price of RMB18 per share. After the deduction of issuing expenses such as underwriting fees and sponsoring fees, the net proceeds raised amounted to RMB1,196,738,331.50, representing a net value of fund raised per share of RMB17.10. Of the funds raised, RMB720,000,000 was contributed to the 180mm Special Petroleum Pipes Technical Reconstruction Project, RMB220,000,000.00 was used in the implementation of oil pipes processing project by Weihai Baolong, and RMB256,738,331.50 was used to satisfy the liquidity of the Company. The registered capital has changed to RMB398,924,200.00 after the issuance. 山東正源和信有限責任會計師事務所 has verified and issued the capital examination report Lu Zheng Xin Yan Zi (2010) No. 3032 (魯正信驗字(2010)第3032號).

31. Capital reserves

Consolidation and the Company

| Items | RMB | | | |
|-------------------------------------|-----------------------|----------------------------|-------------------------|-------------------------|
| | Opening balance | Increase for the period | Decrease for the period | Closing balance |
| 2010: | | | | |
| Capital premium | 121,667,859.42 | 1,126,738,331.50 | — | 1,248,406,190.92 |
| Of which: | | | | |
| Capital contribution from investors | 121,667,859.42 | 1,126,738,331.50 (Note) | — | 1,248,406,190.92 |
| Total | 121,667,859.42 | 1,126,738,331.50 | — | 1,248,406,190.92 |
| 2009: | | | | |
| Capital premium | 121,667,859.42 | — | — | 121,667,859.42 |
| Of which: | | | | |
| Capital contribution from investors | 121,667,859.42 | — | — | 121,667,859.42 |
| Total | 121,667,859.42 | — | — | 121,667,859.42 |

Note : The new capital premium for the current year was due to payment of underwriting commission for the shares and balance after other issuing expenses for the issuance of Renminbi ordinary share (A Shares) on 11 October 2010 by the Company to raise capital (deducting nominal value of capital).



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

32. Surplus reserve

Consolidation and the Company

| Items | Opening balance | Increase for the period | Decrease for the period | RMB Closing balance |
|---------------------------|--------------------|----------------------------|----------------------------|---------------------------|
| 2010: | | | | |
| Statutory surplus reserve | 108,376,005.02 | 32,017,442.04 | — | 140,393,447.06 |
| 2009: | | | | |
| Statutory surplus reserve | 80,086,723.93 | 28,289,281.09 | — | 108,376,005.02 |

Statutory surplus reserve is detailed in note (V) 33

33. Undistributed profits

Consolidation

| Items | Amount | RMB Proportion of appropriation or allocation |
|---|----------------|--|
| 2010: | | |
| Undistributed profits at the beginning of the year | 694,089,054.29 | |
| Add: Net profits attribute to the shareholders of the Company of the year | 276,149,165.54 | |
| Less: Appropriation of statutory surplus reserves | 32,017,442.04 | Note 1 |
| Ordinary shares dividend payable | 39,470,904.00 | Note 2 |
| Ordinary shares dividend transfer as share capital | — | |
| Undistributed profits at the end of the year | 898,749,873.79 | |
| 2009 : | | |
| Undistributed profits at the beginning of the year | 519,848,018.05 | |
| Add: Net profits attribute to the shareholders of the Company of the year | 268,315,157.33 | |
| Less: Appropriation of statutory surplus reserves | 28,289,281.09 | Note 1 |
| Ordinary shares dividend payable | 65,784,840.00 | Note 2 |
| Ordinary shares dividend transfer as share capital | — | |
| Undistributed profits at the end of the year | 694,089,054.29 | |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

33. Undistributed profits (continued)

The Company

| Items | Amount | RMB Proportion of appropriation or allocation |
|---|----------------|--|
| 2010: | | |
| Undistributed profits at the beginning of the year | 575,546,933.68 | |
| Add: Net profits attribute to the shareholders of the Company of the year | 320,174,420.42 | |
| Less: Appropriation of statutory surplus reserves | 32,017,442.04 | Note 1 |
| Ordinary shares dividend payable | 39,470,904.00 | Note 2 |
| Ordinary shares dividend transfer as share capital | — | |
| Undistributed profits at the end of the year | 824,233,008.06 | |
| 2009: | | |
| Undistributed profits at the beginning of the year | 386,728,243.88 | |
| Add: Net profits attribute to the shareholders of the Company of the year | 282,892,810.89 | |
| Less: Appropriation of statutory surplus reserves | 28,289,281.09 | Note 1 |
| Ordinary shares dividend payable | 65,784,840.00 | Note 2 |
| Ordinary shares dividend transfer as share capital | — | |
| Undistributed profits at the end of the year | 575,546,933.68 | |

As at 31 December 2010, the statutory surplus reserve provided for each subsidiary as calculated by the shareholding proportion of the undistributed profit of the Group amounted to RMB30,036,593.43 (31 December 2009: RMB29,752,392.16). As at 31 December 2010, the profit distributed to shareholders of the Company was RMB824,233,008.06 (31 December 2009: RMB575,546,933.68).

Note1: Withdrawal of statutory surplus reserve

As required by the Articles of Association, statutory surplus reserve is withdrawn at 10% of net profit. If the accumulated amount of the Company's statutory surplus reserve is over 50% of its registered capital, no withdrawal would be allowed.

Note2: Cash dividend for the first half of the year as approved in 2008-2009 annual general meeting.

According to the resolution of the Board meeting of the Company convened on 16 February 2009, with 30 June 2009 as the base date of dividend distribution and a total of 3,289,242,000 shares (with a nominal value of RMB0.10 per share) as the basis, as well as a cash dividend of RMB0.02 per share distributed to all shareholders. Such resolution has been passed in the 2008 general meeting.

According to the Board resolution of the Company convened on 5 February 2010, with 28 March 2010 as the base date of dividend distribution and a total of 328,924,200 shares (with a nominal value of RMB1 as the basis, a cash dividend of RMB0.12 per share distributed to all shareholders. Such resolution has been passed in the 2009 general meeting.

Note3: Distribution of profits after Balance Sheet

The proposed profit distribution plan of 2010 was passed in the sixth Board meeting of the third session which hold on 29 March 2011, based on the total share capital of 398,924,200 shares as at the end of 2010, RMB0.15 per share was paid and the total cash dividends amount to RMB59,838,630.00. The above proposal will be approved by Shareholders' Meeting.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

34. Minority shareholders' interest

Minority shareholders' interest are as follows:

| Name | RMB | |
|---------------------------|-----------------|-----------------|
| | Closing balance | Opening balance |
| MPM International Limited | 1,113,902.05 | 5,879,803.06 |
| Shouguang Baolong | 56,099,071.75 | 55,435,222.53 |
| Total | 57,212,973.80 | 61,315,025.59 |

35. Operating revenue and cost of operations

Consolidation

(1) Operating Revenue

| Items | RMB | |
|-----------------------------|------------------------------------|-------------------------------------|
| | Incurred during the current period | Incurred during the previous period |
| Principal operating revenue | 2,652,746,555.56 | 2,041,376,910.67 |
| Other business revenue | 51,160,279.63 | 34,174,375.00 |
| Cost of operations | 2,237,506,663.67 | 1,678,634,536.19 |

(2) Principal operations (by product)

| Products | RMB | | | |
|------------------------------|------------------------------------|--------------------|-------------------------------------|--------------------|
| | Incurred during the current period | | Incurred during the previous period | |
| | Operating Revenue | Cost of operations | Operating Revenue | Cost of operations |
| Casing and Tubing | 2,126,589,473.71 | 1,722,881,977.14 | 1,725,410,397.39 | 1,385,110,266.51 |
| Three kinds of pumping units | 111,655,198.06 | 88,484,979.52 | 105,720,191.88 | 80,279,175.50 |
| Petroleum machinery | 148,493,859.41 | 125,039,346.09 | 83,505,727.48 | 64,545,773.00 |
| Others | 266,008,024.38 | 253,518,564.08 | 126,740,593.92 | 117,847,541.33 |
| Total | 2,652,746,555.56 | 2,189,924,866.83 | 2,041,376,910.67 | 1,647,782,756.34 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

35. Operating revenue and cost of operations (continued)

Consolidation (continued)

(3) Principal operations (by Geographical segment)

| Regions | Incurred during the current period | | Incurred during the previous period | |
|----------|---------------------------------------|-----------------------|--|-----------------------|
| | Operating Revenue | Cost of operations | Operating Revenue | Cost of operations |
| | RMB | | | |
| PRC | 1,703,047,344.22 | 1,424,007,536.39 | 1,308,532,347.24 | 1,056,685,164.08 |
| Overseas | 949,699,211.34 | 765,917,330.44 | 732,844,563.43 | 591,097,592.26 |
| Total | 2,652,746,555.56 | 2,189,924,866.83 | 2,041,376,910.67 | 1,647,782,756.34 |

(4) Top 5 customers' revenue from sales are as follows:

| Name of customer | Operating Revenue | The percentage of the total sales revenue% |
|---|----------------------|--|
| | | RMB |
| China National Petroleum Corporation | 491,134,492.75 | 18.16 |
| SB International Inc | 300,664,882.73 | 11.12 |
| Shandong Luxin Steel Pipes Co., Ltd | 285,369,517.58 | 10.55 |
| Liaocheng Shandong Zhong Ganglian Steel Metal Manufacturing Co., Ltd | 220,290,055.42 | 8.15 |
| Yantai Steel Pipe Co., Ltd. of Laiwu Iron & Steel Group | 142,292,945.04 | 5.26 |
| Total | 1,439,751,893.52 | 53.24 |

The Company

(1) Operating Revenue

| Items | Incurred during the current period | Incurred during the previous period |
|--------------------------------|---------------------------------------|--|
| | RMB | |
| Principal operating Revenue | 2,474,408,308.66 | 1,915,937,699.78 |
| Other operating Revenue (Note) | 188,633,332.92 | 83,686,651.60 |
| Cost of operations | 2,253,227,044.55 | 1,698,338,793.43 |

Note: The income from investment real estate included in other operation income of 2010 and 2009 were all RMB690,000.00.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

35. Operating revenue and cost of operations (continued)

The Company (continued)

(2) Principal operations (by product)

| Products | Incurred during the current period | | Incurred during the previous period | |
|---------------------------------|---------------------------------------|-------------------------|--|-------------------------|
| | Operating Revenue | Cost of operations | Operating Revenue | Cost of operations |
| | | | | |
| Casing and Tubing | 2,126,589,473.71 | 1,763,881,977.14 | 1,724,614,928.07 | 1,460,348,952.54 |
| Three kinds of pumping units | 111,655,198.06 | 93,484,979.52 | 100,692,074.77 | 82,583,781.10 |
| Petroleum machinery | 148,493,859.41 | 125,380,683.43 | 84,051,508.17 | 71,227,666.41 |
| Others | 87,669,777.48 | 85,297,570.28 | 6,579,188.77 | 3,167,602.44 |
| Total | 2,474,408,308.66 | 2,068,045,210.37 | 1,915,937,699.78 | 1,617,328,002.49 |

(3) Principal operations (by Geographical segment)

| Regions | Incurred during the current period | | Incurred during the previous period | |
|--------------|---------------------------------------|-------------------------|--|-------------------------|
| | Operating Revenue | Cost of operations | Operating Revenue | Cost of operations |
| | | | | |
| PRC | 1,524,709,097.32 | 1,302,127,879.93 | 1,183,093,136.35 | 1,026,230,410.23 |
| Overseas | 949,699,211.34 | 765,917,330.44 | 732,844,563.43 | 591,097,592.26 |
| Total | 2,474,408,308.66 | 2,068,045,210.37 | 1,915,937,699.78 | 1,617,328,002.49 |

(4) Top 5 customers' revenue from sales are as follows:

| Name of customer | Operating Revenue | The percentage of the total sales revenue% |
|---|-------------------------|--|
| | | RMB |
| China National Petroleum Corporation | 491,134,492.75 | 18.44 |
| SB International Inc | 300,664,882.73 | 11.29 |
| Shandong Luxin Steel Pipes Co., Ltd | 285,369,517.58 | 10.72 |
| Liaocheng Shandong Zhong Ganglian Steel Metal Manufacturing Co., Ltd | 220,290,055.42 | 8.27 |
| Campex Inc | 140,568,554.07 | 5.28 |
| Total | 1,438,027,502.55 | 54.00 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

36. Tax and levies on operations

Consolidation

| Items | RMB | |
|---|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Business tax | 100.00 | 49,790.97 |
| Urban maintenances and construction tax | 3,062,313.86 | 2,326,991.45 |
| Educational surcharges | 1,504,236.04 | 1,176,639.27 |
| Others | 245,657.56 | 153,070.14 |
| Total | 4,812,307.46 | 3,706,491.83 |

The Company

| Items | RMB | |
|--------------|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Business tax | — | 33,124.30 |

37. Selling expenses

Consolidation

| Items | RMB | |
|-------------------------------|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Delivery expenses | 40,861,583.20 | 28,685,555.36 |
| Intermediate fees | 2,182,935.78 | 8,924,345.73 |
| Travelling expenses | 1,722,858.54 | 1,908,538.05 |
| Business reception fees | 1,697,598.20 | 2,121,735.77 |
| Salary | 1,313,289.67 | 2,190,974.36 |
| Office expenses | 507,632.80 | 578,617.63 |
| Agency fees | 392,833.43 | 14,220,324.47 |
| Transportation fees | 274,414.95 | 556,286.99 |
| Storage and sales agency fees | 210,332.65 | 286,402.55 |
| Depreciation charge | 177,752.87 | 202,009.58 |
| Others | 2,019,596.43 | 1,575,847.30 |
| Total | 51,360,828.52 | 61,250,637.79 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

37. Selling Expenses (continued)

The Company

| Items | RMB | |
|-------------------------------|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Delivery expenses | 40,777,883.31 | 28,201,397.07 |
| Intermediate fees | 2,182,935.78 | 8,924,345.73 |
| Travelling expenses | 1,560,071.14 | 1,675,200.25 |
| Business reception fees | 1,485,494.00 | 1,993,447.67 |
| Salary | 1,117,076.03 | 2,051,959.33 |
| Office expenses | 451,265.80 | 450,039.71 |
| Agency fees | 392,833.43 | 14,220,324.47 |
| Transportation fees | 274,414.95 | 526,276.99 |
| Storage and sales agency fees | 210,332.65 | 286,402.55 |
| Depreciation charge | 177,752.87 | 202,009.58 |
| Others | 1,971,074.43 | 1,524,543.34 |
| Total | 50,601,134.39 | 60,055,946.69 |

38. Management fees

Consolidation

| Item | RMB | |
|---|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Research and development fees of new products | 25,522,276.35 | 11,775,944.36 |
| Amortization of intangible assets | 12,078,058.98 | 7,878,717.31 |
| Salary and Staff welfare expenses | 9,682,607.82 | 7,422,239.78 |
| Depreciation charges | 8,634,192.67 | 12,675,711.71 |
| Repair fees | 8,574,919.85 | 1,640,543.11 |
| Taxes | 7,426,098.83 | 5,875,486.33 |
| Machinery material consumption | 7,198,839.15 | 6,858,702.52 |
| Office expenses | 3,375,501.27 | 743,006.36 |
| Electricity fees | 1,258,328.67 | 1,017,622.46 |
| Business reception fees | 881,678.00 | 600,211.38 |
| Property insurance fees | 795,582.84 | 470,549.79 |
| Intermediate fees | 731,650.28 | 2,504,270.94 |
| Travelling expenses | 572,643.42 | 1,088,385.43 |
| Environmental protection expenses | 531,842.14 | 525,866.30 |
| Transportation fees | 485,824.60 | 431,423.15 |
| Promotion expenses | 482,411.48 | 374,310.00 |
| Stream fees | 445,936.07 | 155,023.87 |
| Delivery expenses | 307,926.85 | 782,189.26 |
| Water fees | 220,170.82 | 250,265.63 |
| Others | 2,177,480.95 | 758,942.34 |
| Total | 91,383,971.04 | 63,829,412.03 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

38. Management fees (continued)

The Company

| Item | RMB | |
|---|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Research and development fees of new products | 25,392,276.35 | 11,164,233.61 |
| Amortization of intangible assets | 10,546,033.07 | 6,352,468.47 |
| Machinery material consumption | 7,146,708.74 | 6,669,457.07 |
| Salary and Staff welfare expenses | 6,818,458.53 | 5,058,455.35 |
| Depreciation charges | 5,747,945.14 | 5,588,503.99 |
| Taxes | 4,668,507.68 | 3,578,000.15 |
| Office expenses | 3,040,248.20 | 543,284.35 |
| Electricity fees | 1,251,528.67 | 1,007,236.01 |
| Intermediate fees | 680,642.30 | 2,069,973.14 |
| Business reception fees | 596,565.96 | 456,699.91 |
| Promotion expenses | 482,411.48 | 374,310.00 |
| Transportation expenses | 467,693.64 | 413,910.08 |
| Stream fees | 445,936.07 | 570,495.27 |
| Travelling expenses | 416,621.05 | 924,645.67 |
| Environment protection expenses | 372,662.14 | 592,886.30 |
| Property insurance fees | 368,568.62 | 273,153.75 |
| Delivery expenses | 304,020.85 | 720,997.52 |
| Repair fees | 321,029.08 | 306,725.48 |
| Water fees | 175,852.82 | 174,929.63 |
| Others | 1,036,771.05 | 779,574.59 |
| Total | 70,280,481.44 | 47,619,940.34 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

39. Finance fees

Consolidation

| Item | RMB | |
|--|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Interest expenses | 65,978,204.21 | 47,919,108.93 |
| Less : Capitalized interest expenses | 26,583,267.92 | 17,602,842.64 |
| Less : Interest income | 5,112,478.99 | 17,077,509.81 |
| Foreign exchange difference | 6,584,539.78 | (3,894,351.98) |
| Less : Capitalized foreign exchange difference | — | — |
| Others | 3,474,875.66 | 1,312,477.04 |
| Total | 44,341,872.74 | 10,656,881.54 |

The Company

| Items | RMB | |
|--|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Interest expenses | 55,472,225.93 | 35,478,263.23 |
| Less : Capitalized interest expenses | 25,752,087.94 | 17,602,842.64 |
| Less : Interest income | 4,791,051.40 | 17,012,595.51 |
| Foreign exchange difference | 6,584,539.78 | (3,903,809.79) |
| Less : Capitalized foreign exchange difference | — | — |
| Others | 2,302,427.80 | 1,278,859.77 |
| Total | 33,816,054.17 | (1,762,124.94) |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

40. Loss on impairment of assets

Consolidation

| Items | RMB | |
|--------------------------------------|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Provision of bad debt | (513,766.81) | (11,061,162.98) |
| Including: accounts receivable | (513,766.81) | (8,461,162.98) |
| Other accounts receivable | — | (2,600,000.00) |
| Provision of allowance for inventory | (1,510,521.67) | (1,654,396.94) |
| Including: Raw materials | (1,395,116.85) | 383,578.58 |
| Work-in-progress | 41,242.13 | (2,288,013.33) |
| Finished product | (156,646.95) | 250,037.81 |
| Total | (2,024,288.48) | (12,715,559.92) |

The Company

| Items | RMB | |
|--------------------------------------|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Provision of bad debt | (513,766.81) | (8,048,812.97) |
| Including: accounts receivable | (513,766.81) | (8,048,812.97) |
| Other accounts receivable | — | — |
| Provision of allowance for inventory | (1,027,510.28) | (1,654,396.94) |
| Including: Raw materials | (878,259.08) | 383,578.58 |
| Finished product | 105,306.61 | (2,288,013.33) |
| Work-in-progress | (254,557.81) | 250,037.81 |
| Total | (1,541,277.09) | (9,703,209.91) |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

41. Profit or loss on changes in fair value

Consolidation

| Source of profit and loss on changes in fair value | RMB | |
|--|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Tradable financial assets | — | (49,650,000.00) |
| Tradable financial liabilities | — | 44,380,000.00 |
| Total | — | (5,270,000.00) |

The Company

| Source of profit and loss on changes in fair value | RMB | |
|--|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Tradable financial liabilities | — | 44,380,000.00 |
| Total | — | 44,380,000.00 |

42. Investment income

Consolidation

(1) Breakdown of investment income

| Items | RMB | |
|---|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Gain from long-term equity investments accounted for using the equity method | 191,250.95 | 247,137.15 |
| Investment gain received from the disposal of tradable financial assets/liabilities | — | 5,580,000.00 |
| Total | 191,250.95 | 5,827,137.15 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

42. Investment income (continued)

Consolidation (continued)

(2) Gain from long-term equity investments accounted for using the equity method

| Investee | Incurred during the current period | Incurred during the previous period | RMB |
|-----------------|---------------------------------------|--|--|
| | | | Reason of change from the previous period to the current period |
| Yalong Oil Pump | 191,250.95 | 247,137.15 | the net profit of the investee achieved in the current year took change |

(3) There are no significant restrictions on remittance of investment gains back to the Company.

The Company

(1) Breakdown of investment income

| Items | Incurred during the current period | RMB |
|---|---------------------------------------|--|
| | | Incurred during the previous period |
| Gain from long-term equity investments accounted for using the equity method | 85,765,164.48 | 76,610,000.00 |
| Investment gain/loss received from the disposal of tradable financial assets/liabilities | — | (41,200,000.00) |
| Total | 85,765,164.48 | 35,410,000.00 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

42. Investment income (continued)

The Company (continued)

(2) Gain from long-term equity investments accounted for using the cost method

| Investee | | | RMB |
|--------------------------------------|--|---|---|
| | Incurred during the current period | Incurred during the previous period | Reason of change from the previous period to the current period |
| Molong Drilling Equipment | — | 33,260,000.00 | Declaration of dividend distribution of investee in previous year |
| Shouguang Baolong | — | 10,500,000.00 | Declaration of dividend distribution of investee in previous year |
| Maolong Machinery Company Limited | 41,220,000.00 | 32,850,000.00 | Dividend distribution of investee in previous year |
| MPM International Limited | 44,545,164.48 | — | Dividend distribution of investee in previous year |
| Total | 85,765,164.48 | 76,610,000.00 | |

(3) There are no significant restrictions on remittance of investment gains back to the Company.

43. Non-operating income

Consolidation

(1) Breakdown of non-operating income is set out as follows:

| Items | RMB | | |
|--|--|---|---|
| | Incurred during the current period | Incurred during the previous period | Amounts credited to non-recurring profit or loss during the current year |
| Total income on disposal of non-current assets | 1,624,848.11 | 8,134,381.98 | 1,624,848.11 |
| Of which: Income on disposal of fixed assets | 1,624,848.11 | 8,134,381.98 | 1,624,848.11 |
| Government grants | 47,330,650.51 | 45,167,903.47 | 29,580,022.42 |
| Income from penalty | 261,980.70 | 821,728.11 | 261,980.70 |
| Others | 1,214,278.20 | 30,000.01 | 1,214,278.20 |
| Total | 50,431,757.52 | 54,154,013.57 | 32,681,129.43 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

43. Non-operating income (continued)

Consolidation (continued)

(2) Breakdown of Government grants

| Items | RMB | |
|--|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Financial subsidies (Note 1) | 29,580,022.42 | 37,162,000.00 |
| Tax rebate from value-added tax (Note 2) | 17,750,628.09 | 8,005,903.47 |
| Total | 47,330,650.51 | 45,167,903.47 |

Note 1: On 15 January 2010, the Company received the financial subsidies of RMB600,000.00 given to by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2010] No. 3 "Notice Regarding the Allocation of Special Fund for Fostering Stable Growth of Foreign Trade in 2009" (壽財企字[2010]3號文《關於撥付2009年促進對外貿易穩定增長專項資金的通知》). On 28 April 2010, the Company received the financial subsidies of RMB6,637,500.00 given by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2010] No. 76 "Notice Regarding the Financial Subsidies Given to Shandong Molong" (壽財預指字[2010]76號文《關於下達山東墨龍財政貼息資金的通知》). On 30 April 2010, the Company received the financial subsidies of RMB5,000,000.00 given to the Company by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2010] No. 280 "Notice Regarding the Financial Subsidies Given to Shandong Molong" (壽財預指字[2010]280號文《關於下達山東墨龍新產品研發資金的通知》). In 2010, Weihai Baolong Company received financial subsidies of RMB11,596,496.57 from Wei Hai City Gao Cun Town government and Baolong Resources Company received financial subsidies of RMB4,615,209.43 from Wei Hai City Gao Cun Town government.

Note 2: Molong Drilling Company is a social welfare enterprise. According to the requirements under "Cai Shui [2007] No. 92 Notice Regarding Taxation Concessionary Policies on Fostering Employment of Disabled People" (財稅[2007]92號文《關於促進殘疾人就業稅收優惠政策的通知》) issued by the Ministry of Finance and State Administration of Taxation, the company recognized income on value-added tax rebates of RMB2,476,758.58 for the current year. Maolong Reycle Company and Baolong Resources Company are operating entities involving scrap materials. According to the requirements under "Cai Shui [2008] No. 157 "Notice Regarding the Policies on Value-added Tax for Recyclable Resources" (財稅[2008]157號《關於再生資源增值稅政策的 通知》) issued by the Ministry of Finance and State Administration of Taxation, income on value-added tax rebates recognized for the current year amounted to RMB7,804,984.16 and RMB7,468,885.35.



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

43. Non-operating income (continued)

Consolidation (continued)

The Company

(1) Breakdown of non-operating expenses is set out as follows:

| Items | Incurred during the current period | Incurred during the previous period | RMB |
|---|---------------------------------------|--|--|
| | | | Amounts credited to non-recurring profit or loss during the current year |
| Total loss on disposal of non-current assets | 1,879,329.93 | 1,361,896.78 | 1,879,329.93 |
| Of which: | | | |
| Loss on disposal of fixed assets | 1,879,329.93 | 1,361,896.78 | 1,879,329.93 |
| Government grants | 12,237,500.00 | 30,225,000.00 | 12,237,500.00 |
| Income from penalty | — | 597,250.29 | — |
| Others | 716,313.29 | — | 716,313.29 |
| Total | 14,833,143.22 | 32,184,147.07 | 14,833,143.22 |

(2) Breakdown of Government grants:

| Items | Incurred during the current period | Incurred during the previous period |
|---------------------|---------------------------------------|--|
| Financial subsidies | 12,237,500.00 | 30,225,000.00 |

Note: On 15 January 2010, the Company received the financial subsidies of RMB600,000.00 given to by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2010] No. 3 "Notice Regarding the Allocation of Special Fund for Fostering Stable Growth of Foreign Trade in 2009" (壽財企字[2010]3號文《關於撥付2009年促進對外貿易穩定增長專項資金的通知》). On 28 April 2010, the Company received the financial subsidies of RMB6,637,500.00 given to the Company by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2010] No. 76 "Notice Regarding the Financial Subsidies Given to Shandong Molong" (壽財預指字[2010]76號文《關於下達山東墨龍財政貼息資金的通知》). On 30 April 2010, the Company received the financial subsidies of RMB5,000,000.00 given to the Company by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2010] No. 280 "Notice Regarding the Financial Subsidies Given to Shandong Molong" (壽財預指字[2010]280號文《關於下達山東墨龍新產品研發資金的通知》).

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

44. Non-operating expenses

Consolidation

| Items | RMB | | |
|--|-------------------------------------|--------------------------------------|---|
| | Incurring during the current period | Incurring during the previous period | Amounts credited to non-recurring profit or loss for the current year |
| Total loss on disposal of non-current assets | 2,123,471.06 | 312,747.82 | 2,123,471.06 |
| Of which: Loss on disposal of fixed assets | 2,123,471.06 | 312,747.82 | 2,123,471.06 |
| Donation expenses | 437,078.00 | 224,000.00 | 437,078.00 |
| Others | 104,138.20 | 82,850.50 | 104,138.20 |
| Total | 2,664,687.26 | 619,598.32 | 2,664,687.26 |

The Company

| Items | RMB | | |
|--|-------------------------------------|--------------------------------------|---|
| | Incurring during the current period | Incurring during the previous period | Amounts credited to non-recurring equity for the current year |
| Total loss on disposal of non-current assets | 1,717,023.19 | 145,359.56 | 1,717,023.19 |
| Of which: Loss on disposal of fixed assets | 1,717,023.19 | 145,359.56 | 1,717,023.19 |
| Donation expenses | 306,000.00 | 192,000.00 | 306,000.00 |
| Others | — | 25,090.59 | — |
| Total | 2,023,023.19 | 362,450.15 | 2,023,023.19 |

45. Non-operating expenses

| Items | Consolidation | | The Company | |
|---|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|
| | Incurring during the current period | Incurring during the previous period | Incurring during the current period | Incurring during the previous period |
| Income tax for the current period calculated according to tax laws and relevant rules | 42,950,274.04 | 48,530,504.19 | 37,838,088.74 | 25,667,385.39 |
| Adjustment on deferred income tax | 4,553,218.77 | 1,927,652.02 | (2,779,020.53) | 8,093,382.11 |
| Total | 47,503,492.81 | 50,458,156.21 | 35,059,068.21 | 33,760,767.50 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

45. Non-operating expenses (continued)

Reconciliation between income tax expenses and accounting profits is set out as follows:

| | Consolidation | | The Company | |
|---|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|
| | Incurring during the current period | Incurring during the previous period | Incurring during the current period | Incurring during the previous period |
| Accounting profit | 324,483,801.45 | 324,280,438.61 | 355,233,488.63 | 316,653,578.39 |
| Income tax calculated at tax rate of 15% on the Company | 48,672,570.21 | 48,642,065.79 | 53,285,023.29 | 47,498,036.76 |
| Effect of non-deductible expenses | 524,061.58 | 736,783.97 | 125,614.35 | 156,622.44 |
| Effect of non-taxable income | (99,241.34) | (3,015,209.90) | (12,935,328.37) | (12,536,907.15) |
| Additional charge on research and development expenses | (2,351,549.34) | (1,047,182.77) | (2,351,549.34) | (1,047,182.77) |
| Additional charge on disabled staff salary | (158,187.20) | (170,061.10) | — | — |
| Income exempted for civil welfare enterprises | — | (621,145.04) | — | — |
| Effect of non-consistent tax rates among branch companies of subsidiaries | 3,980,530.62 | 6,242,707.04 | — | — |
| Difference between applicable income tax rate for previous year and applicable tax rate for deferred income tax assets/liabilities recognized | (285,335.03) | (309,801.78) | (285,335.03) | (309,801.78) |
| Changes on balance of deferred income tax assets at the beginning of the year caused by adjustment of tax rate | (2,779,356.69) | — | (2,779,356.69) | — |
| Income tax expense | 47,503,492.81 | 50,458,156.21 | 35,059,068.21 | 33,760,767.50 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

46. The computational process of basic and diluted earnings per share

- (1) Net profits for the period attributable to ordinary shareholders for the purpose of calculating earnings per share are as follows:

| | RMB | RMB |
|--|---|--|
| | Incurred during the current period | Incurred during the previous period |
| Net profits for the period attributable to ordinary shareholders | 276,149,165.54 | 268,315,157.33 |
| Of which: net profits attributable to going concern | 276,149,165.54 | 268,315,157.33 |

- (2) For the purpose of calculating earnings per share, the denominator is the weighted average of outstanding ordinary shares. The calculation is as follows:

| | Unit: share | Unit: share |
|--|---|--|
| | Incurred during the current period | Incurred during the previous period |
| Number of outstanding ordinary shares at the beginning of the year | 328,924,200.00 | 328,924,200 |
| Add: number of weighted ordinary shares issued during the period | 11,666,667.00 | — |
| Number of outstanding weighted ordinary shares at the end of the year | 340,590,867.00 | 328,924,200 |

The Group does not have any dilutive potential ordinary shares.

- (3) Earnings per share

| | RMB | RMB |
|---|---|--|
| | Incurred during the current period | Incurred during the previous period |
| Calculated based on net profits attributable to the equity holders of the Company: | | |
| Basic earnings per share | 0.81 | 0.82 |
| Diluted earnings per share | N/A | N/A |
| Calculated based on net profits attributable to equity holders of the Company on the going concern basis | | |
| Basic earnings per share | 0.81 | 0.82 |
| Diluted earnings per share | N/A | N/A |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

47. Other comprehensive income

Consolidation

| | RMB | |
|---|---|--|
| | Incurr during the current period | Incurr during the previous period |
| Translation difference of financial statements denominated in foreign currency | 269,875.82 | 73,998.29 |

48. Notes to cash flow statements

(1) Receipt of other cash related to operating activities

| | Consolidation | | The Company | |
|---|---|--|---|--|
| Item | Incurr during the current period | Incurr during the previous period | Incurr during the current period | Incurr during the previous period |
| Interest income | 5,112,478.99 | 15,233,600.51 | 4,791,051.40 | 15,168,686.21 |
| Decrease in other operating receivables | — | 2,933,872.42 | — | — |
| Decrease in guarantees of promissory notes | — | 25,318,728.56 | — | 25,318,728.56 |
| Government grants | 29,580,022.42 | 37,162,000.00 | 12,237,500.00 | 30,225,000.00 |
| Others | 5,607,161.49 | 10,454,790.17 | 1,732,252.63 | 6,556,009.18 |
| Total | 40,299,662.90 | 91,102,991.66 | 18,760,804.03 | 77,268,423.95 |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

48. Notes to cash flow statements (continued)

(2) Payment of other cash related to operating activities

| | Consolidation | | The Company | |
|---|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|
| | Incurrred during the current period | Incurrred during the previous period | Incurrred during the current period | Incurrred during the previous period |
| Hospitality expense | 2,579,276.20 | 2,720,291.15 | 2,082,059.96 | 2,450,147.58 |
| Increase in guarantees of promissory foreign exchange notes | 32,953,041.76 | — | 22,953,041.76 | — |
| Expense Intermediary service | 2,914,586.06 | 11,390,916.86 | 2,863,578.08 | 10,984,318.87 |
| Transportation expense | 41,169,510.05 | 29,467,744.62 | 41,081,904.16 | 28,922,394.59 |
| Travel expense | 2,295,501.96 | 2,996,923.48 | 1,976,692.19 | 2,599,845.92 |
| Electricity expense | 1,258,328.67 | 1,547,236.01 | 1,251,528.67 | 1,547,236.01 |
| Return of current accounts of other companies | — | 11,000,000.00 | — | 11,000,000.00 |
| Agency fees | 392,833.43 | 14,221,980.47 | 392,833.43 | 14,220,324.47 |
| Development fees for new products | 24,299,332.74 | 9,463,031.24 | 24,299,332.74 | 9,463,031.24 |
| Machinery material consumption fees | 7,198,839.15 | 6,858,702.52 | 7,146,708.74 | 6,669,457.07 |
| Repair expense | 8,574,919.85 | 1,640,543.11 | 321,029.08 | 306,725.48 |
| Other | 24,609,432.24 | 14,122,402.93 | 21,231,691.19 | 14,555,412.72 |
| Total | 148,245,602.11 | 105,429,772.39 | 125,600,400.00 | 102,718,893.95 |

(3) Receipt of other cash related to fund raising activities

| | Consolidation | | The Company | |
|--------------------------|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|
| | Incurrred during the current period | Incurrred during the previous period | Incurrred during the current period | Incurrred during the previous period |
| Guarantees for borrowing | — | 53,730,000.00 | — | 53,730,000.00 |

(4) Payment of other cash related to fund raising activities

| | Consolidation | | The Company | |
|-------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|
| | Incurrred during the current period | Incurrred during the previous period | Incurrred during the current period | Incurrred during the previous period |
| Guarantees for borrowing | 25,720,000.00 | — | 25,720,000.00 | — |
| Intermediate fees for listing | 56,923,150.54 | 3,468,517.96 | 56,923,150.54 | 3,468,517.96 |
| Total | 82,643,150.54 | 3,468,517.96 | 82,643,150.54 | 3,468,517.96 |



Notes to the Financial Statements

For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

49. Supplementary information on cash flow statements

(1) Supplementary information on cash flow statements

| Supplementing Information | Consolidation | | The Company | |
|--|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|
| | Incurring during the current period | Incurring during the previous period | Incurring during the current period | Incurring during the previous period |
| RMB | | | | |
| (1) Reconciliation of net profits as cash flows from operating activities: | | | | |
| Net profits | 276,980,308.64 | 273,822,282.40 | 320,174,420.42 | 282,892,810.89 |
| Add: Provision of impaired assets | (2,024,288.48) | (12,715,559.92) | (1,541,277.09) | (9,703,209.91) |
| Depreciation of fixed assets | 98,682,327.10 | 90,514,369.72 | 57,237,838.02 | 48,996,550.50 |
| Depreciation of real estate held for investment | — | — | 364,940.40 | 364,940.40 |
| Intangible assets amortized | 12,078,058.98 | 7,911,194.94 | 10,546,033.07 | 6,352,468.47 |
| Amortization of long-term deferred expenses | — | 3,295,660.69 | — | — |
| Losses (Gains) on disposal of fixed assets, intangible assets and other long-term assets | 498,622.95 | (7,821,634.16) | (162,306.74) | (1,216,537.22) |
| Losses (Gains) from change of fair value | — | 5,270,000.00 | — | (44,380,000.00) |
| Financial expenses (gains) | 39,212,114.46 | 30,259,495.87 | 29,775,978.56 | 17,876,187.41 |
| Investment losses (gains) | (191,250.95) | (5,827,137.15) | (85,765,164.48) | (35,410,000.00) |
| Decrease (Increase) in deferred income tax assets | 1,995,768.03 | 10,821,466.63 | (3,301,219.73) | 8,093,382.11 |
| Decrease (Increase) in deferred income liabilities | 2,557,450.74 | (8,893,814.61) | 522,199.20 | — |
| Decrease (Increase) in stock | (27,515,030.04) | 84,844,791.98 | (21,455,200.04) | 90,619,903.65 |
| Decrease (Increase) in operating receivables | (182,538,977.11) | 55,339,650.12 | (152,187,649.76) | 108,278,826.85 |
| Increase (Decrease) in operating receivables | 169,278,411.17 | (432,050,845.19) | (26,174,489.76) | (441,201,938.60) |
| Net cash flows from operating activities | 389,013,515.49 | 94,769,921.32 | 128,034,102.07 | 31,563,384.55 |
| (2) Net change in cash and cash equivalents: | | | | |
| Cash balance at the end of the year | 754,225,131.33 | 226,121,078.70 | 709,106,130.16 | 205,767,350.33 |
| Less: cash balance at the beginning of the year | 226,121,078.70 | 415,623,029.23 | 205,767,350.33 | 340,601,531.63 |
| Net increase in cash and cash equivalents | 528,104,052.63 | (189,501,950.53) | 503,338,779.83 | (134,834,181.30) |

Notes to the Financial Statements



For the year ended 31 December 2010

V. Notes to the Financial Statements (continued)

49. Supplementary information on cash flow statements (continued)

(2) Components of cash and cash equivalents

| | Consolidation | | The Company | |
|---|-----------------|-----------------|-----------------|-----------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| | | | | RMB |
| I. Cash | | | | |
| Consist of : treasury cash | 353,112.99 | 199,283.81 | 248,496.92 | 57,140.39 |
| Bank deposits readily available for payment | 634,926,122.65 | 121,392,348.77 | 601,411,737.55 | 101,180,763.82 |
| Other currency capital readily available for payment | 118,945,895.69 | 104,529,446.12 | 107,445,895.69 | 104,529,446.12 |
| II. Cash and cash equivalent balance at the end of year | 754,225,131.33 | 226,121,078.70 | 709,106,130.16 | 205,767,350.33 |
| Other restricted currency capital | 138,061,458.60 | 79,388,416.84 | 128,061,458.60 | 79,388,416.84 |
| III. Currency capital at the end of the year | 892,286,589.93 | 305,509,495.54 | 837,167,588.76 | 285,155,767.17 |

VI. Related Party and Transactions

1. Situation on Controlling Shareholders of the Group

As at 31 December 2010, Mr. Zhang En Rong owns 35.03% of voting shares in the Company, and is the controlling shareholder of the Company.

2. Situation on Subsidiaries of the Group is detailed in Note (IV).

3. Situation on Associates of the Group is detailed in Note (V).9 .



Notes to the Financial Statements

For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction

(1) Purchase and Sales of Commodities. Rendering and Acceptance of Service

Table on situation on commodities procurement:
The Company

| Related party | Subject of connected transaction | Pricing method and decision of connected transaction | Incurred during the current year | | Incurred during the previous year | |
|---|---|--|----------------------------------|---|-----------------------------------|---|
| | | | Amount | As a proportion to same type of transaction amount(%) | Amount | As a proportion to same type of transaction amount(%) |
| Molong Drilling Equipment | Three kinds of pumping equipment | Agreed price (Note 1) | 18,264,024.05 | 0.78 | 19,246,251.27 | 1.26 |
| Shouguang Baolong | Casting | Agreed price (Note 2) | 1,616,539,241.27 | 68.82 | 794,474,730.08 | 51.86 |
| Molong Electro-mechanical Equipment Company Limited | Casting, accessories, cold bed and electrical cabinet | Agreed price (Note 3) | 105,170,847.10 | 4.48 | 57,182,096.85 | 3.73 |
| Weihai Baolong | Oil well pipes | Agreed price (Note 4) | 244,957,892.32 | 10.43 | 316,358,899.83 | 20.65 |
| Maolong Old Metals Recycle Company Limited | Scrap steel | Agreed price (Note 5) | 307,876.07 | 0.01 | — | — |
| Total | | | 1,985,239,880.81 | 84.52 | 1,187,261,978.03 | 77.50 |

Note 1: The purchase of raw materials by the Company from Molong Drilling Company was settled at a discounted price of market price less a discounted price of 5% gross profit.

Note 2: The purchase of raw materials by the Company from Shouguang Baolong was settled by the transaction price determined by the contract signed by both parties.

Note 3: The purchase of raw materials by the Company from Molong Electro-mechanical Equipment Company was settled by the fixed price prescribed by China's relevant government authorities. If there is no limitation of any prescribed price, the price would be negotiated and agreed by both parties with reference to market price (subject to adjustment).

Note 4: The purchase of raw materials by the Company from Weihai Baolong Company was determined by the market price less the discounted price of not more than RMB100 per ton. Meanwhile, Weihai Baolong Company promised to provide the Company with a commodity price of not more than that provided to independent third party for the same commodity at the same time. °

Note 5: The purchase of raw materials by the Company from Maolong Reycle Company was settled at the transaction price determined by the contract signed by both parties.

Notes to the Financial Statements



For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(1) Purchase and Sales of Commodities. Rendering and Acceptance of Service (continued)

Table on situation on commodities sales:

Consolidation

| Related party | Subject of connected transaction | Pricing method and decision procedures of connected transaction | Incurred during the current year | | Incurred during the previous year | |
|-----------------|-----------------------------------|---|----------------------------------|--|-----------------------------------|--|
| | | | Amount | As a proportion to same type of transaction amount (%) | Amount | As a proportion to same type of transaction amount (%) |
| | | | | | | |
| Yalong Oil Pump | Oil well pumpings and accessories | Agreed price (Note 6) | 8,022,376.45 | 0.30 | 7,912,063.67 | 0.87 |
| Total | | | 8,022,376.45 | 0.30 | 7,912,063.67 | 0.87 |

The Company

| Related party | Subject of connected transaction | Pricing method and decision procedures of connected transaction | Incurred during the current year | | Incurred during the previous year | |
|---|--------------------------------------|---|----------------------------------|--|-----------------------------------|--|
| | | | Amount | As a proportion to same type of transaction amount (%) | Amount | As a proportion to same type of transaction amount (%) |
| | | | | | | |
| Molong Drilling Equipment | Scrap steel and oil machinery parts | Agreed price (Note 6) | 5,446,821.38 | 0.20 | 5,857,893.44 | 0.29 |
| Shouguang Baolong | Scrap steel | Agreed price (Note 6) | 64,616,120.84 | 2.43 | 7,978,453.39 | 0.40 |
| Molong Electro-mechanical Equipment Company Limited | Scrap steel metal | Agreed price (Note 6) | 32,386,756.91 | 1.22 | 7,862,451.99 | 0.39 |
| Weihai Baolong | Scrap steel and cylindric steel, etc | Agreed price (Note 6) | 58,102,318.68 | 2.18 | 34,496,193.12 | 1.73 |
| Yalong Oil Pump | Oil well pumping and accessories | Agreed price (Note 6) | 8,022,376.45 | 0.30 | 7,912,063.67 | 0.40 |
| Total | | | 168,574,394.26 | 6.33 | 64,107,055.61 | 3.21 |

Note 6 : The purchase of raw materials by the Company from related parties was settled by the fixed price prescribed by China's relevant government authorities. If there is no limitation of any prescribed price, the price would be negotiated and agreed by both parties with reference to market price (subject to adjustment) °



Notes to the Financial Statements

For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(2) Situation on connected tenancy

The Company

| Name of Lessor | Name of Lessee | Type of leased asset | Initial date of lease | Expiry date of lease | Basis of lease gains determination | RMB Lease gains recognized during the year |
|----------------|---|-------------------------|-----------------------|----------------------|------------------------------------|--|
| The Company | Molong Electro-mechanical Equipment Company Limited | Housing construction | 2005.11.1 | 2015.10.31 | Agreement price | 540,000.00 |
| The Company | Molong Electro-mechanical Equipment Company Limited | Machinery and equipment | 2008.12.1 | 2012.12.31 | Agreement price | 150,000.00 |
| Total | | | | | | 690,000.00 |

(3) Situation on connected guarantees :

The Company

| Guarantor | Guarantee | Guaranteed amount | Initial date of guarantee | Expiry date of guarantee | RMB Whether guarantee has been fulfilled |
|----------------|----------------|-------------------|---------------------------|--------------------------|--|
| The Company | Weihai Baolong | 35,000,000.00 | 2009.09.03 | 2010.09.03 | Yes |
| Weihai Baolong | The Company | 150,000,000.00 | 2009.02.23 | 2010.11.05 | Yes |

Notes to the Financial Statements



For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(4) Assets assignment of related party:

The Company

RMB

| Related party | Subject of connected transaction | Type of connected transaction | Pricing principles for connected transaction | Incurred during the current period | | Incurred during the previous period | |
|---|----------------------------------|-------------------------------|--|------------------------------------|--|-------------------------------------|--|
| | | | | Amount | As a proportion to same type of transaction amount (%) | Amount | As a proportion to same type of transaction amount (%) |
| Molong Drilling Equipment | Fixed Asset | Sales | Net carrying value | — | — | 1,218.55 | 0.07 |
| Molong Electro-mechanical Equipment Company Limited | Fixed Asset | Sales | Net carrying value | — | — | 12,275.26 | 0.67 |
| Weihai Baolong | Fixed Asset | Sales | Net carrying value | 5,561,188.67 | 75.57 | — | — |
| Total | | | | 5,561,188.67 | 75.57 | 13,493.81 | 0.74 |
| Molong Drilling Equipment | Fixed Asset | Purchase | Net carrying value | 14,499.62 | — | 4,701.41 | 0.01 |
| Shouguang Baolong | Fixed Asset | Purchase | Net carrying value | — | — | 26,832.54 | 0.06 |
| Molong Electro-mechanical Equipment Company Limited | Fixed Asset | Purchase | Net carrying value | 20,149,227.42 | 2.45 | — | — |
| Total | | | | 20,163,727.04 | 2.45 | 31,533.95 | 0.07 |



Notes to the Financial Statements

For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(5) Remuneration of Key Management Consolidation and the Company

The remuneration of key management of the Company in 2010 amounted to RMB2,488,750.00 (2009: RMB2,340,000.00).

The emoluments paid or payable on each of the 16 (2009: 16) directors and supervisors were as follows:

| | Executive directors | | | | Independent non-executive directors | | | | Supervisors | | | | Total | | | | | |
|---------------------------------|---------------------|---------------|------------|--------------|-------------------------------------|---------------------------|------------------------|------------------------|---------------------|---------------|-------------------|-----------------------|-------|---------------------|-------------|------------|--------------|------------|
| | Zhang EnRong | Zhang Yun San | Lin FuLong | Xie Xin Gang | Wang Ping (Note 1) | Cheng Jian Xiong (Note 1) | Qin Xue Chang (Note 2) | Yan Yi Zhuang (Note 2) | Lu Hai Lin (Note 3) | Wang Chun Hua | John Paul Cameron | Chau Shing Yim, David | | Li Bao Hui (Note 2) | Liu Hui Duo | Liu Wan Fu | Fan Ren Yi | |
| 2010: | | | | | | | | | | | | | | | | | | |
| Fees | 710,463.67 | | | | | | | | | | | | | | | | | 225,600.00 |
| Basic salaries and allowances | | 561,238.89 | 297,332.46 | 378,809.57 | | | | | | 36,000.00 | 94,800.00 | 94,800.00 | | 55,800.00 | 24,000.00 | 12,000.00 | 2,039,644.59 | |
| Retirement scheme contributions | | 3,060.72 | 3,007.20 | 3,007.20 | | | | | | | | | | 3,500.00 | | | 12,575.12 | |
| Other | | 5,304.73 | 5,244.38 | 5,244.38 | | | | | | | | | | | | | 15,793.49 | |
| Total | 710,463.67 | 569,604.34 | 305,584.04 | 387,061.15 | | | | | | 36,000.00 | 94,800.00 | 94,800.00 | | 59,300.00 | 24,000.00 | 12,000.00 | 2,293,613.20 | |
| 2009: | | | | | | | | | | | | | | | | | | |
| Fees | | | | | | | | | | | | | | | | | | 194,933.46 |
| Basic salaries and allowances | 550,000.00 | 416,936.16 | 246,998.62 | 266,998.24 | 47,000.00 | | 11,876.73 | 20,949.82 | 1,629.82 | 20,850.55 | 55,145.45 | 84,481.09 | | 47,000.00 | 22,000.00 | 11,000.00 | 1,560,933.02 | |
| Retirement scheme contributions | | 3,063.84 | 3,001.38 | 3,001.76 | | | | | | | | | | 3,000.00 | | | 12,066.98 | |
| Other | | 5,308.25 | 5,237.81 | 5,238.24 | | | | | | | | | | | | | | 15,784.31 |
| Total | 550,000.00 | 425,308.25 | 255,237.81 | 275,238.24 | 47,000.00 | | 11,876.73 | 20,949.82 | 1,629.82 | 20,850.55 | 55,145.45 | 84,481.09 | | 50,000.00 | 22,000.00 | 11,000.00 | 1,783,717.77 | |

Notes to the Financial Statements



For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

(4) Situation of asset transfer of connected parties:

Note 1: These personnel have not received remuneration of any form from the Group.

Note 2: These personnel have resigned on 12 May 2009.

Note 3: These personnel have resigned on 8 January 2009.

Note 4: Payment of remuneration for key management are all made in the form of monetary currency.

Note 5: In 2010 and 2009, no director has waived any remuneration.

Note 6: During the current year, no amount is paid or payable for procuring any director to join or upon joining the Group; and no amount is paid or payable to them as the compensation for any director or resigned director for his/her loss of position as the director of the members of the Group.

Note 7: The Group has formulated the remuneration of directors and supervisors according to the remuneration management system of the Group, which has been approved by the Board.

| Name of item | RMB | |
|--------------------------------|------------------------------|-------------------------------|
| | Occurred in the current year | Occurred in the previous year |
| Salaries | 796,526.60 | 286,998.62 |
| Retirement scheme contribution | 6,014.40 | 3,001.38 |
| Other | 12,836.00 | 6,410.00 |
| Total | 813,377.00 | 296,410.00 |



Notes to the Financial Statements

For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

5. Account receivable and payable of related parties

(1) Account receivable of related party:

Consolidation

| Item | Related party | Closing balance | | Opening balance | |
|---------------------|-----------------|-----------------|------------------|-----------------|------------------|
| | | Book balance | Bad debt balance | Book balance | Bad debt balance |
| Accounts receivable | Yalong Oil Pump | 2,576,611.00 | — | 4,363,757.00 | — |

The Company

| Item | Related party | Closing balance | | Opening balance | |
|---------------------|---|----------------------|------------------|-----------------|------------------|
| | | Book balance | Bad debt balance | Book balance | Bad debt balance |
| Accounts receivable | Yalong Oil Pump | 2,576,611.00 | — | 4,363,757.00 | — |
| Other receivables | Molong Electro-mechanical Equipment Company Limited | 690,000.00 | — | — | — |
| Advance Payment | Weihai Baolong | 42,880,150.69 | — | — | — |
| | Shouguang Baolong | 49,077,015.70 | — | — | — |
| Total | | 91,957,166.39 | — | — | — |

Notes to the Financial Statements



For the year ended 31 December 2010

VI. Related Party and Transactions (continued)

5. Account receivable and payable of related parties (continued)

(2) Account payable of related party:

The Company

| Item | Name | Closing balance | RMB Opening balance |
|---------------------|--|-----------------|---------------------------|
| Accounts receivable | Molong Drilling Equipment | 20,194,138.58 | 13,259,789.17 |
| | Shouguang Baolong | — | 78,381,361.29 |
| | Weihai Baolong | — | 56,420,012.58 |
| | Molong Electro-mechanical Equipment Company Limited | 7,415,268.46 | 11,601,146.77 |
| | Maolong Old Metals Recycle Company Limited | 360,215.00 | — |
| | Total | | 27,969,622.04 |
| Other receivables | Maolong Old Metals Recycle Company Limited | 622,553.06 | — |
| Advance Payment | MPM International Limited | 58,889,120.06 | 44,915,955.73 |
| Bills payable | Molong Electro-mechanical Equipment Company Limited | 18,805,654.37 | 7,060,525.19 |
| | Weihai Baolong | 13,830,000.00 | 30,157,885.20 |
| | Shouguang Baolong | 257,400,000.00 | 106,160,666.63 |
| | Molong Drilling Equipment | 1,048,000.00 | 1,879,161.46 |
| Total | | 291,083,654.37 | 145,258,238.48 |



Notes to the Financial Statements

For the year ended 31 December 2010

VII. Commitments

1. Capital Commitment

| | Closing balance | Opening balance |
|--|-----------------|-----------------|
| Contracted but not recognized in financial statements | | RMB |
| - Commitment on acquisition and construction of long-term assets | 75,560,023.34 | 173,726,109.99 |

VIII. Non-adjustment subsequent to balance sheet date

- (1) On 11 February 2011, the Company commenced the first extraordinary general meeting, on which, it is resolved to pass the resolution on using RMB220,000,000.00 raised by the initial offering of A Shares and the implementation of oil well pipe processing project by its subsidiary, Weihai Baolong Company, as well as the resolution on using RMB256,738,331.50 raised by the initial offering of A Shares to satisfy liquidity.
- (2) Distribution of profits after Balance Sheet

| Item | Amount |
|--|---|
| Profit or dividend which would distribute (Note) | 59,838,630.00 |
| Profit or dividend approved to issue | Will be approved on Shareholders' Meeting |

Note: For details, please refer to Note (V)33.

IX. Other Significant Items

1. Segment Reporting

According to the internal organization structure, management requirements and internal reporting system of the Group, the Group's operating segments are divided into 4 reportable segments. The Group's management regularly evaluates the operating results of these reportable segments to determine the resources to be allocated and evaluates its results. Each of the Group's reportable segments includes casing, tubing, three kinds of pumping units, petroleum machinery and others.

Segment reporting information is disclosed in accordance to the accounting policies and measurement standards adopted for reporting to the management by each segment, which are consistent with the accounting policies and measurement basis for preparing financial statements.

Transfer and transaction among segments are measured on the basis of actual transaction price. Segment income and segment expenses are recognized on the basis of actual income and expense of each segment. Segment assets or liabilities are allocated in accordance with assets attributable to such operating segment used or liabilities attributable to such operating segment incurred during normal course of operation of the operating segment.

Notes to the Financial Statements



For the year ended 31 December 2010

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(1) Segment Reporting Information

Combined segment reporting-2010

| | | | | | | | RMB |
|--|----------------------|---------------------------------|------------------------|----------------|----------------------|----------------------------------|------------------|
| | Casing and Tubing | Three kinds of pumping units | Petroleum machinery | Other | Unallocated Items | Inter- segment elimination | Total |
| Operation Revenue | | | | | | | |
| External transaction income | 2,126,589,473.71 | 111,655,198.06 | 148,493,859.41 | 317,168,304.01 | — | — | 2,703,906,835.19 |
| Income for inter-segment transaction | — | — | — | — | — | — | — |
| Total Segment Operation Revenue | 2,126,589,473.71 | 111,655,198.06 | 148,493,859.41 | 317,168,304.01 | — | — | 2,703,906,835.19 |
| Total operation revenue presented | 2,126,589,473.71 | 111,655,198.06 | 148,493,859.41 | 317,168,304.01 | — | — | 2,703,906,835.19 |
| Segment Costs | 1,765,924,819.79 | 90,804,594.44 | 128,124,277.00 | 307,689,470.44 | (887,650.50) | — | 2,291,655,511.17 |
| Segment operating profit | 360,664,653.92 | 20,850,603.62 | 20,369,582.41 | 9,478,833.57 | 887,650.50 | — | 412,251,324.02 |
| Adjustment items: | | | | | | | |
| Administrative Expenses | — | — | — | — | 91,383,971.04 | — | 91,383,971.04 |
| Finance expenses | — | — | — | — | 44,341,872.74 | — | 44,341,872.74 |
| Investment income | — | — | — | — | 191,250.95 | — | 191,250.95 |
| Operation Profit | 360,664,653.92 | 20,850,603.62 | 20,369,582.41 | 9,478,833.57 | (134,646,942.33) | — | 276,716,731.19 |
| Non-operation income | — | — | — | — | 50,431,757.52 | — | 50,431,757.52 |
| Non-operation expenditure | — | — | — | — | 2,664,687.26 | — | 2,664,687.26 |
| Total Profit | 360,664,653.92 | 20,850,603.62 | 20,369,582.41 | 9,478,833.57 | (86,879,872.07) | — | 324,483,801.45 |
| Income tax | — | — | — | — | 47,503,492.81 | — | 47,503,492.81 |
| Net profit | 360,664,653.92 | 20,850,603.62 | 20,369,582.41 | 9,478,833.57 | (134,383,364.88) | — | 276,980,308.64 |
| Total segment assets | 2,879,744,594.66 | 105,967,422.92 | 590,841,404.05 | 89,847,662.69 | 920,009,730.87 | — | 4,586,410,815.18 |
| Total segment liabilities | 974,692,381.05 | 25,778,108.93 | 54,523,677.02 | 37,575,191.04 | 750,638,097.21 | — | 1,843,207,455.25 |
| Supplementary Information: | | | | | | | |
| Depreciation | 83,113,141.70 | 2,415,819.56 | 4,718,452.52 | — | 8,434,913.32 | — | 98,682,327.10 |
| Amortize | 11,051,502.34 | — | 1,026,556.64 | — | — | — | 12,078,058.98 |
| Interest Income | — | — | — | — | 5,112,478.99 | — | 5,112,478.99 |
| Interest cost | — | — | — | — | 65,978,204.21 | — | 65,978,204.21 |
| Impairment losses recognized in current year: | (1,136,637.98) | — | — | — | (887,650.50) | — | (2,024,288.48) |
| Non-current assets other than long-term equity investment | 2,064,014,359.04 | 41,443,738.55 | 18,487,846.47 | 48,975,422.63 | 15,095,861.12 | — | 2,188,017,227.81 |
| Capital expenditure | 634,988,815.03 | 489,529.51 | 40,232,058.22 | — | 16,890,017.19 | — | 692,600,419.95 |
| Consist of: | | | | | | | |
| Expenses on construction in progress | 558,871,719.53 | 476,572.51 | 8,099,611.62 | — | — | — | 567,447,903.66 |
| Expenses on purchase of fixed assets | 22,100,646.12 | 12,957.00 | 3,042,453.43 | — | 2,194,380.64 | — | 27,350,437.19 |
| Expenses on purchase of intangible assets | 54,016,449.38 | — | 29,089,993.17 | — | 14,695,636.55 | — | 97,802,079.10 |
| Non-cash expenses other than depreciation and amortization | — | — | — | — | — | — | — |



Notes to the Financial Statements

For the year ended 31 December 2010

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(1) Segment Reporting Information (continued)

Combined segment reporting-2009

| | RMB | | | | | | |
|--|----------------------|---------------------------------|------------------------|----------------|----------------------|----------------------------------|------------------|
| | Casing and Tubing | Three kinds of pumping units | Petroleum machinery | Other | Unallocated items | Inter- segment elimination | Total |
| External transaction income | 1,725,410,397.79 | 105,720,191.88 | 83,505,727.48 | 160,914,968.52 | — | — | 2,075,551,285.67 |
| Income for inter-segment transaction | — | — | — | — | — | — | — |
| Total Segment Operation Revenue | 1,725,410,397.79 | 105,720,191.88 | 83,505,727.48 | 160,914,968.52 | — | — | 2,075,551,285.67 |
| Total operation revenue presented | 1,725,410,397.79 | 105,720,191.88 | 83,505,727.48 | 160,914,968.52 | — | — | 2,075,551,285.67 |
| Segment costs | 1,434,216,218.05 | 83,449,032.90 | 67,994,740.73 | 150,663,100.61 | (5,446,986.40) | — | 1,730,876,105.89 |
| Segment operating profit | 291,194,179.74 | 22,271,158.98 | 15,510,986.75 | 10,251,867.91 | 5,446,986.40 | — | 344,675,179.78 |
| Adjustment items: | | | | | | | |
| Administrative expenses | — | — | — | — | 63,829,412.03 | — | 63,829,412.03 |
| Finance expenses | — | — | — | — | 10,656,881.54 | — | 10,656,881.54 |
| Profit or Loss from change in fair value | — | — | — | — | (5,270,000.00) | — | (5,270,000.00) |
| Investment income | — | — | — | — | 5,827,137.15 | — | 5,827,137.15 |
| Operation Profit | 291,194,179.74 | 22,271,158.98 | 15,510,986.75 | 10,251,867.91 | (68,482,170.02) | — | 270,746,023.36 |
| Non-operation income | — | — | — | — | 54,154,013.57 | — | 54,154,013.57 |
| Non-operation expenditure | — | — | — | — | 619,598.32 | — | 619,598.32 |
| Total Profit | 291,194,179.74 | 22,271,158.98 | 15,510,986.75 | 10,251,867.91 | (14,947,754.77) | — | 324,280,438.61 |
| Income tax | — | — | — | — | 50,458,156.21 | — | 50,458,156.21 |
| Net profit | 291,194,179.74 | 22,271,158.98 | 15,510,986.75 | 10,251,867.91 | (65,405,910.98) | — | 273,822,282.40 |
| Total segment assets | 2,555,535,530.11 | 99,702,731.07 | 71,128,823.48 | 195,202,665.43 | 335,037,153.56 | — | 3,256,606,903.65 |
| Total segment liabilities | 724,690,747.61 | 30,188,836.27 | 60,543,228.94 | 29,275,325.64 | 1,098,273,554.50 | — | 1,942,971,692.96 |
| Supplementary Information: | | | | | | | |
| Depreciation | 71,045,514.39 | 2,798,034.35 | 2,179,592.78 | — | 14,491,228.20 | — | 90,514,369.72 |
| Amortization | 2,931,316.81 | — | — | — | 8,275,538.82 | — | 11,206,855.63 |
| Interest Income | — | — | — | — | 17,077,509.81 | — | 17,077,509.81 |
| Interest cost | — | — | — | — | 47,919,108.93 | — | 47,919,108.93 |
| Impairment losses recognized in previous year: | (71,045,573.52) | — | (128,000.00) | — | (5,446,986.40) | — | (12,715,559.92) |
| Non-current assets other than long term equity investment | 1,531,256,406.31 | 45,832,304.09 | 19,111,144.52 | 42,989,284.40 | 17,091,629.15 | — | 1,656,280,768.47 |
| Capital expenditure | 74,320,892.28 | 19,658.12 | 3,188,033.88 | — | 392,173,806.17 | — | 469,702,390.45 |
| Consist of: | — | — | — | — | — | — | — |
| Expenses on construction in progress | 11,160,135.90 | — | — | — | 340,011,557.12 | — | 351,171,693.02 |
| Expenses on purchase of fixed assets | 33,437,497.91 | 19,658.12 | 3,188,033.88 | — | 11,593,768.59 | — | 48,238,958.50 |
| Expenses on purchase of intangible assets | 29,723,258.47 | — | — | — | 40,568,480.46 | — | 70,291,738.93 |
| Non-cash expenses other than depreciation and amortization | — | — | — | — | — | — | — |

Notes to the Financial Statements



For the year ended 31 December 2010

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(2) External transaction income by location of income source and non-current assets by location of assets

In 2010 and 2009, all of the Group's external transaction income were from China and oversea, while all assets were located in China, hence the external transaction income by location of income source is disclosed as follows:

| | RMB | RMB |
|--------------------------------------|---------------------------------------|--|
| | Incurred during the current period | Incurred during the previous period |
| Domestic external transaction income | 1,754,207,623.85 | 1,342,706,722.24 |
| Foreign external transaction income | 949,699,211.34 | 732,844,563.43 |
| Total | 2,703,906,835.19 | 2,075,551,285.67 |

(3) Reliability on major customers

The Group's major customers are China National Petroleum Corporation, SB International Inc, Shandong Luxing Steel Co., Ltd, Liaocheng Shandong Zhong Ganglian Steel Metal Manufacturing Co., Ltd and Laigang Group Yantai Steel Pipe Co., Ltd. Specific details could be referred to Note (v) 35.

2. Financial instruments and risk management

Major financial instruments of the Group include bills receivable, accounts receivables, equity investment, borrowings, bills payables, accounts payables, financial assets held for trading, financial liabilities held for trading, etc. Detailed descriptions of these financial instruments are set out in related note. Below are the risks associated with such financial instruments and the risk management policies adopted by the Group to mitigate such risks. The management of the Group manages and monitors such risk exposures to ensure such risks are contained within a prescribed scope.

2.1. Objective and policies of risk management

The Group engages in risk management with the aim of achieving an appropriate balance between risk and return, where the negative effects of risks against the Group's operating results are minimized, in order to maximize the benefits of shareholders and other stakeholders. Based on such objective in risk management, the underlying strategy of the Group's risk management is to ascertain and analyze all types of risks exposures of the Group, establish appropriate risk tolerance thresholds, carry out risk management procedures and perform risk monitoring on all kinds of risks in a timely and reliable manner, thus containing risk exposures within a prescribed scope.



Notes to the Financial Statements

For the year ended 31 December 2010

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.1. Objective and policies of risk management (continued)

2.1.1 Market risks

2.1.1.1 Foreign exchange risk

Foreign exchange risk represents risks of loss incurred as a result of changes in exchange rate. The Group is mainly exposed to foreign exchange risks in connection with USD; except for the Company and its subsidiaries MPM of which effect purchases and sales in USD, all the business activities of the remaining principal operations of the Group are settled with RMB. On 31 December 2010, except for the USD balances in assets and liabilities, odd monies in EUR and balances in HKD as set out below, all the balances of assets and liabilities of the Group were denominated in RMB. The foreign exchange risk arising from assets and liabilities in such USD balances may affect the operating results of the Group.

| | | RMB |
|-------------------------------|-----------------|-----------------|
| | Closing balance | Opening balance |
| Cash and cash equivalents-USD | 5,385,617.68 | 2,711,208.79 |
| Cash and cash equivalents-HKD | 14,788.49 | 17,418.09 |
| Cash and cash equivalents-EUR | 883.47 | 1,149.40 |
| Accounts receivable-USD | 216,735,933.07 | 177,188,427.60 |
| Accounts receivable-EURO | 2,593,713.72 | 3,702,840.31 |
| Other receivables-USD | 1,326,354.02 | 1,367,510.31 |
| Other receivables-USD | 241,257.61 | — |
| Short-term borrowings-USD | 117,866,417.20 | 19,648,512.00 |

The Group closely monitors changes in foreign exchange rates as to their effects to the Group's exposure in foreign exchange risk.

For foreign exchange risk, the Group has always placed its concern on the research of foreign exchange risk management policies and strategies, and maintain close co-operation with financial institutions engaging in foreign exchange business, while arranging favorable settlement terms via contracts. Meanwhile, with the continuous increase in the proportion of international market, if risks beyond the control of the Group, such as the appreciation of Renminbi, incurs, the Group will mitigate such risk via suitable adjustment of sales strategies.

2.1.1.2 Interest rate risk — risk in change in cash flow

The risk that changes in interest rate lead to changes in cash flow of the financial instruments of the Group is mainly associated with floating-rate bank borrowings. The Group's goal is to maintain these borrowings in floating rates.



For the year ended 31 December 2010

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.1. Objective and policies of risk management (continued)

2.1.2. Credit risk

On 31 December 2010, the most significant credit risk exposure that might incur financial losses on the Group was mainly attributable to a contractual counterparty's failure to perform its obligations, the effects of which could lead to losses in financial assets of the Group, specific details are set out as follows:

The carrying amount of financial assets recognized in the combined balance sheet: in respect of financial instruments carried at fair value, the carrying amount reflects the risk exposure; however, such amount does not represent the maximum credit exposure which changes in line with future changes in fair value.

In order to mitigate credit risk, the Group reassesses the collectability of each amount receivable on an individual basis at each balance sheet date, in order to ensure sufficient provision is allocated for amounts that are not recoverable. As such, the management of the Group believes the credit risk assumed by the Group has been significantly reduced.

The Group has adopted necessary policies to ensure that all sales customers have good credit records. Apart from the top five accounts receivables, the Group has no other significant concentration risk.

| | RMB |
|---------------------|------------------------|
| | Closing balance |
| Accounts receivable | 192,168,826.57 |

2.1.3. Liquidity risk

In managing liquidity risk, the Group maintains cash and cash equivalent at a level deemed sufficient by the management and carry out monitoring, in order to satisfy the operating needs of the Group and lower the effects of fluctuations in cash flows. The management of the Group monitors the utilization of bank borrowings and makes sure the related borrowing agreements are complied with.

The primary source of funding for the Group is bank borrowings. On 31 December 2010, the Group had outstanding bank facilities of RMB2,549,893,081.28 (On 31 December 2009, the Group had unutilized bank facilities of RMB911,605,366.02), including outstanding short-term bank facilities of RMB2,549,893,081.28 (On 31 December 2009, the Group had unutilized bank facilities of RMB911,605,366.02).



Notes to the Financial Statements

For the year ended 31 December 2010

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.1. Objective and policies of risk management (continued)

2.1.3. Liquidity risk (continued)

Maturity analysis of financial assets and financial liabilities of the Group at undiscounted remaining contractual obligations are set out as follows:

| Item | Closing balance | | RMB |
|-----------------------|-----------------|--------------|----------------|
| | Within 1 year | Over 1 year | Total |
| Monetary capital | 892,286,589.93 | — | 892,286,589.93 |
| Bills receivable | 19,120,729.91 | — | 19,120,729.91 |
| Account receivables | 507,656,952.73 | — | 507,656,952.73 |
| Dividends receivables | 150,000.00 | — | 150,000.00 |
| Other receivables | 30,400,769.88 | — | 30,400,769.88 |
| Short-term borrowings | 726,744,320.07 | — | 726,744,320.07 |
| Bills payables | 482,816,088.17 | — | 482,816,088.17 |
| Account payables | 501,771,570.34 | — | 501,771,570.34 |
| Interests payables | 955,547.63 | — | 955,547.63 |
| Dividends payables | 23,788,680.00 | — | 23,788,680.00 |
| Other payables | 24,885,301.36 | 1,106,611.30 | 25,991,912.66 |

2.2. Fair value

The value of financial assets and financial liabilities are determined using the following method:

The fair values of derivative instrument are determined based on the publicly quoted price in an active market. If public quotation does not exist, the fair value of derivatives without options is estimated on the basis of appropriate revenue curve using future cash flow discounting method; fair value of derivatives with options is measured and determined using fixed price option model (eg. binomial model).

In the opinion of the Group's management, the carrying values for financial assets and financial liabilities measured at amortized costs in financial statements are approximate to the fair value of those assets and liabilities.

2.3. Sensitivity analysis

The Group adopts sensitivity analysis techniques to analyze the possible effects of rational and probable changes in risk variables to profit and loss for the current period or to the beneficial interests. Since risk variables seldom change on a stand-alone basis, while the correlation between variables has significant influence to the ultimate amount of change effected by the change in a single risk variable; therefore, the below analysis is based on the assumption that the changes in each variable occurred separately.

Notes to the Financial Statements



For the year ended 31 December 2010

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.3. Sensitivity analysis

2.3.1. Sensitivity analysis of foreign exchange risk

Assumption of foreign exchange risk sensitivity analysis: all overseas operating net investment hedging and cash flow hedging are highly efficient.

Based on the above basis, holding all other variables constant the effects of probable and rational changes in exchange rate to the profit and loss for the current period and after-tax consequences of interests are set out below:

| Item | Change in exchange rate | Current year | | Previous year | |
|----------------------|-------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | | Effects on profit | Effects on shareholder's equity | Effects on profit | Effects on shareholder's equity |
| All foreign currency | Appreciate 5% relative to RMB | 4,578,127.44 | 4,578,127.44 | 7,125,554.20 | 7,125,554.20 |
| All foreign currency | Depreciate 5% relative to RMB | (4,578,127.44) | (4,578,127.44) | (7,125,554.20) | (7,125,554.20) |

2.3.2. Sensitivity analysis of interest rate risk

Sensitivity analysis of interest rate risk is based on the below assumptions:

- Changes in market rate affects the interest income or expense of floating-rate financial instruments;
- For fixed rate financial instruments measured at fair value, the change in market rates only affect its interest income or expenses;
- For derivative financial instruments designated as hedging instruments, the change in market rates affects its fair value, and all interest rate hedging are anticipated to be highly effective;
- The changes in fair value of derivative financial instruments and other financial assets and liabilities were calculated by Discounted Cash Flow (DCF) with the market rate at the balance sheet date.



Notes to the Financial Statements

For the year ended 31 December 2010

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.3. Sensitivity analysis (continued)

2.3.2. Sensitivity analysis of interest rate risk (continued)

Based on the above assumptions, holding all other variables constant, the effect of possible occurrence of rational changes in interest rate to the profit and loss for the period and aftertax consequences of interests are set out below:

| Item | Change in exchange rate | Current year | | Previous year | |
|--------------------------|-------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | | Effects on profit | Effects on shareholder's equity | Effects on profit | Effects on shareholder's equity |
| Floating-rate borrowings | Decreased by 1% | 3,709,016.51 | 3,709,016.51 | 3,254,512.35 | 3,254,512.35 |
| Floating-rate borrowings | Increased by 1% | (3,709,016.51) | (3,709,016.51) | (3,254,512.35) | (3,254,512.35) |

3. Retirement/Pension Scheme Benefits:

| Item | Consolidation | |
|--|-------------------------------|-------------------------------|
| | Amount for the current period | Amount for the current period |
| Retirement and Pension Scheme Benefits | 6,041,392.54 | 6,508,805.32 |
| Less: amount capitalised | 470,642.37 | 39,356.27 |
| Total | 5,570,750.17 | 6,469,449.05 |

The Group is required to make contributions to the retirement plans at a rate of 20% of the salaries, a member of the plan is entitled to a pension, to be paid by the municipal governments. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. When the staff leaves the positions, the Group is not entitled to recover the contributions paid in respect of their pension.

Notes to the Financial Statements



For the year ended 31 December 2010

IX. Other Significant Items (continued)

4. Other financial information

| Item | Consolidation | | The Company | |
|--------------------------------------|------------------|------------------|------------------|------------------|
| | Closing balance | Opening balance | Closing balance | Opening balance |
| Net current assets | 555,736,304.68 | 235,388,414.99 | 643,693,593.86 | 204,537,156.98 |
| Total assets reducing current assets | 2,756,230,812.31 | 1,904,105,212.33 | 2,612,479,045.24 | 1,694,514,998.12 |

| Item | Consolidation | | The Company | |
|----------------------|-------------------------------|--------------------------------|-------------------------------|--------------------------------|
| | Amount for the current period | Amount for the previous period | Amount for the current period | Amount for the previous period |
| Depreciation | 98,682,327.10 | 90,514,369.72 | 57,602,778.42 | 49,361,490.90 |
| Amortization | 12,078,058.98 | 11,206,855.63 | 10,546,033.07 | 6,352,468.47 |
| Annual auditor's fee | 800,000.00 | 600,000.00 | 800,000.00 | 600,000.00 |

X. Approval of the Financial Statements

These financial statements had been approved by the Board of Directors of the Company on 29 March 2011.



Supplementary Information

I. Breakdown of extraordinary gains and losses

| Item | Amount | RMB Remarks |
|--|----------------------|----------------|
| Profit or loss from disposal of on-current assets | (498,622.95) | |
| Government grants accounted for in profit and loss account of the current period (except for government grants closely related to the corporate business that were given under at a fixed standard amount or quantity as stipulated by the State) (Note) | 29,580,022.42 | |
| Reversal of impairment provision on receivables tested for impairment on individual basis | 513,766.81 | |
| Non-operating gains and losses other than the above items | 935,042.70 | |
| Effect of income tax | (6,200,727.22) | |
| Effect of minority interests (after tax) | (44,755.33) | |
| Total | 24,284,726.43 | |

Note: As mentioned in Note (III). 2, the rebates on value-added tax for Weifang Molong Drilling Equipment Company Limited was due to the entitlement of national taxation requirements, and the taxation concessionary policy has been duly approved. The rebates on value-added tax for Shouguang Maolong Old Metals Recycle Company Limited(壽光市懋隆廢舊金屬回收有限公司) and Wendeng Baolong Recyclable Resource Company Limited (文登市寶隆再生資源有限公司) were due to the rebates of value-added taxes paid during the normal course of operation pursuant to the requirements under national taxation laws, which belong to anticipated recurring profit or loss, and such rebates on value-added tax were not included in non-recurring profit or loss items.

II. Return on net assets and earnings per share

This calculation of return on net assets and earnings per was prepared by Shandong Molong in accordance with the relevant requirements of the spare "Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 09) — Calculations and disclosures for the return on net assets and earnings per share" (as amended in 2010) issued by the China Securities Regulatory Commission.

| Profit during the reporting period | Weighted average return on assets (%) | Earnings per share | |
|--|---------------------------------------|--------------------|---------|
| | | Basic | Diluted |
| Net profit attributable to holders of ordinary shares of the Company | 17.70 | 0.81 | N/A |
| Net profit attributable to holders of ordinary shares of the Company, after deducting extraordinary gains and losses | 16.14 | 0.74 | N/A |

III. Irregular movements in major items of the accounting statements of the Company and explanation on their reasons

This movements in items of the accounting statements of the Company was prepared by Shandong Molong in accordance with the relevant requirements of the spare “Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 15) — general regulation of financial statement” (as amended in 2010) issued by the China Securities Regulatory Commission.

1. Items of combined balance sheet as at 31 December 2010 with relatively material changes as compared with that as at 31 December 2009 are set forth below:

| Item | Note | 2010.12.31 | 2009.12.31 | RMB'000 |
|---|------|------------|------------|---------------------|
| | | | | Range of change (%) |
| Cash and bank balance | (1) | 892,287 | 305,509 | 192.07 |
| Bills receivable | (2) | 19,121 | 34,631 | (44.79) |
| Prepayments | (3) | 158,602 | 54,615 | 190.40 |
| Other current assets | (4) | 41,055 | — | 100.00 |
| Fixed assets | (5) | 1,644,970 | 908,171 | 81.53 |
| Construction in progress | (6) | 131,446 | 391,594 | (66.43) |
| Construction materials | (7) | — | 7,540 | (100.00) |
| Intangible assets | (8) | 249,918 | 165,631 | 53.89 |
| Other non-current assets | (9) | — | 23,279 | (100.00) |
| Short-term loans | (10) | 712,866 | 274,649 | 159.56 |
| Accounts payable | (11) | 501,772 | 345,188 | 45.36 |
| Advance receipts | (12) | 34,722 | 52,528 | (33.90) |
| Dividends payable | (13) | 23,789 | 39,592 | (39.92) |
| Other payables | (14) | 25,992 | 17,271 | 50.49 |
| Non-current liabilities due within 1 year | (15) | — | 193,000 | (100.00) |
| Long-term loans | (16) | — | 580,000 | (100.00) |
| Capital reserve | (17) | 1,248,406 | 121,668 | 926.08 |

- (1) The increase in currency fund was mainly due to the raising of funds upon the successful domestic listing of the Company during the current year, which improved the Company's cash flow, while cash flow position also improved as a result of increase in corporate sales on the back of recovery of economy.
- (2) The decrease in bills receivables was mainly due to the larger purchase volume of raw materials during the current year, and payment for the goods after endorsement upon the receipt of bills.
- (3) The increase in prepayments was mainly due to the fact that the Company expected the surge in price level of major raw materials, and prepaid the payments of goods to suppliers to lock the maximum purchase price of major raw materials in order to reduce the soaring price risk.



III. Irregular movements in major items of the accounting statements of the Company and explanation on their reasons *(continued)*

1. Items of combined balance sheet as at 31 December 2010 with relatively material changes as compared with that as at 31 December 2009 are set forth below *(continued)*

- (4) The increase in other current assets was mainly due to the reclassification of the borrower's balance of value-added tax receivables.
- (5) The increase in fixed assets was mainly due to the crediting of fixed assets as a result of the completion of the Company's 180mm Special Petroleum Pipes Technical Reconstruction Project during the current year.
- (6) The decrease in construction in progress was mainly due to the crediting of fixed assets as a result of the completion of the Company's 180mm Special Petroleum Pipes Technical Reconstruction Project during the current year.
- (7) The decrease in construction materials was mainly due to the crediting to fixed assets upon the completion of examination for equipment.
- (8) The increase in intangible assets was mainly due to the purchase of land use rights of the Company's 180mm Special Petroleum Pipes Technical Reconstruction Project and the capitalization of the development costs for intangible assets.
- (9) The decrease in other non-current assets was due to the obtaining of land use rights certificate for some prepaid land use right premium of the Company, which were credited to the computation of intangible assets.
- (10) The increase in short-term loans was due to the increase in short-term loans due to the prepayments for major raw materials made by the Company, while the amounts of foreign exchange loans also increased during the current year as a result of the increase in financial products such as export exchange pledge by the Company to reduce foreign exchange risk exposure.
- (11) The increase in accounts payable was mainly due to the increase in raw materials procurement and project equipment during the year.
- (12) The decrease in advance receipts was mainly due to the increase in the amount of goods delivered during the end of the period.
- (13) The decrease in dividends payable was due to the payment of dividends to off-shore H Shares shareholders.
- (14) The increase in other payables was mainly due to the increase in accrued electricity fees and delivery expenses, as well as the addition of A Shares listing expenses payable.
- (15) The decrease in non-current liabilities due within 1 year was due to the repayment of long-term borrowings due within 1 year by the Company.
- (16) The decrease in long-term loans was mainly due to the repayment of most long-term borrowings by the Company during the current year.
- (17) The increase in capital reserve was due to the share premium incurred by the listing of new shares during the current year.



III. Irregular movements in major items of the accounting statements of the Company and explanation on their reasons *(continued)*

2. Items of combined income statement for 2010 with relatively material changes as compared with that for 2009 are set forth below:

| | | 2010 | 2009 | RMB'000 Range of change (%) |
|-----------------------------|-----|-----------|-----------|-----------------------------------|
| Operation Revenue | (1) | 2,703,907 | 2,075,551 | 30.27 |
| Cost of Operation | (2) | 2,237,507 | 1,678,635 | 33.29 |
| Management fees | (4) | 91,384 | 63,829 | 43.17 |
| Financing expenses | (5) | 44,342 | 10,657 | 316.09 |
| Impairment losses on assets | (6) | (2,024) | (12,716) | (84.08) |
| Gains on fair value change | (7) | — | (5,270) | (100.00) |
| Investment gains | (8) | 191 | 5,827 | (96.72) |
| Non-operation expenses | (9) | 2,665 | 620 | 330.07 |

- (1) The increase in operation revenue was mainly due to the recovery of economy during the year, under which domestic sales, especially sales of oil well pipes, gradually increased, while foreign sales also recorded a rebound.
- (2) The increase in cost of operation was mainly due to the increase in sales volume and material costs.
- (3) The increase in management fees was mainly due to the increase in the research and development fees for new products.
- (4) The increase in financing expenses was mainly due to the surge in short-term borrowings and the increase in foreign exchange losses as a result of the appreciation of Renminbi.
- (5) The increase in impairment losses on assets was mainly due to write back of RMB8,461,162.98 of bad debt provision due from South China Petrochemical Group in the previous year.
- (6) The decrease in gains on fair value change was mainly due to the completion of the transaction of all tradable financial assets and liabilities of the Company in the previous year.
- (7) The decrease in investment gains was due to the investment gains of RMB5,580,000.00 received from the disposal of tradable financial assets and liabilities by the Company in the previous year, while there are no other gains except for the net income from Kelamayi Ya Long Oil Pump Company Limited, an associate.
- (8) The increase in non-operating expenses was mainly due to the donation expenses and the increase in net losses on disposal of fixed assets during the current period.



XI. Documents Available for Inspection

1. The financial statements which were signed and sealed by the legal representative, financial controller and head of the financial department of the Company.
2. The original copy of the auditors' report which was sealed by the accounting firm and signed by a certified public accountant.
3. Original copies of all of the documents and announcements of the Company which have been disclosed in the designated newspaper and website as approved by China Securities Regulatory Commission during the reporting period.

Shandong Molong Petroleum Machinery Company Limited

March 29, 2011