# 中國高速傳動設備集團有限公司*

# China High Speed Transmission Equipment Group Co., Ltd.

*(incorporated in the Cayman Islands with limited liability)*

(Stock Code: 658)

Annual Report 2010

* For identification purpose only

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# CORPORATE INFORMATION

## BOARD OF DIRECTORS

### Executive Directors

Mr. Hu Yueming *(Chairman and Chief Executive Officer)*
Mr. Chen Yongdao
Mr. Lu Xun
Mr. Li Shengqiang
Mr. Liu Jianguo
Mr. Liao Enrong
Mr. Jin Maoji (appointed on 7 May 2010)

### Independent non-executive Directors

Mr. Jiang Xihe
Mr. Zhu Junsheng
Mr. Chen Shimin

## AUDIT COMMITTEE

Mr. Jiang Xihe *(Chairman)*
Mr. Zhu Junsheng
Mr. Chen Shimin (appointed on 7 May 2010)

## REMUNERATION COMMITTEE

Mr. Chen Shimin *(Chairman)*
Mr. Jiang Xihe
Mr. Liu Jianguo (appointed on 7 May 2010)

## REGISTERED OFFICE

Second Floor of Cayside
Harbour Drive
P.O. Box 30592 S.M.B.
Grand Cayman
Cayman Islands

## AUDITORS

Deloitte Touche Tohmatsu

## HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Room 1302
13th Floor
Top Glory Tower
No.262 Gloucester Road
Causeway Bay
Hong Kong

## PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
Grand Cayman, KYI-1107
Cayman Islands

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
17M Floor
Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

## COMPANY SECRETARY

Mr. Lui Wing Hong, Edward CPA (Aust.), FCPA

## QUALIFIED ACCOUNTANT

Mr. Lui Wing Hong, Edward CPA (Aust.), FCPA

## AUTHORISED REPRESENTATIVES

Mr. Liao Enrong
Mr. Lui Wing Hong, Edward

# CORPORATE INFORMATION

## PRINCIPAL BANKERS

Bank of Communications Co., Ltd., Nanjing Branch
China Merchants Bank Co., Ltd., Nanjing Branch

## WEBSITE

www.chste.com

## PLACE OF LISTING

The Stock Exchange of Hong Kong Limited
(Stock Code: 00658)

## PERFORMANCE HIGHLIGHTS

Revenue for 2010 was approximately RMB7,392,649,000, representing an increase of 30.9% as compared with last year.

Profit attributable to owners of the Company as shown in the accounts for the year 2010 was approximately RMB1,383,635,000, representing an increase of 43.2% as compared with last year.

Excluding the changes in fair values of convertible bonds and equity swap, adjusted profit attributable to owners of the Company for 2010 was approximately RMB1,272,318,000, representing an increase of 15.0% as compared with last year.

Basic and diluted earnings per share amounted to RMB1.08 and RMB0.91 respectively.

The Board recommended payment of a final dividend of HK33 cents per share for the year ended 31 December 2010.

# CHAIRMAN'S STATEMENT

I am pleased to present the 2010 annual report of China High Speed Transmission Equipment Group Co., Ltd. (the "Company"). For the year ended 31 December 2010 (the "Period under Review"), the Company and its subsidiaries (collectively referred to as the "Group") recorded sales revenue of approximately RMB7,392,649,000, representing an increase of approximately 30.9% over 2009. Profit attributable to owners of the Company was approximately RMB1,383,635,000, representing an increase of 43.2% over last year, or an increase of 15.0% over last year if excluding the changes in fair values of convertible bonds and equity swap. The gross profit margin for the year was 31.1%, representing a decrease of 1.9% over last year. Benefitted from government's supporting policy and favourable market conditions against the backdrop of a global economic recovery, major business of the Group achieved remarkable results in 2010 due to the hard work and dedication of our staff and the support from all circles. I would like to take this opportunity to express my heartfelt gratitude to the management, the directors, all our staff, shareholders and investors for their efforts and trust as well as business partners for their continuous support.

In 2010, the global economy began to recover at a steady pace. In China, the renewable energy industry developed rapidly with the support of government policies. Under favourable market environment, the Group maintained its prudent strategy to diversify its business by introducing more products into the market. Last year, adhering to its core value of product quality and reputation, the Group adjusted its development strategy to cope with the changing market environment and consolidated its leading position as the largest supplier of wind power gear boxes in the PRC. Our excellent product quality and reputation are regarded as the benchmarks of the industry.

During the Period under Review, sales volume of each principal business segment of the Group was remarkable:

The development of the PRC wind power industry in 2010 was noteworthy. The new installed capacity and aggregate installed capacity of the wind power industry in China in 2010 were 16 million KW and 41.827 million KW respectively, which surpassed the United States and were ranked first in the world. Sales of wind gear transmission equipment, a major line of products of the Group, increased significantly during the Period under Review due to our continuous efforts. It recorded sales of RMB5,457,532,000, representing an increase of 43.4% as compared to last year. The Group successfully expanded the production capacity to 9,000MW. Sales of the 1.5MW and 2MW wind gear transmission equipment in domestic and overseas markets remained stable and they were well recognized by customers. High capacity wind power equipment has become the mainstream after the launch of offshore wind power projects for tendering. Leveraging the sophisticated production technology of 3MW wind power gear box, the Group was the first to commence mass production of 3MW wind power gear box in the PRC and became a leading offshore wind power gear transmission equipment manufacturer in China. In 2010, the first batch of 3MW offshore wind power gear box of the Group was delivered to its customers and has been in smooth operation.

With regard to the marine gear transmission equipment segment, the Group possesses annual production capacity of 400 sets of controllable pitch propeller and is one of the top marine propeller system manufacturers in the PRC. The high precision marine products of the Group are mainly sold to domestic and overseas high-end customers. The Group entered into long-term strategic cooperation agreements with reliable overseas partners in 2010, which laid a solid foundation for the Group to further develop the overseas market of marine gear transmission equipment.

## CHAIRMAN'S STATEMENT

The transmission equipment for high-speed locomotives and urban light rail segment of the Group has developed steadily with sales of RMB36,310,000, representing 0.5% of total sales. The Group's products are used in subways of major cities including Shanghai, Beijing, Nanjing and Shenzhen and operate well. In 2010, "high-speed railway" has become a popular keyword in railway construction and development in the PRC. In the Twelfth Five-year Economic and Social Development Plan, high-speed railway is regarded as a strategic emerging industry. Favourable government policies in respect of funding, land, technology innovation and operating environment will be adopted to support the construction of high-speed railways. In light of the favourable policy and market environment, the Group will capitalise on the opportunities to enhance the research and development of light rail and high-speed train gear equipment. The Group will further expand the high-speed railway, subway and urban light rail business to become new sources of growth.

During the Period under Review, traditional gear transmission equipment business of the Group maintained healthy growth. As a leading traditional gear transmission equipment supplier in China, while maintaining its foothold in China, the Group has taken steps to explore overseas markets, mainly in developing countries such as India, Vietnam, Brazil and Middle East, etc. The Group has successfully developed the market in India. In accordance with its product diversification strategy, the Group began to develop speed control transmission gear product and explore the business of electrical transmission equipment by modifying its mechanical transmission equipment. The new business segment of the Group recorded profits during the Period under Review.

During the Period under Review, the Group has registered 29 new patents and the total number of registered patents was 119. In addition, the Group has applied for the registration of 42 patents. The new patents involved various technologies being applied in wind gear transmission equipment, rail transportation transmission equipment, marine propulsion system, construction materials conveying equipment, metallurgy conveying equipment, coal conveying equipment, electrical and mechanical equipment, etc. For wind power gear transmission equipment, the 3MW wind power gear transmission equipment of the Group has been introduced into the market and the research and development of the 5 MW high wind power gear transmission equipment has been proceeding as scheduled. For light rail and high-speed railway transmission equipment, the Group cooperated with Alstom, S.A. in France in the research and development of the transmission for AGV high-speed train with a maximum speed of 570 km/h. If the research and development is successful, this AGV will be the fastest train in the world.

In 2010, with the support of government policies and the rapid growth of renewable energy industry, the Group grasped the opportunities in the domestic market to boost the sales to RMB6,526,235,000, representing an increase of 35.7% as compared to the previous year. In addition, the overseas sales of the Company recorded a steady growth as the overseas markets have not fully recovered. Export sales of the Group increased by 3.4% to RMB866,414,000 when compared with last year. The Group intends to establish offices in Texas, USA to service overseas customers. The Group has maintained a stable and good relationship with excellent domestic and foreign customers. The products of the Group were highly recognised by major brands. The orders from major customers have been increasing, which proved the excellent quality and competitiveness of the Group's products in the international markets. Based on the solid foundation laid in 2010, the Group intends to expand the production capacity of wind power gear transmission equipment to 12,000 MW to grasp the opportunities in the domestic and overseas markets.

# CHAIRMAN'S STATEMENT

However, it is believed that the renewable energy industry in China is not mature and will face various challenges during its rapid development. Currently various infrastructure equipment is under the progress of cousolidation. International financial markets are recovering gradually from the economic crisis at different paces. Therefore, in addition to maintaining its growth momentum, the Group will focus on products restructuring, expanding its product scale and enriching its product variety, so as to reduce market risks and cope with the changes in market more easily. In addition to the core business of wind power gear transmission equipment, the Group will also consolidate other business segments to seize market opportunities. The Group will provide the global customers with high quality products to maintain its leading position in the market and to bring stable returns for its shareholders.

**Hu Yueming**
*Chairman*
25 March 2011

# MANAGEMENT DISCUSSION AND ANALYSIS

## BUSINESS REVIEW

The Group is principally engaged in research, design, development, manufacture and distribution of a broad range of mechanical transmission equipment that are used in a wide range of industrial applications. For the year ended 31 December 2010, the Group recorded total sales revenue of approximately RMB7,392,649,000, representing a substantial increase of 30.9% over 2009. The gross profit margin recorded for the year was approximately 31.1%. Profit attributable to owners of the Company was approximately RMB1,383,635,000, representing a significant increase of 43.2% over 2009. If the effect of the fair value change of convertible bonds and equity swap had been excluded, the adjusted profit attributable to owners of the Company in 2010 would have been approximately RMB1,272,318,000, representing an increase of 15.0% over 2009. Basic and diluted earnings per share attributable to the owners of the Company amounted to approximately RMB1.08 and RMB0.91 respectively.

### Principal business review

1. **Wind gear transmission equipment**

   *Great progress has been made in the research and development of large wind gear transmission equipment*

   The wind gear transmission equipment is a major product that has been developed by the Company in recent years. Sales revenue of wind gear transmission equipment business surged by approximately 43.4% to approximately RMB5,457,532,000 (2009: RMB3,805,074,000) as compared with last year. The increase was mainly attributable to the proactive policies and measures adopted by the PRC government to encourage the use of renewable energy and green power generation. The increase was also attributable to the encouragement for the use of clean energy, including wind power, by the PRC government in support of the policy for the reduction in carbon dioxide emission.

   The Group is a leading supplier of wind gear transmission equipment in the PRC. By leveraging its strong research, design and development capabilities, the Group's research and development has achieved good results. Of these, the 1.5MW and 2MW wind gear transmission equipment has been provided to domestic and overseas customers in bulk. The product technology has reached an international advanced technical level and is well recognised by our customers. In addition, the Group has achieved significant progress in the research and development of 3MW wind gear transmission equipment. During the Period under Review, the products delivered to customers by the Group were of satisfactory quality and are believed to bring a larger flow of business to the Group.

   Currently, the customers of the wind power business of the Group include the major wind turbine manufacture in the PRC, as well as renowned international wind turbine manufacturers such as GE Energy, Vestas, REPower, Nordex, Fuji Heavy, etc. During the Period under Review, Guangdong Mingyang Wind Power Industrial Group Co. Ltd. has become one of the customers of the Group. With the Group's increasingly global operation, we believe that the Group will attract more wind turbine manufacturers.

# MANAGEMENT DISCUSSION AND ANALYSIS

**2. Marine gear transmission equipment**

*Actively expand the domestic market*

Marine gear transmission equipment is one of the Company's products in recent years. Sales of marine gear transmission equipment were generated from overseas and domestic orders. In the face of the global financial crisis, the Company is actively expanding its presence in the domestic market and enhancing diversification of marine gear transmission equipment products.

The Company began to develop the domestic market for marine gear transmission equipment last year and the market development is on schedule. During the Period under Review, turnover of marine gear transmission equipment increased significantly to approximately RMB234,253,000 (2009: RMB209,579,000), representing an increase of approximately 11.8% over the corresponding period last year.

**3. Transmission equipment for high-speed locomotives and urban light rails**

*Results have been achieved in the research and development with promising market potential*

The use of high-speed trains, metros and urban light rail systems as environmentally-friendly transportation has become a major global trend. It is believed that the industry has promising potential. The development of intercity transportation in the PRC, one of the most densely populated countries in the world, will provide a tremendous market for manufacturers of high-speed locomotives and urban light rail transportation systems. The high-speed railway transportation network in Europe is expected to expand two fold by 2020. In order to capture this tremendous business opportunity, the Group conducted research and development of transmission equipment for high-speed locomotives, metros and urban light rails, and passed the product quality certification conducted by ALSTOM Group in April 2008. Our products have been installed in the metros used in Beijing, Shanghai and Nanjing for field tests during the Period under Review. The Group will endeavor to further expand the domestic and overseas markets to make it a new motivator for the revenue growth of the Group. In the Period under Review, such business generated sales revenue of approximately RMB36,310,000 for the Group (2009: RMB14,279,000).

## MANAGEMENT DISCUSSION AND ANALYSIS

4. **Traditional transmission products**

*Sales of new products remain strong*

The Group's traditional gear transmission equipment products are mainly provided for customers from various industries including metallurgy, construction materials, traffic, transportation, petrochemicals, aerospace and mining. During the Period under Review, sales of gear transmission equipment for bar-rolling, wire-rolling and plate-rolling mills and other mechanical transmission equipment increased by 17.8% and 24.9% to approximately RMB550,743,000 (2009: RMB467,721,000) and RMB229,740,000 (2009: RMB183,872,000), respectively. Sales of high speed heavy load gear transmission equipment and gear transmission equipment for construction materials decreased by 14.6% and 15.8% to approximately RMB24,798,000 (2009: RMB29,049,000) and RMB668,452,000 (2009: RMB794,200,000), respectively.

Despite the macro-economic control imposed by the PRC government, the Group's gear transmission equipment for bar-rolling, wire-rolling and plate-rolling mills recorded sales growth, primarily attributable to the research and development of new products and the expansion to overseas markets. The Group focused on the development of energy-saving and environmentally-friendly products which are well received in the market. Benefited from the PRC government policy which promoted the development and upgrade of equipment manufacturing industry and in response to equipment upgrades in the metallurgy industry, the Group has proactively developed complete sets of transmission equipment during the Period under Review such as cold-rolled, hot-rolled, strip and bar, wire rolling and plate-rolling mills which are well received by the market.

5. **Computer numerical controlled ("CNC") products**

*CNC products industry*

Equipment manufacturing is a pillar industry of the national economy. Independent developing of the equipment manufacturing industry is one of the strategic objectives of the "Eleventh Five-Year Plan". "Machine tool is the core equipment of the equipment manufacturing industry. The modernisation of the equipment manufacturing industry of China depends on the development of its machine tool industry. We must enhance the manufacturing capacity of our machine tool, in particular CNC machine tool, to support the development of equipment manufacturing industry," said Wen Jiabao, the Premier of the State Council. Besides, the price for heavy machine tools is very high as the market is dominated by few international manufacturers. The Group intends to take the opportunity to develop precise and efficient general and special machine tool products to explore the high-end market and provide advanced machine tools for the equipment manufacturing industry.

In order to seize the developing market of CNC machine tools, during the Period under Review, the Group has acquired a local manufacturer specialising in the research and development and production of CNC system and CNC machine tools. Such manufacturer possessed the proprietary intellectual property rights of its self-developed CNC system and machine tools. Its high-end machine tools technology was further strengthened by capitalising on the technology platform of the Group.

## MANAGEMENT DISCUSSION AND ANALYSIS

During the Period under Review, the Group provided CNC machine tool products to customers through the newly acquired subsidiary and recorded sales of approximately RMB46,081,000 (2009: nil).

### LOCAL AND EXPORT SALES

During the year, the Group maintained its position as the leading supplier of mechanical transmission equipment in the PRC. During the Period under Review, the overseas sales amounted to approximately RMB866,414,000 (2009: RMB838,097,000), accounting for 11.7% to total sales (2009: 14.8%) and representing a decrease of 3.1% to total sales over the corresponding period last year. At present, the overseas customer base of the Company extends to the U.S., India, Japan and Europe. Since the economies in Europe and the U.S. was yet to be recovered during the Period under Review, the Company currently allocates more resources to the domestic market in response to the strong demand for the Company's products in China.

### PATENTED PROJECTS

The business of the Group has high entry barriers and requires specific technical know-how. The Group enhances corporate growth by introducing new products and new technology. Various new products have made their debuts in the domestic market under the Group's on-going innovation of products and technology. Leveraging its advanced technology and premium quality, the Group has obtained over 100 national, provincial and municipal technology advancement awards, outstanding new products awards, certification for new products, certification for high and new tech products and certification of high and new tech enterprise. 161 patent applications have been filed, of which 119 patents are granted. The Company was the first producer to adopt ISO1328 and ISO06336 international standards. It was nominated as an enterprise for the 863 State Plan and a Computer Integrated Manufacturing System (CIMS) Application Model Enterprise by the Ministry of Science and Technology of the PRC. Until now, the Company passed ISO9001:2008 quality management system certification, ISO14001:2004 environmental management system certification and GB/T28001-2001 Occupational Health and Safety Management System Certification. Nanjing High Accurate Marine Equipment Co., Ltd., a subsidiary of the Company, has obtained the workshop approval issued by Bureau Veritas (BV) in France. The welding workshop of the Company has obtained the workshop approvals issued by China Classification Society (CCS), Lloyd's Register of Shipping (LR) in UK, Germanischer Lloyd (GL) in Germany and Bureau Veritas (BV) in France. Our wind power products have obtained certifications from Technischer Uberwachungs-Verein (TUV), Germanischer Lloyd (GL) and DEWI-OCC Offshore and Certification Centre in Germany.

### DIVIDENDS

The Board recommended the payment of a final dividend of HK33 cents per share in respect of the year ended 31 December 2010.

# MANAGEMENT DISCUSSION AND ANALYSIS

## FINANCIAL PERFORMANCE

In the year of 2010, the Group's results gradually reflected the success of the Group's investment, the vision of the management team as well as the Group's advantage as a leading mechanical transmission equipment manufacturer. Overall sales revenue increased by 30.9% to approximately RMB7,392,649,000.

| | Revenue<br>Year ended 31 December | |
|---|---|---|
| | 2010<br>*RMB'000* | 2009<br>*RMB'000* |
| High-speed Heavy-load Gear Transmission Equipment | **24,798** | 29,049 |
| Gear Transmission Equipment for Construction Materials | **668,452** | 794,200 |
| General Purpose Gear Transmission Equipment | **144,740** | 143,271 |
| Gear Transmission Equipment for Bar-rolling, Wire-rolling and Plate-rolling Mills | **550,743** | 467,721 |
| Wind Gear Transmission Equipment | **5,457,532** | 3,805,074 |
| Marine Gear Transmission Equipment | **234,253** | 209,579 |
| Transmission Equipment for High-speed Locomotives and Urban Light Rails | **36,310** | 14,279 |
| CNC Products | **46,081** | — |
| Others | **229,740** | 183,872 |
| | **7,392,649** | 5,674,045 |

## REVENUE

The Group's sales revenue for 2010 was approximately RMB7,392,649,000, representing an increase of 30.9% as compared with last year. The increase was mainly due to the continued growth in sales volume during the year. In particular, this was mainly attributable to an increase of 43.4% in sales revenue of wind gear transmission equipment from approximately RMB3,805,074,000 for 2009 to approximately RMB5,457,532,000 for 2010 and an increase of 17.8% in traditional transmission products including gear transmission equipment for bar-rolling, wire-rolling and plate-rolling mills from approximately RMB467,721,000 for 2009 to approximately RMB550,743,000 for 2010. Sales of marine gear transmission equipment also increased by 11.8% from approximately RMB209,579,000 for 2009 to approximately RMB234,253,000 for 2010.

# MANAGEMENT DISCUSSION AND ANALYSIS

### Gross profit margin and gross profit

The Group's consolidated gross profit margin was approximately 31.1% for 2010, representing a slight decrease of 1.9% as compared with last year. The decrease was mainly attributable to the adjustment of the selling prices of some traditional products based on the market environment and the stable gross profit of wind gear transmission equipment. Consolidated gross profit for 2010 reached approximately RMB2,298,848,000 (2009: RMB1,861,241,000), representing an increase of 23.5% as compared with last year. This was mainly attributable to the increased sales of wind gear transmission equipment. The gross profit of wind gear transmission equipment increased from approximately RMB1,215,254,000 for 2009 to approximately RMB1,703,663,000 for 2010, representing an increase of 40.2%.

### Other income, other gain and loss

The total amount of other income of the Group for 2010 was approximately RMB200,185,000 (2009: RMB105,369,000), an increase of 90.0% as compared with last year. Other income is mainly comprised of bank interest income, government grants and sales of wastages.

During the year, other gain and loss recorded a net gain of approximately RMB111,317,000 (2009: a net loss of RMB139,778,000), which mainly comprised fair value gain on convertible bonds and loss on derivative financial instruments.

### Distribution and selling costs

The distribution and selling costs of the Group for 2010 were approximately RMB287,156,000 (2009: RMB139,174,000), representing an increase of 106.3% over 2009. The increase was mainly attributable to increased sales. The percentage of distribution and selling costs to sales revenue for 2010 was 3.9% (2009: 2.5%), representing an increase of 1.4% to sales revenue over 2009. This was mainly attributable to the increase of the provision of quality margin based on the principle of prudence in view of the strong market demand for wind gear transmission equipment.

### Administrative expenses

Administrative expenses of the Group increased from approximately RMB318,036,000 for 2009 to approximately RMB460,049,000 for 2010, mainly due to the increase in the number of staff and staff costs, and depreciation charges arising from increased investment in fixed assets by the Company. The percentage of administrative expenses to sales revenue was increased by 0.6% to 6.2% as compared with the last year.

### Other expenses

Other expenses of the Group for 2010 were approximately RMB57,300,000 (2009: RMB48,939,000), which mainly comprised a net loss on foreign exchange of approximately RMB31,057,000 (2009: RMB30,587,000).

### Finance costs

In 2010, the finance costs of the Group was approximately RMB146,842,000 (2009: RMB99,832,000), representing an increase of 47.1% as compared with last year, which was mainly due to the increase in bank loans and interest rates of loans.

# MANAGEMENT DISCUSSION AND ANALYSIS

## FINANCIAL RESOURCES AND LIQUIDITY

As at 31 December 2010, the equity attributable to owners of the Company amounted approximately to RMB7,392,730,000 (2009: RMB4,420,937,000). The Group had total assets of approximately RMB14,931,515,000 (2009: RMB10,234,919,000), representing an increase of approximately RMB4,696,596,000, or 45.9%, as compared with the beginning of the year. Total current assets of the Group were approximately RMB8,142,157,000 (2009: RMB5,037,358,000), representing an increase of 61.6% as compared with the beginning of the year and accounting for 54.5% of total assets (2009: 49.2%). Total non-current assets were approximately RMB6,789,358,000 (2009: RMB5,197,561,000), representing an increase of approximately 30.6% as compared with the beginning of the year and accounting for 45.5% of the total assets (2009: 50.8%).

As at 31 December 2010, total liabilities of the Group were approximately RMB7,417,174,000 (2009: RMB5,784,567,000), representing an increase of RMB1,632,607,000 as compared with the beginning of the year. Total current liabilities were approximately RMB5,225,886,000 (2009: RMB3,288,119,000), representing an increase of 58.9% as compared with the beginning of the year whereas total non-current liabilities were approximately RMB2,191,288,000 (2009: RMB2,496,448,000), representing a decrease of approximately 12.2% as compared with the beginning of the year.

As at 31 December 2010, the net current asset of the Group was approximately RMB2,916,271,000 (2009: RMB1,749,239,000), representing an increase of RMB1,167,032,000, or 66.7%, as compared with the beginning of the year.

As at 31 December 2010, total cash and bank balances of the Group were approximately RMB3,037,405,000 (2009: RMB1,074,486,000), including pledged bank deposits of RMB766,839,000 (2009: RMB451,389,000) and restricted cash of RMB146,798,000 (2009: RMB151,904,000). These restricted cash represents the remaining balance of restricted deposits payable by the Group in respect of the Equity Swap entered into with Morgan Stanley & Co. International plc on 22 April 2008.

As at 31 December 2010, the Group had total bank loans of approximately RMB3,251,701,000 (2009: RMB2,568,314,000), of which short-term bank loans were RMB1,208,651,000 (2009: RMB1,556,273,000), accounting for approximately 37.2% (2009: 60.6%) of the total bank loans. The short-term bank loans are repayable within one year. The average effective interest rate of the Group's bank loans for 2010 ranges from 3.51% to 7.97% (2009: 3.51% to 7.97%).

Taking into account of the internal financial resources of and the banking facilities available to the Group, the issue of RMB denominated USD settled zero coupon convertible bonds of RMB1,996,300,000 in May 2008, and the allotment of 130,000,000 top-up placing shares with net proceeds of approximately HK$2,223,000,000 in September 2010, the directors of the Company believe that the Group will have a sound and strong financial position as well as sufficient resources to meet its working capital requirements and foreseeable capital expenditure.

# MANAGEMENT DISCUSSION AND ANALYSIS

## Gearing ratio

The Group's gearing ratio (defined as total liabilities as a percentage of total assets) decreased from 56.5% in 2009 to 49.7% in 2010.

## Capital structure

*Convertible bonds*

On 14 May 2008, the Company issued RMB denominated USD settled zero coupon convertible bonds due 2011 in an aggregate principal amount of RMB1,996,300,000 (equivalent to approximately US$286,000,000) to Morgan Stanley & Co. International plc (as the lead manager) which is detailed as below:

(i) Reasons for the convertible bonds issue: to raise further capital for the purposes as set out in the paragraph headed "Use of proceeds" below whilst enlarging the shareholder base of the Company.

(ii) Type of the convertible bonds: convertible into ordinary shares.

(iii) Size and principal amount of the bonds: the aggregate principal amount of the bonds is RMB1,996.3 million.

(iv) Issue price: 100% of the principal amount of the bonds.

(v) According to the announcement dated 18 June 2010, the conversion price was adjusted from HK$17.2886 per share to HK$16.9817 per share from 18 June 2010 as a result of the payment of final dividends for the year ended 31 December 2009.

(vi) Net proceeds: approximately US$280 million.

(vii) Use of proceeds: approximately US$142.8 million (representing approximately 51.0% of the net proceeds) will be applied to enter into an equity swap contract, and the remaining proceeds of approximately US$137.2 million (representing approximately 49.0% of the net proceeds) will be used to further enhance production capacity till 2010 to meet the increasing demand for gear boxes and gear transmission equipment from various industries, such as wind power generation, marine and rail transportation, and applied as capital expenditure and daily working capital (including payment for imported equipment and components).

During the year, the Company did not repurchase and cancel any other convertible bonds.

In the second quarter of 2010, the convertible bonds with a total nominal value of RMB100,000 were converted into 6,566 shares.

## MANAGEMENT DISCUSSION AND ANALYSIS

As at 31 December 2010, the outstanding principal of the convertible bonds amounted to RMB1,147,000,000 (2009: RMB1,147,100,000). Based on the adjusted conversion price of HK$16.9817 per share and assuming full conversion of the bonds at the adjusted conversion price, the number of conversion shares falling to be issued in connection with the outstanding bonds will be 75,315,897 ordinary shares, representing approximately 5.5% of the existing issued share capital of the Company and approximately 5.2% of the issued share capital of the Company as enlarged by the full conversion of the bonds.

For the year ended 31 December 2010, gain on fair value changes of such convertible bonds was approximately RMB148,916,000 (2009: loss on fair value changes of convertible bonds was RMB438,382,000).

*Equity Swap*

Concurrently with the issuance of the RMB denominated USD settled zero coupon convertible bonds, the Company entered into a cash settled equity swap transaction with Morgan Stanley & Co. International plc (the "Equity Swap Counterparty") for the Company's shares amounting to HK$1,113,013,000 (equivalent to approximately RMB981,566,000). Further details for the Equity Swap were set out in the Company's announcement dated 24 April 2008.

As at 4 May 2009, the Company and the Equity Swap Counterparty had undertaken the partial termination in respect of 68,758,000 shares under the Equity Swap at an average final price of HK$12.8495 per share (net of early termination fee and other costs and expenses). Further details were set out in the Company's announcement dated 5 May 2009.

On 6 November 2009, the Company entered into an amended and restated Equity Swap with the Equity Swap Counterparty. Under the amended and restated Equity Swap, the Company may elect for physical delivery of shares (the "Share Delivery Option") as an alternative to cash settlement. In the event that the Company elects to exercise the Share Delivery Option to settle a scheduled termination of the remaining Equity Swap in whole, the Equity Swap Counterparty will deliver to the Company the number of ordinary shares in the issued share capital of the Company specified in the Equity Swap as amended from time to time (i.e. 12,612,707 ordinary shares), whereupon the Equity Swap Counterparty will have no obligation to repay the remaining proportional amount of the Initial Exchange Amount (i.e. HK$172,520,390.16) to the Company. In the event that the Company elects to exercise the Share Delivery Option to settle a partial optional early termination of the Equity Swap, the Equity Swap Counterparty will deliver to the Company the terminated number of shares and the Equity Swap Counterparty's obligation to repay to the Company a proportional amount of the initial exchange amount shall no longer apply. Where the Company has elected for the Share Delivery Option to apply, the shares to be delivered by the Equity Swap Counterparty will be promptly cancelled by the Company. Exercising the Share Delivery Option on one or more occasions will constitute an off-market repurchase of up to a total of 12,612,707 ordinary shares (representing approximately 1.0% of the existing issued share capital of the Company) under the Hong Kong Code on Share Repurchases. The potential off-market repurchase of shares was approved by the extraordinary general meeting of shareholders by way of a special resolution on 15 January 2010. Further details of the amended and restated Equity Swap were set out in the Company's announcements dated 6 November 2009 and 15 January 2010 and circular dated 24 December 2009.

# MANAGEMENT DISCUSSION AND ANALYSIS

For the year ended 31 December 2010, loss on fair value changes of the Equity Swap was approximately RMB37,599,000 (2009: gain was RMB298,604,000).

*Share Placing*

On 10 September 2010, the Company agreed to place 130,000,000 shares to not less than 6 independent places with the following particulars:

1. **Reason for placing:** the placing represents an opportunity to raise capital for the Company while broadening the Shareholders' base and capital base of the Company.

2. **Class of shares:** Ordinary

3. **Number of placing shares and aggregate nominal value:** US$1,300,000, divided into 130,000,000 shares of US$0.01 each

4. **Issue price:** HK$17.38

5. **Net price:** HK$17.10

6. **Placees:** not less than 6 independent places

7. **Closing price on the date of agreement:** HK$18.50

8. **Use of proceeds:** the Company intends to use the net proceeds of the Top-up Subscription to fund capital expenditure, investments in our existing products extension (including mechanical electrical integration), general corporate purposes, as well as to further strengthen the balance sheet and liquidity position of the Company.

For details, please refer to the Company's announcements dated 10 and 21 September 2010, respectively.

The Group's loans and cash and cash equivalents were mainly denominated in Renminbi.

The Group's operations were financed mainly by shareholder's equity and internal resources. The Group will continue to adopt its treasury policy of placing its cash and cash equivalents as interest bearing deposits.

# MANAGEMENT DISCUSSION AND ANALYSIS

## PROSPECTS

Environmental protection, energy conservation and emission reduction are the major concerns of every country in the world. The PRC government considered renewable energy development as the core of "The Twelfth Five-Year Plan for National Economic and Social Development". In 2010, with favourable market environment, all business segments of the Group developed steadily. In the future, the new development targets of the Group are to expand its product scale and diversify its product mix. Capitalising on its advanced techniques of research and development, high quality products and excellent market insights, the Group will continuously expand its businesses and carry out products restructuring to consolidate its position in the industry and attract more customers.

In 2010, installed capacity of the PRC wind power industry was ranked first in the world. Expansion of the scale of wind power generating units has become the development trend of the industry due to the rapid development of offshore wind power of the PRC. The Group intends to expand its total production capacity to 12,000MW in 2011 in line with the development of the wind power industry in the PRC. Owing to the enormous demands, the Group is confident in the development of 3MW wind gear transmission equipment in the PRC market in the future, and the Group had secured bulk orders in China already. The Group has also started the research and development of 5MW wind gear transmission equipment to realise its large-scale development strategy.

In addition to consolidating the development of wind gear equipment, the Group will also develop railway and marine transmission equipment. Popularisation of high-speed railway in China has boosted the development of high-speed locomotives, metros and urban light rail transmission equipment markets. The Group is currently working with Alstom France, its French partner, to develop high-speed train gear with a speed of 570 km, which will become the fastest high-speed train in the world upon its successful development. The cooperation has proved the leading position of the Group in the overseas market and laid a solid foundation for its future rapid profit growth in the railway sector.

In respect of marine equipment, Nanjing High Accurate Marine Equipment Co., Ltd., a wholly-owned subsidiary of the Group, has completed operation tests of its self-developed steel-made high speed shaft CP propeller(鋼制高速軸可調槳推進系統), which is the first-ever in China. 3000 HP Azimuth thrusters(全迴轉推進器)with the first-ever power in China was also researched and developed successfully and the largest tunnel propeller(側向推進器)passed the test and will be delivered and commence operation. The Group will strive to secure more domestic and overseas orders through its continuous efforts in the research and development of new marine equipment.

The Group is planning to expand its traditional gear transmission equipment business overseas as the metallurgy equipment set delivered to India last year was well received by the customers. Moreover, the Group will continue to develop high-tech CNC product and explore the business of electrical transmission equipment by modifying its mechanical transmission equipment. At the end of last year, the Group planned to develop coal and agricultural mechanical equipment business through acquisitions and joint ventures in order to expand different business segments to generate profits and comply with its future development strategy of business transformation from the provision of single parts and components to electrical transmission mechanical equipment.

# MANAGEMENT DISCUSSION AND ANALYSIS

The Group will capitalise on its leading position in the industry and its high quality products to consolidate its market position in the PRC market. It will also increase its market share in the overseas market to strive for higher profitability from its export business. It established a subsidiary in California, the U.S. in 2008 to provide after-sale services of wind gear transmission equipment products. A repair and maintenance factory of wind gear equipment is planned to be set up in Texas, the U.S., which will provide geographical advantages for the Group's overseas business and facilitate the services provision for overseas customers.

Looking forward, the renewable power industry is full of opportunities and challenges and fluctuations are unavoidable in the recovering global financial market. Through expanding different business segments and developing diversified products, the Group will consolidate its major businesses and develop additional sources of profit growth. As such, the Group will be able to cope with the changing market environment, strengthen its overall competitiveness and minimise market risks.

## PLEDGE OF ASSETS

As at 31 December 2010, bank deposits of approximately RMB766,839,000 (2009: RMB451,389,000) were pledged to banks to secure notes payable utilised by the Group. Save as the above, the Group has made no further pledge of assets as at 31 December 2010.

## CONTINGENT LIABILITIES

As at 31 December 2010, the directors were not aware of any material contingent liabilities.

## COMMITMENTS

As at 31 December 2010, the Group had expenditure contracted for but not provided in the consolidated financial statements in respect of acquisition of property, plant and equipment, and outstanding commitments payable under non-cancellable operating lease in respect of rented premises of approximately RMB509,021,000 and RMB12,244,000 respectively (2009: RMB666,806,000 and RMB57,498,000). Details are set out in notes 38 and 39 to the notes to the consolidated financial statements respectively.

# MANAGEMENT DISCUSSION AND ANALYSIS

## EXPOSURE IN EXCHANGE RATE FLUCTUATIONS

The Group's operations are mainly conducted in the PRC. With the exception of export sales and the imported equipment, spare parts and materials which are transacted in U.S. dollars and Euros, most of the Group's revenue and expense are denominated in Renminbi. Therefore, the Board of the Company is of the view that the Group's operating cash flow and liquidity during the Period under Review are not subject to significant foreign exchange rate risks. The Group has not used any foreign currency derivatives to hedge against the exposure in foreign exchange.

As at 31 December 2010, the balance of the Hong Kong dollar net proceeds which the Company received from the global offerings on 4 July 2007 and the net proceeds of approximately US$280,000,000 derived from the issue of convertible bonds on 14 May 2008, the amount recovered from the early termination of the equity swap contract of approximately HK$883,505,000 and the net proceeds of approximately HK$2,223,000,000 from the 130,000,000 top-up placing shares on 21 September 2010 were mostly converted into Renminbi. In addition, for bank borrowings that may expose to foreign exchange rate risks, would be the Group's bank borrowing denominated in U.S. dollars as at 31 December 2010 amounting to approximately US$1,133,000. The Group may thus be exposed to foreign exchange risks.

The net losses of foreign exchange recorded by the Group for the year was approximately RMB31,057,000 (2009: RMB30,587,000), which was due to the appreciation of Renminbi against major foreign currencies in 2010. In light of the above, the Group will actively manage the net amount of foreign currency assets and liabilities by formulating foreign currency control measures and strategies, with a view to reducing its exposures to foreign exchange risks in 2011.

## INTEREST RATE RISK

The loans of the Group are mainly sourced from bank borrowings. Therefore, the benchmark lending rate announced by the People's Bank of China ("PBOC") will have a direct impact on the Group's cost of debt and future changes in interest rate will also have certain impacts on the Group's cost of debt. With a good credit record, part of the Group's cost of debt was charged at an interest rate below the prevailing interest rate of PBOC of RMB loans over the same period. The Group will strive to reduce the finance cost by actively monitoring the changes in credit policies, taking pre-emptive actions, strengthening capital management and expanding financing channels. The Group currently does not have any interest rate hedging policy.

# MANAGEMENT DISCUSSION AND ANALYSIS

## EMPLOYEES AND REMUNERATION POLICY

As at 31 December 2010, the Group employed approximately 5,932 employees (2009: 4,931). Staff cost of the Group for 2010 approximated to RMB532,600,000 (2009: RMB389,034,000). The cost included basic salaries and benefits as well as staff benefits such as discretionary bonus, medical and insurance plans, pension scheme, unemployment insurance plan, etc.

The salary levels of employees are generally determined by reference to the employees' positions, responsibilities and performance as well as the Group's financial performance. In addition to salaries, the Group provides housing allowances to some of its employees. The Group also offers incentive programmes to encourage its employees to take initiatives and rewards employees who have made valuable contributions or achieved technical breakthroughs. The Group's employees are rewarded for their creativity achievements in technologies and technical skills, management of information, product quality and enterprise management.

The Group has adopted incentive programmes (including the Share Option Scheme) to encourage employee performance and a range of training programmes for the development of its staff.

The Group's criteria in relation to the determination of directors' remuneration take into consideration factors including but not limited to salaries paid by comparable companies, time commitment and responsibilities of the directors, employment conditions elsewhere in the Group and desirability of performance-based remuneration.

## PENSION SCHEME

The employees of the Group are members of state-managed pension scheme operated by the local government in China. The Group is required to contribute a specific percentage of their payroll costs to the pension scheme for the funding of the scheme. The sole responsibility of the Group in respect of this pension scheme is making specific contribution to this scheme.

## SIGNIFICANT INVESTMENT HELD

Save as disclosed above, there was no significant investment held by the Group during the year.

## MATERIAL ACQUISITION AND DISPOSAL

During the year, there was no material acquisition or disposal of subsidiaries and associated companies.

## FUTURE PLANS RELATING TO MATERIAL INVESTMENT OR CAPITAL ASSET

As at the date of this report, the Group did not enter into any agreement in respect of any proposed acquisitions and did not have any future plans relating to material investment or capital asset.

# DIRECTORS AND SENIOR MANAGEMENT

Details of the biographies of directors and senior management are listed as follows:

## EXECUTIVE DIRECTORS

**Mr. Hu Yueming,** aged 61, is the Chairman, Chief Executive Officer and executive Director of the Company. Mr. Hu is a university graduate and was graduated from Fudan University majoring in laser technology in 1977. Mr. Hu has more than 30 years of experience in the management of machinery and industrial enterprises and has served as the head of various state-owned enterprises such as Nanjing Engineering Equipment Factory（南京工藝裝備廠）and general manager of various foreign invested enterprises including Nanjing Atlas Copco Construction Machinery Ltd. He has extensive experience in enterprise management. In 1998, he became the general manager of Nanjing High Speed Gear Factory. He has been the chairman and the general manager of Nanjing High Accurate Drive Equipment Manufacturing Group Co., Ltd. ("NGC"), the subsidiary of the Group, since March 2007. Mr. Hu also holds directorship in certain subsidiaries of the Group (see also the note below). Mr. Hu is an expert on mechanical transmission equipment technology and business management. He is also the vice president of the 中國新能源發電網, a council member of China General Machine Components Industry Association, the vice chairman of Gear Manufacturers Association（齒輪專業協會）of China General Machine Components Industry Association and chairman of Nanjing Renewable Energy Association（南京可再生能源協會）. He has been awarded the "National May 1 Labour Medal"（全國五一勞動獎章）and title of "The 4th Outstanding Entrepreneur of the Machinery Industry"（第四屆全國機械工業明星企業家）.

Note: Including Nanjing High Speed & Accurate Gear (Group) Co., Ltd. ("Nanjing High Accurate"), Nanjing High Speed Gear Manufacturing Co., Ltd. ("Nanjing High Speed"), Nanjing Gaote Gearbox Manufacturing Co., Ltd. (formerly known as Nanjing Ningjiang Gearbox Manufacturing Co., Ltd.) ("Nanjing Gaote"), Nanjing Dongalloy Machinery & Electronics Co., Ltd. ("Dongalloy"), Nanjing Ningkai Mechanical Co., Ltd. ("Ningkai"), Nanjing High Accurate Marine Equipment Co., Ltd. ("Nanjing Marine"), Nanjing Ninghongjian Mechanical Co., Ltd. ("Ninghongjian"), Nanjing High Drive Automation Equipment Co., Ltd. ("High Drive"), Nanjing Sky Electronic Enterprise Co., Ltd. ("Sky Electronic"), Zhenjiang Tongzhou Propeller Co., Ltd. ("Zhenjiang Tongzhou"), Jiangsu Hongsheng Heavy Industry Group Co., Ltd. ("Hongsheng Heavy Industry"), NGC Transmission Equipment (America), Inc. ("NGC (US)"), Eagle Nice Holdings Limited ("Eagle Nice"), and China Transmission Holdings Limited ("China Transmission Holdings").

**Mr. Chen Yongdao,** aged 48, is an executive Director of the Company. Mr. Chen is a university graduate. He obtained a bachelor's degree from Jiangsu Institute of Technology majoring in metal material and heat treatment in 1983 and a master's degree from Nanjing University of Science and Technology majoring in engineering in 2007. He is a senior engineer. He served as the deputy head of the inspection and gauging section, head of the production allocation section of the factory and deputy general manager of Nanjing High Speed Gear Factory. He has become a director and the deputy general manager of NGC since March 2007. Mr. Chen also holds directorship in certain subsidiaries of the Group, namely Nanjing High Accurate, Nanjing High Speed, Nanjing Marine, Dongalloy, Ningkai, High Drive, Zhenjiang Tongzhou and China Transmission Holdings. He is also the general manager of Nanjing High Accurate. Mr. Chen is an expert on heat treatment of metal material and has engaged in the research, design and development of mechanical transmission equipment production techniques, gauging and inspection of mechanical transmission equipment and enterprise management for more than 25 years. He has received a number of awards for the achievement of his research on mechanical transmission equipment production techniques.

# DIRECTORS AND SENIOR MANAGEMENT

**Mr. Lu Xun,** aged 56, is an executive Director of the Company. Mr. Lu graduated from Nanjing Aeronautical Institute majoring in managerial engineering in 1991. He also attended and finished postgraduate courses. He is a senior engineer. He worked as the deputy head of the quality assurance section, deputy head of the technology section, head of the operational planning section, deputy Chief Economist, head of the operational planning division and deputy general manager of Nanjing High Speed Gear Factory. He has become a director and deputy general manager of NGC since March 2007. Mr. Lu also holds directorship in certain subsidiaries of the Group, namely Nanjing High Accurate, Nanjing High Speed, High Drive, Eagle Nice and China Transmission Holdings. Mr. Lu is an expert on marketing management for mechanical transmission equipment and has engaged in the technology and marketing management of mechanical transmission equipment for more than 25 years and has extensive experience in marketing management and client resources.

**Mr. Li Shengqiang,** aged 57, is an executive Director of the Company. Mr. Li is a university graduate. He graduated from Jiangsu Administration Institute majoring in administrative management in 1992. He has served as a deputy party secretary of the tools section, Chairman of the Workers' Union and deputy general manager of Nanjing High Speed Gear Factory. He has become a director and deputy general manager of NGC since March 2007. Mr. Li also holds directorship in certain subsidiaries of the Group, namely Nanjing High Accurate, Nanjing High Speed, Nanjing Gaote, Ningkai, High Drive, Eagle Nice and China Transmission Holdings. He is also the general manager of Nanjing Gaote. Mr. Li has been engaged in the enterprise management for more than 25 years and has extensive experience in mechanical transmission equipment production management.

**Mr. Liu Jianguo,** aged 41, is an executive Director of the Group. Mr. Liu is a university graduate. He graduated from Shanghai Jiaotong University with a bachelor's degree majoring in mechanical technology and equipment in 1990. He is a senior engineer. He has served as deputy head and head of the research centre, assistant to general manager, acting chief engineer and chief engineer of Nanjing High Speed Gear Factory. He has also become a director and deputy general manager of NGC since March 2007. Mr. Liu holds directorship in certain subsidiaries of the Group, namely Nanjing High Accurate, Nanjing High Speed, Nanjing Gaote, Ningkai, Ninghongjian, High Drive, NGC (US)and China Transmission Holdings. He is also the general manager of Nanjing High Speed. Mr. Liu is the president of Chinese Renewable Energy Industries Association（可再生能源行業協會）in Jiangsu Province and has engaged in the research, design and development of mechanical transmission equipment and enterprise management for more than twenty years. He has received a number of awards including the certificate of expert with outstanding contribution in the gear industry in the PRC and Science and Technology Awards for the PRC Mechanical Industry (FD1660-type Wind Power Gear)（中國機械工業科學技術獎(FD1660型風力發電機齒輪箱)）.

# DIRECTORS AND SENIOR MANAGEMENT

**Mr. Liao Enrong,** aged 50, is an executive Director of the Group. Mr. Liao is a postgraduate. He graduated from Anhui Institute of Technology with a bachelor's degree majoring in metal material and heat treatment in 1984. He also graduated from the Graduate School of the Chinese Academy of Social Sciences majoring in investment economics. He is a senior engineer. He has served as deputy head and head of the workshop, head of the technological reform section, deputy chief engineer, head of the enterprise management section, assistant to general manager of Nanjing High Speed Gear Factory. Mr. Liao has been a director and deputy general manager of NGC since March 2007. Mr. Liao also holds directorship in certain subsidiaries of the Group, namely Nanjing High Accurate, Nanjing High Speed, Dongalloy, Ningkai, Nanjing Marine, Ninghongjian, High Drive, Sky Electronic, Hongsheng Heavy Industry, NGC (US) and China Transmission Holdings. He is also the general manager of High Drive. Mr. Liao has experience in the heat treatment of metal material and has engaged in technology, investment and enterprise management for more than 25 years.

**Mr. Jin Maoji,** aged 57, is an executive Director of the Company. Mr. Jin is a university graduate. He graduated from Shanghai Mechanical Institute in 1986. He also attended and finished postgraduate courses. He is a senior economist. Mr. Jin joined Nanjing High Speed Gear Factory in 1970 and served as deputy head and head of workshop, head of human resources department and office head. He has served as director and vice general manager of NGC since May 2010. Mr. Jin also holds directorship of certain subsidiaries of the Group, namely, Nanjing High Accurate and High Drive. He has engaged in management for over 30 years with extensive management experience.

## INDEPENDENT NON-EXECUTIVE DIRECTORS

**Mr. Jiang Xihe,** aged 52, is an independent non-executive Director of the Company. He is a Doctor in accountancy. He graduated from the Central University of Finance and Economics（中央財務大學）majoring in accountancy in June 1990. He obtained professional accounting qualification recognized in the PRC in July 1999. He is also a member of the Chinese Institute of Finance and Cost for Young & Mid-career professionals as well as a member of the Hong Kong International Accounting Association. He is currently a professor at the Faculty of Accounting and Financial Management of Nanjing Normal University（南京師範大學）, head of Accounting and Financial Development Research Centre of Nanjing Normal University（南京師範大學）and the deputy dean of Jinling Girl's College, Nanjing Normal University（南京師範大學）. Mr. Jiang joined the Company on 8 June 2007 as independent non-executive Director.

**Mr. Zhu Junsheng,** aged 71, is an independent non-executive Director of the Company. He graduated from Nankai University in 1964. He engaged in technological development of the aviation industry from 1964 to 1984 and renewable energy management in government authorities from 1984 to 2000. Mr. Zhu is currently a vice president of the Chinese Renewable Energy Society, director of the Renewable Energy Professional Committee of the China Association of Resource Comprehensive Utilisation, honorary president of the wind machinery branch of the Chinese Farm Machinery Industrial Association and an executive member of the China Energy Research Society. He has extensive experience in the renewable energy industry, one of the markets that the Company strives to develop for its products. Mr. Zhu joined the Group on 8 June 2007 as independent non-executive Director.

# DIRECTORS AND SENIOR MANAGEMENT

**Mr. Chen Shimin,** aged 52, is an independent non-executive Director of the Company. Mr. Chen graduated from Shanghai University of Finance and Economics and obtained a bachelor's degree and a master's degree in economics in 1982 and 1985 respectively. He also obtained a doctorial degree majoring in accounting from the University of Georgia, the United States, in 1992. He is a management accountant registered in the United States, member of the Institute of Management Accountants of the United States and the American Accounting Association of the United States. He is currently a professor of accounting at China Europe International Business School. He is also a guest professor and Ph.D. supervisor of the Department of Accounting in Nanjing University and School of Accounting, Shanghai University of Finance and Economics. He has extensive education and research experience in domestic and overseas financial accounting and management accounting. He taught in a number of universities in the PRC and overseas, including Shanghai University of Finance and Economics, Lingnan University in Hong Kong, Hong Kong Polytechnic University, Clarion University of Pennsylvania and University of Lousiana at Lafayette. Mr. Chen has published numerous articles related to researches on accounting in the PRC and the United States in renowned academic journals of the PRC and overseas. He was awarded with a number of academic awards and hosted research seminars in the PRC and overseas. He is also a contributing author in Asian Accounting Handbook and Accounting and Auditing in the People's Republic of China. Since 2005, Mr. Chen has been an executive editor of China Accounting and Finance Review. Mr. Chen joined the Company on 8 June 2007 as an independent non-executive director. Currently, Mr. Chen is an independent non-executive director of Shanghai Oriental Pearl (Group) Co., Ltd. and Hangzhou i-Cafe Information Technology Co., Ltd.

## SENIOR MANAGEMENT

**Mr. Lui Wing Hong,** Edward, aged 48, is a chief financial officer and company secretary of the Group. He graduated from York University with a Bachelor of Arts degree majoring in business and economics. He further obtained a postgraduate diploma in financial management from the University of New England. Mr. Lui is a qualified accountant, associate member of the Australian Society of Certified Practising Accountants and a member fellow of Hong Kong Institute of Certified Public Accountants. Mr. Lui joined the Group in June 2006 and is responsible for the financial and accounting management and secretarial affairs of the companies under the Group. Mr. Lui is also a director of China Transmission Holdings, a subsidiary of the Company.

**Ms. Zhou Jingjia, aged 47,** is the financial controller of NGC. She graduated from Soochow University majoring in accounting and is a member of the Chinese Institute of Certified Public Accountants and a qualified accountant. Ms. Zhou joined Nanjing Engineering Mechanical Plant in 1982 and became the deputy head of finance department in 1990. In 1994, Ms. Zhou joined the Nanjing Atlas Copco Construction Machinery Ltd. as the finance department manager. In January 2006, Ms. Zhou was transferred from Nanjing Altas Copco Construction Machinery Ltd. to Altas Copco (Nanjing) Construction and Mining Equipment Ltd. From 2004 to 2006, in addition to being the accounting department manager, Ms. Zhou was appointed as the regional manager of certain production companies of the Atlas Copco Group in China and was responsible for overseeing the accounting departments. Ms Zhou joined the Group in July 2006. She became the director of NGC in March 2007. Ms. Zhou also holds directorship in certain subsidiaries of the Group, including Nanjing High Accurate, Nanjing High Speed, High Drive, Sky Electronic, Hongsheng Heavy Industry, NGC (US) and China Transmission Holdings.

## DIRECTORS AND SENIOR MANAGEMENT

**Mr. Zhang Xueyong,** aged 47, is the deputy head of the financial department of NGC. He graduated from Agricultural Economics and Trade Institute of Nanjing Agricultural University(南京農業大學)in 1990. Mr. Zhang is a qualified accountant. He joined Nanjing High Speed Gear Factory in January 1985 and has become the deputy head of the financial department of the company since November 2000. He has become the head of the financial department of Nanjing High Accurate since December 2003 and the assistant to general manager of the Company since January 2005. Mr. Zhang has been the deputy head of the financial department of NGC since January 2007. He is also one of the controlling shareholders of the Company (the "Management Shareholder").

**Mr. Wang Zhengbing,** aged 39, is the deputy general manager of Nanjing High Speed. He graduated from Zhejiang University（浙江大學）in 1993 with a bachelor's degree majoring in metal material and heat treatment. Mr. Wang is a senior engineer. He joined Nanjing High Speed Gear Factory in 1993. He served as the deputy general manager and the head of production planning department of Nanjing High Speed from 2003 to December 2004 and the deputy general manager of Nanjing High Speed since January 2005. Mr. Wang is also a director of Ninghongjian, a subsidiary of the Company.

**Mr. Wang Zhengrong,** aged 43, is the deputy general manager of Nanjing High Speed. He graduated from Chengdu University of Science and Technology（成都科技大學）in 1988 with a bachelor's degree majoring in machinery design and manufacturing and obtained a master's degree from Nanjing University of Science and Technology majoring in engineering in July 2010. Mr. Wang is a senior engineer. He joined Nanjing High Speed Gear Factory in 1988 and was appointed as head of production process department of the company in December 2000. He was appointed as the head of production process department of Nanjing High Speed in May 2004 and has been the deputy general manager of the company since July 2006. Mr. Wang is also a director of Ninghongjian, a subsidiary of the Group, and one of the Management Shareholders of the Company.

**Mr. Xu Yong,** aged 38, is the deputy head of the financial department of NGC. He graduated from Nanjing Institute of Economics majoring in accounting in 1994 and obtained the MBA degree from Macau University of Science and Technology (澳門科技大學)in August 2006. Mr. Xu is a qualified accountant. He joined Nanjing High Speed Gear Factory in 1994 and served as the deputy head of financial department of the company in November 2000. He was appointed as the head of financial department of Nanjing High Speed in December 2003 and has been the assistant to general manager of the company since January 2005. He has been the deputy head of the financial department of NGC since January 2007. He is also one of the Management Shareholders of the Company.

**Mr. Zhou Zhijin,** aged 38, is the deputy general manager of Nanjing High Speed. Mr. Zhou graduated from Nanjing Institute of Technology(南京工業學校)in 1991 and pursued further studies in management in School of Distance Learning of the Party School of the Central Committee of the Chinese Communist Party(中共中央黨校函授學院)from 2002 to 2004. Mr. Zhou joined Nanjing High Speed Gear Factory in 1991. Mr. Zhou has served as the deputy head of human resources department of Nanjing High Accurate since September 2001. He has been the deputy general manager of Nanjing High Speed since July 2006.

# DIRECTORS' REPORT

The Directors of the Company are pleased to present the Directors' report and the audit financial statements of the group for the year ended 31 December 2010.

## PRINCIPAL ACITVITIES

The Company and the Group are principally engaged in production and sale of gear transmission equipment products.

Details of the principal activities of the subsidiaries, associates and jointly controlled entities of the Company are set out in notes 43, 19 and 20 to the notes to the consolidated financial statements respectively.

## OPERATING RESULTS

The operating results of the Group for the year ended 31 December 2010 are set out in the consolidated statement of comprehensive income on pages 46 and 47 in the consolidated financial statements.

## FINAL DIVIDEND AND CLOSURE OF REGISTER OF MEMBERS

During the year, a final dividend of HK30 cents (equivalent to RMB26 cents) per share (2009: HK25 cents (equivalent to RMB22 cents)) for 2009 has been paid to shareholders.

The Board has recommended payment of a final dividend of HK33 cents per share for the year ended 31 December 2010 to be paid on around 27 June 2011 to shareholders whose names appear on the register of members of the Company on 13 June 2011 subject to shareholders' approval. The register of members of the Company will be closed from Tuesday, 7 June 2011 to Monday, 13 June 2011, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the final dividend, all transfer documents accompanied by the relevant share certificates must be logged with the Company's branch share register in Hong Kong, Computershare Hong Kong Investor Services Limited, at shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not later than 4:30 p.m. on Friday, 3 June 2011.

## RESERVES

Movements in the reserves of the Company and the Group for the year ended 31 December 2010 are separately set out in note 42 to the consolidated financial statement and consolidated statement of changes in equity.

## DISTRIBUTABLE RESERVE

The distributable reserve of the Company as at 31 December 2010 was approximately RMB3,787,818,000 (2009: RMB2,247,471,000).

## PROPERTY, PLANT AND EQUIPMENT

Movements in the property, plant and equipment of the Group for the year ended 31 December 2010 are set out in note 15 to the notes to the consolidated financial statement.

# DIRECTORS' REPORT

## SHARE CAPITAL

Details of the registered and issued share capital of the Company are set out in note 35 to the notes to the consolidated financial statements.

## DONATION EXPENDITURE

During 2010, the donation expenditure of the Group was approximately RMB327,605 (2009: RMB280,000).

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

Save as disclosed below, as at 31 December 2010, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

On 10 September 2010, the Company agreed to place 130,000,000 shares to not less than 6 independent placees. For details, please refer to the paragraph headed "Capital Structure" above.

## SHARE OPTION SCHEME

The Company adopted a share option scheme on 8 June 2007 pursuant to the written resolutions of all shareholders of the Company. The share option scheme is a share incentive scheme and is established to recognize and acknowledge the contributions of the eligible participants who have had or may have made to the Group. The share option scheme will provide the eligible participants an opportunity to have a personal stake in the Company with the view to (i) motivating the eligible participants to optimize their performance and efficiency for the benefit of the Group; and (ii) attracting and retaining or otherwise maintaining on-going business relationships with the eligible participants whose contributions are or will be beneficial to the long-term growth of the Group.

Options granted must be taken up within 12 months from the date of grant, upon payment of HK$1 per option. Options may be exercised at any time prior to the expiry from 10 years from the date of acceptance. The exercise price is determined by the Directors of the Company, and must be at least the higher of (i) the closing price of the Company's shares on the date of grant; (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share. Share options do not confer rights to the holders to receive dividends or vote at shareholder's meetings. Summary of the Company's share options is set out in note 37 to the notes to the consolidated financial statements.

# DIRECTORS' REPORT

## SHARE OPTION SCHEME *(Continued)*

The following table sets out the movements in the Company's share options during the year:

| | | | | | | Number of share options | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Grantee(s) | Date of grant | Exercisable period (Note 1) | Vesting period | Exercise per share (HK$) (Note 2 & 3) | Outstanding as at 1 January 2010 | Granted during the year | Exercised during the year | Cancelled during the year | Lapsed during the year | Outstanding as at 31 December 2010 (Note 5 & 6) |
| Qualified employees | 6 November 2008 | 6 November 2008 to 5 November 2013 | Nil | 5.60 | 12,000,000 | – | – | – | – | 12,000,000 |
| Total | | | | | 12,000,000 | – | – | – | – | 12,000,000 |

Notes:

1. The exercisable period of the share options granted to employees is five years commencing from the date of acceptance.
2. The closing price of the Company's shares on the date of grant was HK$5.60.
3. The average closing price of the Company's shares for the five business days immediately preceding the date of grant was HK$5.536.
4. The Share options were vested immediately at the date of grant.
5. No option had been exercised during the year.
6. The fair value of the share options determined at the date of grant using the Binominal model is approximately RMB30,030,000.
7. None of the directors, chief executives or substantial shareholders of listed companies or their respective associates holds any share options.

## MAJOR SUPPLIERS AND CUSTOMERS

The purchase amount of the Group's five major suppliers and the largest supplier were approximately RMB1,493,960,000 and RMB470,735,000, representing 36.9% and 11.6% of the total purchase amounts respectively. Besides, the revenue amount of the Groups five major customers and the largest customer were approximately RMB4,068,079,000 and RMB1,257,611,000, representing 55.0% and 17.0% of the total revenue amounts respectively. All transactions between the Group and relevant suppliers and customers were carried out on normal commercial terms.

To the best knowledge or the Directors, none of Directors and any shareholders holding over 5% of the Company's shares and their associates (within the meanings of the Listing Rules) had any interests in the above five major suppliers and customers during the year.

# DIRECTORS' REPORT

## DIRECTORS' SERVICE CONTRACTS

All Directors have entered into service contracts with the Company with a term of three years starting from the Listing Date or the date of re-election.

Under the Cayman Companies Law, at every general meeting of the Company, no less than one-third of the Directors for the time being shall retire from office by rotation provided that every Director (including those appointed for a specific term) shall be subject to retirement by rotation at least once every three years and eligible to the offer themselves for re-election.

None of the Directors or Directors intending to seek re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

## DIRECTORS AND THEIR TERMS

Directors in office and their terms for the year and up to the date of this report were:

| | |
|---|---|
| **Executive Directors:** | |
| Mr. Hu Yueming | Three years from the date of his re-election on 18 June 2010 |
| Mr. Chen Yongdao | Three years from the date of his re-election on 18 June 2010 |
| Mr. Lu Xun | Three years from the date of his re-election on 18 June 2010 |
| Mr. Li Shengqiang | Three years from the date of his re-election on 19 June 2009 |
| Mr. Liu Jianguo | Three years from the date of his re-election on 19 June 2009 |
| Mr. Liao Enrong | Three years from the date of his re-election on 19 June 2009 |
| Mr. Jin Maoji | Appointed on 7 May 2010 and three years from the date of his re-election on 18 June 2010 |
| **Independent Directors:** | |
| Mr. Jiang Xihe | Three years from the date of his re-election on 19 June 2009 |
| Mr. Zhu Junsheng | Three years from the date of his re-election on 20 June 2008 |
| Mr. Chen Shimin | Three years from the date of his re-election on 20 June 2008 |

# DIRECTORS' REPORT

## DIRECTORS' INTERESTS IN CONTRACTS

Save as the directors' service contracts disclosed above and the connected transactions mentioned below, no contracts of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the year.

## DIRECTORS AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN THE COMPANY'S ISSUED SHARES

As at 31 December 2010, none of the Directors' or the chief executives of the Company had any interests or short positions in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which would be required to be notified to the Company and the Stock Exchange pursuant to the provisions of Divisions 7 and 8 of Part XV of the SFO (including interests or short positions in which they were taken or deemed to have under such provisions of the SFO) or which would be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which would be required to be notified to the Company and the Stock Exchange, pursuant to the Model Code continued in the Listing Rules.

During the reporting period, none of the Directors and chief executives of the Company or any of their associates had any interests in any securities of the Company or any of its associated corporations (as defined in the SFO). None of the Directors and chief executives or their spouses or children under the age of 18 had any right to subscribe for the securities of the Company or had exercised any such right.

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

# DIRECTORS' REPORT

## SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN THE COMPANY'S ISSUED SHARES

As at 31 December 2010, the following persons (other than the Directors or chief executives of the Company) had interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or which would be required, pursuant to section 336 of the SFO, to be entered in the register referred to therein:

| Name | Nature of interests | Number of securities held | Approximate percentages to the equity (%) |
|---|---|---|---|
| Fortune Apex Limited (Note 1) | Beneficial owner | 211,474,024 (Long Position) | 15.38 (Long Position) |
| JPMorgan Chase & Co. (Note 2) | Beneficial owner, investment manager and custodian corporation/ approved lending agent | 164,476,270 (Long Position) | 11.96 (Long Position) |
| | | 3,831,179 (Short Position) | 0.28 (Short Position) |
| | | 137,319,868 (Lending Pool) | 9.99 (Lending Pool) |
| Norges Bank | Beneficial owner | 68,946,129 (Long Position) | 5.01 (Long Position) |

# DIRECTORS' REPORT

## SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN THE COMPANY'S ISSUED SHARES *(Continued)*

Notes:

(1) Fortune Apex Limited owns 15.38% interest in the issued share capital of the Company. Messrs Hu Yueming, Liu Jianguo, Lu Xun, Chen Yongdao, Li Cunzhang*, Li Shengqiang, Liao Enrong, Jin Maoji, Yao Jingsheng, Chen Zhenxing, Zhang Xueyong, Xu Yong, Wang Zhengrong and Chen Liguo (collectively, the "Management Shareholders") together own 100% interest in the issued share capital of Fortune Apex Limited. The following table sets out the shareholdings of each of the Management Shareholders in Fortune Apex Limited:

| | Name | Shareholdings |
|---|---|---|
| 1. | Mr. Hu Yueming (executive Director) | 30.3813% |
| 2. | Mr. Liu Jianguo (executive Director) | 12.3989% |
| 3. | Mr. Lu Xun (executive Director) | 10.4520% |
| 4. | Mr. ChenYongdao (executive Director) | 10.5343% |
| 5. | Mr. Li Cunzhang (executive Director)* | 8.8945% |
| 6. | Mr. Li Shengqiang (executive Director) | 8.9725% |
| 7. | Mr. Liao Enrong (executive Director) | 5.3422% |
| 8. | Mr. Jin Maoji (executive Director) | 5.9195% |
| 9. | Mr. Yao Jingsheng | 2.5678% |
| 10. | Mr. Chen Zhenxing | 0.9091% |
| 11. | Mr. Zhang Xueyong | 1.1286% |
| 12. | Mr. Xu Yong | 0.7376% |
| 13. | Mr. Wang Zhengrong | 0.6792% |
| 14. | Mr. Cheng Liguo | 1.0825% |
| | Total | 100.0000% |

* Mr. Li Cunzhang passed away on 10 August 2007.

However, none of them singly controls more than one-third of the voting power at general meetings of Fortune Apex Limited and neither Fortune Apex Limited nor its directors are accustomed or obliged to act in accordance with directions or instruction of any single member of the Management Shareholders.

# DIRECTORS' REPORT

## SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN THE COMPANY'S ISSUED SHARES *(Continued)*

Notes: *(Continued)*

(2) According to the disclosure form filed by JP Morgan Chase & Co on 15 December 2010, it is interested in 164,476,270 shares. According to the disclosure form filed by JP Morgan Chase & Co on 15 December2010, the following interests in shares were held by JP Morgan Chase & Co. and corporations controlled by it in the following capacities:

| Capacity | No. of Shares |
|---|---|
| Beneficial owner | 10,131,451 (Long position) |
| | 3,831,179 (Short position) |
| Investment manager | 17,024,951 (Long position) |
| Custodian corporation/approved lending agent | 137,319,868 (Long position) |

These shares were held by JPMorgan Chase Bank, N.A., J.P. Morgan Whitefriars Inc, J.P. Morgan Overseas Capital Corporation, J.P. Morgan International Finance Limited, Bank One International Holdings Corporation, J.P. Morgan International Inc, J.P. Morgan Securities Ltd., J.P. Morgan Chase International Holdings, J.P. Morgan Chase (UK) Holdings Limited, J.P. Morgan Capital Holdings Limited, JF Asset Management Limited, JP Morgan Asset Management (Asia) Inc. and JP Morgan Asset Management Holdings Inc., all of which are either directly or indirectly controlled corporations of JP Morgan Chase & Co..

Save as disclosed above and so far as the Directors are aware of, as at 31 December 2010, there was no other person, other than the directors or chief executives of the Company, who had interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company pursuant to the provisions of Divisions 2 and 3 of Part XV of the SFO, or which would be required, pursuant to section 336 of the SFO, to be entered in the register referred to therein.

## INTERESTS OF CONTROLLING SHAREHOLDERS IN CONTRACTS

Save as disclosed herein, no contracts of significance had been entered into by the Company or its subsidiaries with the controlling shareholders and their subsidiaries as at the balance sheet date or at any time during the year.

# DIRECTORS' REPORT

## CONNECTED TRANSACTIONS

Details of the related party transactions of the Group for the year ended 31 December 2010 are set out in note 41 to the notes to the consolidated financial statements. The Directors of the Company (including our independent executive Directors) believe that the related party transactions set out in the note 41 to the notes to the consolidated financial statements are carried out in the ordinary course of business and on normal commercial terms.

On 10 September 2010, the Company executed (i) a top up placing agreement with Goldman Sachs (Asia) L.L.C. as placing agent and Fortune Apex Limited (being our substantial shareholder) and (ii) a top up subscription agreement with Fortune Apex Limited in respect of, among other things, placing of 130,000,000 shares at a price of HK$17.38 to not less than 6 independent placees. Such transactions with Fortune Apex Limited constitute exempt connected transactions under the Rule 14A.31(3)(d) of the Listing Rules. For details, please refer to the Company's two announcements dated 10 and 21 September 2010, respectively.

No transaction listed in note 41 to the notes to the consolidated financial statements constitute discloseable connected transaction under Chapter 14A of the Listing Rules.

## MANAGEMENT CONTRACTS

As at 31 December 2010, the Company did not enter into or have any management and administration contracts in respect of the whole or any principal business of the Company.

## PRE-EMPTION RIGHT

Though there are no restrictions on the grant of pre-emption right under the Cayman Laws, the Company did not grant any pre-emption rights in accordance with the Articles of Association.

# DIRECTORS' REPORT

## PUBLIC FLOAT

Based on information that is publicly available to the Company and to the best knowledge of the Directors, the Company has maintained the amount of sufficient public float as required under the Listing Rules throughout the year.

## AUDITOR

A resolution will be submitted to the forthcoming annual general meeting of the Company to re-appoint Deloitte Touche Tohmatsu as our auditor for 2011.

## ESTABLISHMENT OF SUBSIDIARIES

Details of the subsidiaries of the Company are set out in note 43 to the notes to the consolidated financial statements. The Company established the following new wholly-owned subsidiaries during the year:

| Name of subsidiary | Place and date of incorporation | Registered capital/ issued and fully paid share capital | Principal activities |
|---|---|---|---|
| Zhong-Chuan Heavy Duty Machine Tool Corporation Limited | The PRC 15 November 2010 | US$35,802,000 | Manufacturing and sales of heavy machine tools |

## BANK BORROWINGS

Details of the bank borrowings of the Group are set out in note 30 to the notes to the consolidated financial statements.

## TAXATION

Details of the taxation of the Group are set out in note 10 to the notes to the consolidated financial statements.

## MATERIAL LITIGATIONS AND ARBITRATIONS

During the reporting period, the Group had no material litigations and arbitrations.

By order of the Board
**Hu Yueming**
*Chairman*

Hong Kong, 25 March 2011

# CORPORATE GOVERNANCE REPORT

## CORPORATE GOVERNANCE PRACTICES

The Board recognizes the importance of corporate governance practice to the success of a listed company. The Company is committed to achieving high standards of corporate governance in the interest of the shareholders of the Company.

The Company has complied with the code provisions set out in the Code on Corporate Governance Practices (the "Code") contained in Appendix 14 to Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") during the year ended 31 December 2010 except for the deviation from code provision A.2.1 which states that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual.

Mr. Hu Yueming is the Chairman and Chief Executive Officer of the Company. The Board believes that vesting the roles of both chairman and chief executive officer in the same person is beneficial to the business development and management of the Group. The Board considers that the balance of power and authority under the present arrangement will not be impaired and this arrangement will enable the Company to make and implement decisions promptly and efficiently.

## MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuer (the "Model Code") set out in Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the directors. Having made specific enquiries of all directors by the Company, all directors have confirmed that they have complied with the required standard set out in the Model Code during the year ended 31 December 2010.

# CORPORATE GOVERNANCE REPORT

## COMPOSITION AND PRACTICES OF THE BOARD

The Board of the Company collectively takes responsibility to all the shareholders in respect of managing and supervising the business of the Group so as to enhance value for our shareholders.

The Board of the Company comprises ten Directors, including seven executive Directors and three independent non-executive Directors. The Board held 4 meetings during the year ended 31 December 2010. The attendance of the Directors at the meetings is as follows:

| | Attendance during the year |
|---|---|
| **Executive Directors:** | |
| Mr. Hu Yueming (Chairman and Chief Executive Officer) | 4/4 |
| Mr. Chen Yongdao | 3/4 |
| Mr. Lu Xun | 3/4 |
| Mr. Li Shengqiang | 3/4 |
| Mr. Liu Jiangguo | 3/4 |
| Mr. Liao Enrong | 4/4 |
| Mr. Jin Maoji (Appointed on 7 May 2010) | 2/3 |
| **Non-executive Directors:** | |
| Mr. Zhang Wei (Resigned on 7 May 2010) | 1/1 |
| **Independent non-executive Directors:** | |
| Mr. Jiang Xihe | 3/4 |
| Mr. Zhu Junsheng | 3/4 |
| Mr. Chen Shimin | 3/4 |

Each of the non-executive Directors of the Company has entered into a service contract with the Company with a term of three years. Each of them (including the one with a specific service term) shall retire from office by rotation at least once every three years yet subject to re-election. In any event, such service term can be terminated subject to the articles of association of the Company and/or applicable laws.

# CORPORATE GOVERNANCE REPORT

## COMPOSITION AND PRACTICES OF THE BOARD *(Continued)*

The Board is responsible for the management and control of the Company as well as supervision of the business, decision and performance of the Group. The Board has respectively granted and delegated the power and responsibility to the management for the management of the daily operation of the Group. The Directors have also specifically granted the management the general authorisation to handle major corporate matters, including the preparation of interim reports, annual reports and announcements for the approval by the Board before publishing, execution of business strategies and measures adopted by the Board, implementation of proper internal control and risk management procedures and compliance with relevant statutory and regulatory requirements, rules and laws.

There is no financial, business, family or other major/related relationships among the members of the Board.

Pursuant to Rule 3.13 of the Listing Rules, each of the independent non-executive Directors has confirmed his independence to the Company. Therefore, the Company considers that all independent non-executive Directors are independent parties. The Company has also complied with the requirements in respect of independent non-executive directors under the Rule 3.10 of the Listing Rules.

## CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Mr. Hu Yueming is the Chairman and Chief Executive Officer of the Company. He is responsible for formulating the overall strategies and policies of the Company for the smooth operation and performance of duties of the Board. The Board believes that appointing the same person as the Chairman and the Chief Executive Officer is favourable to the development and management of the business of the Group while the existing balance between functions and power is not affected. Besides, it enables the Company to formulate and implement decisions in a rapid and efficient manner.

## NON-EXECUTIVE DIRECTORS

The service term of non-executive director is:

| | |
|---|---|
| Mr. Jiang Xihe | Three years from the date of his re-election on 19 June 2009 |
| Mr. Zhu Junsheng | Three years from the date of his re-election on 20 June 2008 |
| Mr. Chen Shimin | Three years from the date of his re-election on 20 June 2008 |

# CORPORATE GOVERNANCE REPORT

## REMUNERATION COMMITTEE

The Company established the remuneration committee on 8 June 2007. The remuneration committee comprises three members, namely Mr. Chen Shimin, Mr. Jiang Xihe and Mr. Liu Jianguo, two of which are independent non-executive Directors. Mr. Chen Shimin is the chairman of the remuneration committee. Mr. Liu Jianguo was appointed as a member of the remuneration committee on 7 May 2010 in replacement of Mr. Zhang Wei, a non-executive Director who resigned on the same day due to his time constraint.

The primary duties of the remuneration committee are to make recommendations to the Board on the Company's remuneration policy and structure of all Directors and senior management and determine the specific remuneration packages of all executive Directors and senior management.

The remuneration committee held 1 meeting during the year ended 31 December 2010. The attendance of the members of the remuneration committee at the meetings is as follows:

| | **Attendance during the year** |
|---|---|
| Non-executive Directors: | |
| Mr. Chen Shimin *(Chairman)* | 1/1 |
| Mr. Zhang Wei (Resigned on 7 May 2010) | 0/0 |
| Mr. Jiang Xihe | 1/1 |
| Mr. Liu Jianguo (Appointed on 7 May 2010) | 1/1 |

# CORPORATE GOVERNANCE REPORT

## NOMINATION OF DIRECTORS

The Board is empowered to nominate, consider and approve the relevant appointment of Directors, with an aim of appointing proper individuals with relevant professional expertise and experience into the Board to enhance the constitution of a strong and diverse Board and to contribute to the functioning of the Board through their continuous participation and contributions.

During the year ended 31 December 2010, the Board did not convene any meeting relating to appointment of Directors, but all Directors considered and approved the appointment of Mr. Jin Maoji as an executive Director through a written resolution.

## CORPORATE GOVERNANCE REPORT

### AUDIT COMMITEE

The Company established the audit committee on 8 June 2007 with written terms of reference which have been adopted for the purpose of reviewing and providing supervision on the financial reporting process and internal controls of the Company as well as nominating and supervising the external auditor and offering advice and recommendations to the Board of the Company.

The audit committee comprises three members, namely Mr. Jiang Xihe, Mr. Zhu Junsheng and Mr. Chen Shimin, all of which are independent non-executive Directors. Mr. Jiang Xihe is the chairman of the audit committee. Mr. Chen Shimin was appointed as a member of the audit committee on 7 May 2010 in replacement of Mr. Zhang Wei, a non-executive Director who resigned on the same day due to his time constraint.

The audit committee held two meetings during the year ended 31 December 2010 to (i) review the functions of the internal audit department of the Group and hear the work report prepared by the internal audit department; and (ii) review the annual report for the year 2009 and the interim report for the year 2010 of the Group and report the review conclusions to the Board. The attendance of Directors at the meetings is as follows:

| | Attendance during the year |
|---|---|
| Mr. Jiang Xihe *(Chairman)* | 2/2 |
| Mr. Zhu Junsheng | 2/2 |
| Mr. Zhang Wei (resigned on 7 May 2010) | 1/1 |
| Mr. Chen Shimin (appointed on 7 May 2010) | 1/1 |

The annual report for the year ended 31 December 2010 of the Group had been reviewed by the audit committee.

### REMUNERATION OF AUDITOR

For the year ended 31 December 2010, the Group paid approximately RMB4,103,000 (2009: RMB3,657,000) to our auditor for the audit services. There was no other non-audit service fees paid to the auditor during the year.

# CORPORATE GOVERNANCE REPORT

## DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL REPORTS

All Directors of the Company acknowledge their responsibility for the preparation of the financial reports of the Group. They also ensure the preparation is in compliance with the relevant laws, regulations and accounting principles and its publication are made in due course.

Reporting responsibility statement with respect to the financial reports of the Group made by the auditor of the Company is set out in the Independent Auditor's Report on pages 44 to 45.

## INTERNAL CONTROL

The Board takes full responsibility to maintain a sound and efficient internal control system for the Group to protect the shareholders' investment and the Group's assets, which is in the interests of the shareholders.

In 2010, the audit committee reviewed the functions of the internal audit department of the Group, including formulating supervision policies and methods, in order to enhance the comprehensiveness of the internal audit system.

In 2010, the Board has reviewed the internal control system of the Group based on the reports from the management and internal audit department. The review covered all critical aspects of the control, including financial control, operational control, compliance control and risk management functions. The Board has also reviewed the adequacy of resources, qualification and experience of staff of the Group's accounting and financial reporting function, and their training programmes and budget. The Board believed that existing internal control system was sufficient and efficient during the year under review and till the publishing date of this annual report and accounts.

## INDEPENDENT AUDITOR'S REPORT

**Deloitte.**
**德勤**

TO THE MEMBERS OF
CHINA HIGH SPEED TRANSMISSION EQUIPMENT GROUP CO., LTD.
中國高速傳動設備集團有限公司
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of China High Speed Transmission Equipment Group Co., Ltd. (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 46 to 137, which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

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

# INDEPENDENT AUDITOR'S REPORT

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

## OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2010 and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**Deloitte Touche Tohmatsu**
*Certified Public Accountants*
Hong Kong
25 March 2011

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|---|
| **Revenue** | 7 | **7,392,649** | 5,647,045 |
| Cost of sales | | **(5,093,801)** | (3,785,804) |
| **Gross profit** | | **2,298,848** | 1,861,241 |
| Other income | 8a | **200,185** | 105,369 |
| Other gains and loss | 8b | **111,317** | (139,778) |
| Distribution and selling costs | | **(287,156)** | (139,174) |
| Administrative expenses | | **(460,049)** | (318,036) |
| Research and development costs | | **(50,476)** | (70,359) |
| Other expenses | | **(57,300)** | (48,939) |
| Finance costs | 9 | **(146,842)** | (99,832) |
| Share of results of associates | | **479** | 1,904 |
| Share of results of jointly controlled entities | | **40,995** | 13,655 |
| Profit before taxation | | **1,650,001** | 1,166,051 |
| Taxation | 10 | **(256,543)** | (200,273) |
| Profit for the year | 11 | **1,393,458** | 965,778 |
| Other comprehensive (expense) income | | | |
| Exchange difference arising on translation | | **(355)** | (3) |
| Gain on fair value change of available-for-sale investments | | **–** | 4,881 |
| Deferred tax liability arising on fair value change of available-for-sale investments | | **–** | (878) |
| Reclassification adjustment: | | | |
| – Release of deferred tax liability upon disposal of available-for-sale investments | | **–** | 1,338 |
| – Release on disposal of available-for-sale investments | | **–** | (8,480) |
| Other comprehensive expense for the year | | **(355)** | (3,142) |
| **Total comprehensive income for the year** | | **1,393,103** | 962,636 |

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | NOTES | 2010 RMB'000 | 2009 RMB'000 |
|---|---|---|---|
| Profit (loss) for the year attributable to: | | | |
| Owners of the Company | | 1,383,635 | 966,377 |
| Non-controlling interests | | 9,823 | (599) |
| | | 1,393,458 | 965,778 |
| Total comprehensive income (expense) attributable to: | | | |
| Owners of the Company | | 1,383,280 | 963,235 |
| Non-controlling interests | | 9,823 | (599) |
| | | 1,393,103 | 962,636 |
| **Earnings per share** | 14 | | |
| Basic (RMB) | | 1.08 | 0.78 |
| Diluted (RMB) | | 0.91 | 0.77 |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

*AT 31 DECEMBER 2010*

| | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| Property, plant and equipment | 15 | **4,869,764** | 3,844,686 |
| Prepaid lease payments | 16 | **399,304** | 270,826 |
| Goodwill | 17 | **17,715** | 12,091 |
| Intangible assets | 18 | **196,570** | 107,605 |
| Interests in associates | 19 | **56,744** | 20,389 |
| Interests in jointly controlled entities | 20 | **624,162** | 583,167 |
| Available-for-sale investments | 21 | **148,646** | 62,500 |
| Deposit for land lease | 22 | **380,458** | 107,300 |
| Prepayment for acquisition of property, plant and equipment | 22 | **59,265** | 105,911 |
| Deferred tax assets | 31 | **36,730** | 27,095 |
| Derivative financial instrument | 33 | **—** | 55,991 |
| | | **6,789,358** | 5,197,561 |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

*AT 31 DECEMBER 2010*

| | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|---|
| **CURRENT ASSETS** | | | |
| Inventories | 23 | **1,257,663** | 1,312,810 |
| Prepaid lease payments | 16 | **8,554** | 5,784 |
| Trade and other receivables | 24 | **3,810,804** | 2,613,260 |
| Amount due from an associate | 25 | **—** | 23,928 |
| Amount due from a jointly controlled entity | 26 | **9,339** | 7,090 |
| Pledged bank deposits | 28 | **766,839** | 451,389 |
| Derivative financial instrument | 33 | **18,392** | — |
| Restricted cash | 33 | **146,798** | 151,904 |
| Bank balances and cash | 28 | **2,123,768** | 471,193 |
| | | **8,142,157** | 5,037,358 |
| **CURRENT LIABILITIES** | | | |
| Trade and other payables | 29 | **2,612,631** | 1,566,058 |
| Amount due to a related party | 27 | **1,435** | 531 |
| Amounts due to associates | 25 | **1,312** | — |
| Amount due to a jointly controlled entity | 26 | **6,665** | 23,568 |
| Tax liabilities | | **175,259** | 141,689 |
| Borrowings – due within one year | 30 | **1,208,651** | 1,556,273 |
| Financial liabilities designated as at fair value through profit or loss – convertible bonds – due within one year | 32 | **1,219,933** | — |
| | | **5,225,886** | 3,288,119 |
| **NET CURRENT ASSETS** | | **2,916,271** | 1,749,239 |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **9,705,629** | 6,946,800 |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

*AT 31 DECEMBER 2010*

| | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|---|
| **NON-CURRENT LIABILITIES** | | | |
| Borrowings – due after one year | 30 | **2,043,050** | 1,012,041 |
| Deferred tax liabilities | 31 | **86,166** | 48,751 |
| Financial liabilities designated as at fair value through profit or loss – convertible bonds – due after one year | 32 | **—** | 1,368,949 |
| Deferred income | 34 | **62,072** | 66,707 |
| | | **2,191,288** | 2,496,448 |
| | | **7,514,341** | 4,450,352 |
| **CAPITAL AND RESERVES** | | | |
| Share capital | 35 | **103,345** | 94,633 |
| Reserves | | **7,289,385** | 4,326,304 |
| Equity attributable to owners of the Company | | **7,392,730** | 4,420,937 |
| Non-controlling interests | | **121,611** | 29,415 |
| | | **7,514,341** | 4,450,352 |

The consolidated financial statements on pages 46 to 137 were approved and authorised for issue by the Board of Directors on 25 March 2011 and are signed on its behalf by:

*DIRECTOR* *DIRECTOR*

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | Attributable to owners of the Company | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital RMB'000 | Share premium RMB'000 | Deemed capital contribution reserve RMB'000 (note a) | Capital reserve RMB'000 (note b) | Statutory surplus reserve RMB'000 (note c) | Other reserve RMB'000 (note d) | Investment revaluation reserve RMB'000 | Exchange reserve RMB'000 | Share option reserve RMB'000 | Retained profits RMB'000 | Total RMB'000 | Non-controlling interests RMB'000 | Total RMB'000 |
| At 1 January 2009 | 94,629 | 2,372,884 | 77,651 | 154,091 | 137,617 | 52,335 | 3,139 | – | 30,030 | 808,710 | 3,731,086 | 3,559 | 3,734,645 |
| Profit (loss) for the year | – | – | – | – | – | – | – | – | – | 966,377 | 966,377 | (599 ) | 965,778 |
| Other comprehensive expense for the year | – | – | – | – | – | – | (3,139 ) | (3 ) | – | – | (3,142 ) | – | (3,142 ) |
| Total comprehensive income (expense) for the year | – | – | – | – | – | – | (3,139 ) | (3 ) | – | 966,377 | 963,235 | (599 ) | 962,636 |
| Dividend recognised as distribution (note 13) | – | – | – | – | – | – | – | – | – | (274,367 ) | (274,367 ) | – | (274,367 ) |
| Appropriation | – | – | – | – | 26,085 | – | – | – | – | (26,085 ) | – | – | – |
| Conversion of convertible bonds | 4 | 979 | – | – | – | – | – | – | – | – | 983 | – | 983 |
| On acquisition of a subsidiary | – | – | – | – | – | – | – | – | – | – | – | 11,756 | 11,756 |
| On deemed disposal of partial interest in a subsidiary | – | – | – | – | – | – | – | – | – | – | – | 14,699 | 14,699 |
| At 31 December 2009 | 94,633 | 2,373,863 | 77,651 | 154,091 | 163,702 | 52,335 | – | (3 ) | 30,030 | 1,474,635 | 4,420,937 | 29,415 | 4,450,352 |
| Profit for the year | – | – | – | – | – | – | – | – | – | 1,383,635 | 1,383,635 | 9,823 | 1,393,458 |
| Other comprehensive expense for the year | – | – | – | – | – | – | – | (355 ) | – | – | (355 ) | – | (355 ) |
| Total comprehensive income (expense) for the year | – | – | – | – | – | – | – | (355 ) | – | 1,383,635 | 1,383,280 | 9,823 | 1,393,103 |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | Attributable to owners of the Company | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital RMB'000 | Share premium RMB'000 | Deemed capital contribution reserve RMB'000 (note a) | Capital reserve RMB'000 (note b) | Statutory surplus reserve RMB'000 (note c) | Other reserve RMB'000 (note d) | Investment revaluation reserve RMB'000 | Exchange reserve RMB'000 | Share option reserve RMB'000 | Retained profits RMB'000 | Total RMB'000 | Non-controlling interests RMB'000 | Total RMB'000 |
| Dividend recognised as distribution (note 13) | – | – | – | – | – | – | – | – | – | (327,427 ) | (327,427 ) | – | (327,427 ) |
| Appropriation | – | – | – | – | 135,191 | – | – | – | – | (135,191 ) | – | – | – |
| Conversion of convertible bonds | 1 | 99 | – | – | – | – | – | – | – | – | 100 | – | 100 |
| Issue of shares on placement of shares | 8,711 | 1,907,129 | – | – | – | – | – | – | – | – | 1,915,840 | – | 1,915,840 |
| Capital contributions by non-controlling shareholders of subsidiaries | – | – | – | – | – | – | – | – | – | – | – | 6,900 | 6,900 |
| On acquisition of subsidiaries | – | – | – | – | – | – | – | – | – | – | – | 79,573 | 79,573 |
| Acquisition of additional interest in subsidiaries | – | – | – | – | – | – | – | – | – | – | – | (4,100 ) | (4,100 ) |
| At 31 December 2010 | 103,345 | 4,281,091 | 77,651 | 154,091 | 298,893 | 52,335 | – | (358 ) | 30,030 | 2,395,652 | 7,392,730 | 121,611 | 7,514,341 |

Note a: The deemed capital contribution reserve arose from a deemed capital contribution from shareholders in 2006.

Note b: The capital reserve represents the difference between the total consideration and the net assets of certain subsidiaries acquired or disposed by the Group with a shareholder of Nanjing High Speed & Accurate Gear (Group) Co., Ltd. ("Nanjing High Accurate").

Note c: Pursuant to relevant laws and regulations in the People's Republic of China ("PRC") and the Articles of Association of the PRC subsidiaries of the Company, the PRC subsidiaries are required to make appropriation from profit after taxation to the statutory surplus reserve at a rate of 10%. The statutory surplus reserve may be used to make up losses incurred and, with the approval from relevant government authorities, to increase capital.

Note d: The other reserve represents the net assets of Nanjing High Accurate, which was contributed to the Group by the founder shareholders of Nanjing High Accurate when the founder shareholders obtained control of Nanjing High Accurate as well as the subsequent acquisition of additional equity interest in Nanjing High Accurate and contributed to the Group by the founder shareholders of Nanjing High Accurate.

# CONSOLIDATED STATEMENT OF CASH FLOWS

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | NOTE | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Profit before taxation | | 1,650,001 | 1,166,051 |
| Adjustments for: | | | |
| Allowance for inventories | | 9,568 | 19,876 |
| Amortisation of intangible assets | | 40,230 | 22,677 |
| Bank interest income | | (31,093) | (26,228) |
| Depreciation of property, plant and equipment | | 329,176 | 193,497 |
| Finance costs | | 146,842 | 99,832 |
| (Gain) loss on fair value change on convertible bonds | | (148,916) | 438,382 |
| (Gain) loss on disposal of property, plant and equipment | | (2,338) | 1,394 |
| Gain on disposal of available-for-sale investments | | – | (8,480) |
| Impairment loss on intangible assets | | 3,213 | 1,416 |
| Impairment loss on trade receivables | | 22,854 | 15,475 |
| Interest on available-for-sale investments | | – | (3) |
| Loss (gain) on fair value change on derivative financial instrument | | 37,599 | (691,823) |
| Loss on partial termination of derivative financial instrument | | – | 393,219 |
| Release of prepaid lease payments | | 7,036 | 4,492 |
| Share of results of associates | | (479) | (1,904) |
| Share of results of jointly controlled entities | | (40,995) | (13,655) |
| Release of deferred income | | (3,828) | (4,908) |
| Operating cash flows before movements in working capital | | 2,018,870 | 1,609,310 |
| Decrease in inventories | | 170,963 | 11,516 |
| Increase in trade and other receivables | | (1,140,486) | (1,329,255) |
| Decrease in amount due from/to associate(s) | | 25,240 | 98 |
| (Increase) decrease in amount due from a jointly controlled entity | | (19,152) | 31,258 |
| Increase (decrease) in trade and other payables | | 778,404 | (498,031) |
| Cash generated from (used in) operations | | 1,833,839 | (175,104) |
| Income tax paid | | (200,014) | (106,873) |
| **NET CASH FROM (USED IN) OPERATING ACTIVITIES** | | 1,633,825 | (281,977) |

# CONSOLIDATED STATEMENT OF CASH FLOWS

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | NOTE | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|---|
| **INVESTING ACTIVITIES** | | | |
| Purchase of property, plant and equipment | | **(1,081,773)** | (1,499,335) |
| Deposit paid for land lease | | **(380,458)** | (7,300) |
| (Increase) decrease in pledged bank deposits | | **(315,450)** | 51,307 |
| Expenditure on development projects | | **(129,021)** | (70,493) |
| Purchase of available-for-sale investments | | **(77,354)** | (32,150) |
| Prepayment for acquisition of property, plant and equipment | | **(59,265)** | (105,911) |
| Acquisition of interest in associates | | **(43,545)** | — |
| Prepaid lease payments paid | | **(28,633)** | (31,761) |
| Acquisitions of subsidiaries | 36 | **38,546** | 1,019 |
| Interest received | | **31,093** | 26,231 |
| Decrease in restricted cash | | **5,106** | 829,662 |
| Proceeds on disposal of property, plant and equipment | | **3,965** | 602 |
| Government grants received | | **5,377** | 39,785 |
| Payment on partial termination of derivative financial instrument | | **—** | (50,181) |
| Refund on deposit for land lease | | **—** | 42,340 |
| Proceeds on disposal of available-for-sale investments | | **—** | 29,979 |
| Repayment from a related party | | **—** | 900 |
| **NET CASH USED IN INVESTING ACTIVITIES** | | **(2,031,412)** | (775,306) |

## CONSOLIDATED STATEMENT OF CASH FLOWS

*FOR THE YEAR ENDED 31 DECEMBER 2010*

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| **FINANCING ACTIVITIES** | | |
| New bank borrowings raised | **2,787,651** | 3,517,323 |
| Gross proceeds on placement of shares | **1,915,840** | — |
| Capital contribution by a non-controlling shareholder | **6,900** | 14,699 |
| Advance from a related party | **904** | 531 |
| Repayment of bank borrowings | **(2,182,764)** | (2,311,521) |
| Dividend paid | **(327,427)** | (274,367) |
| Interest paid | **(146,842)** | (99,832) |
| Acquisition of additional interest in a subsidiary | **(4,100)** | — |
| **NET CASH FROM FINANCING ACTIVITIES** | **2,050,162** | 846,833 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **1,652,575** | (210,450) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR** | **471,193** | 681,643 |
| **CASH AND CASH EQUIVALENTS AT END OF THE YEAR, representing bank balances and cash** | **2,123,768** | 471,193 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 1. GENERAL

The Company is a public limited company incorporated in the Cayman Islands as an exempted company with limited liability on 22 March 2005 and its shares are listed on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") with effect from 4 July 2007. The addresses of the registered office and principal place of business of the Company are disclosed in the section Corporate Information in the annual report.

The Company acts as investment holding. Particulars of the principal activities of its subsidiaries, associates and jointly controlled entities are set out in notes 43, 19 and 20 respectively.

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

## 2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS(s)")

### New and revised Standards and Interpretations applied in the current year

In the current year, the Group has applied the following new and revised Standards and Interpretations ("new and revised IFRSs").

| | |
|---|---|
| IFRS 2 (Amendments) | Group Cash-settled Share-based Payment Transactions |
| IFRS 3 (as revised in 2008) | Business Combinations |
| IAS 27 (as revised in 2008) | Consolidated and Separate Financial Statements |
| IAS 39 (Amendments) | Eligible Hedged Items |
| IFRSs (Amendments) | Improvements to IFRSs issued in 2009 |
| IFRSs (Amendments) | Amendments to IFRS 5 as part of Improvements to IFRSs issued in 2008 |
| IFRIC 17 | Distributions of Non-cash Assets to Owners |

Except as described below, the application of the new and revised Standards and Interpretations in the current year has had no material effect on the amounts reported in these consolidated financial statements and/or disclosures set out in these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS(s)") *(Continued)*

### IFRS 3 (as revised in 2008) Business Combinations

IFRS 3 (as revised in 2008) has been applied in the current year prospectively to business combinations of which the acquisition date is on or after 1 January 2010 in accordance with the relevant transitional provisions. Its application has affected the accounting for business combinations in the current year.

- IFRS 3 (as revised in 2008) allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests at the date of acquisition (previously referred to as "minority" interests) either at fair value or at the non-controlling interests' share of recognised identifiable net assets of the acquiree. In the current year, in accounting for the acquisition of Nanjing Sky Electronic Enterprise Co., Ltd ("Sky Electronic"), Nanjing Marine Propulsion (as defined in note 19) and Nantong Diesel Engine Co., Ltd. ("Nantong" together with Sky Electronic, Nanjing Marine Propulsion, collectively referred to as the "Acquired Subsidiaries"), the Group has elected to measure the non-controlling interests at the proportionate share of the acquirees' net identifiable assets at the date of acquisition.

- IFRS 3 (as revised in 2008) changes the recognition and subsequent accounting requirements for contingent consideration. Previously contingent consideration was recognised at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably; any subsequent adjustments to the contingent consideration were always made against the cost of the acquisition. Under the revised Standard, contingent consideration is measured at fair value at the acquisition date; subsequent adjustments to the consideration are recognised against the cost of acquisition only to the extent that they arise from new information obtained within the measurement period (a maximum of 12 months from the acquisition date) about the fair value at the acquisition date. All other subsequent adjustments to contingent consideration classified as an asset or a liability are recognised in profit or loss.

- IFRS 3 (as revised in 2008) requires acquisition-related costs to be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition.

In the current year, the application of IFRS 3 (as revised in 2008) has affected the accounting for the acquisition of the Acquired Subsidiaries and resulted in a reduction in goodwill recognised in the consolidated statement of financial position of RMB245,000 and a corresponding decrease in profit for the year in the consolidated statement of comprehensive income arising on the recognition of acquisition-related costs when incurred as a result of the application of IFRS 3 (as revised in 2008). The effect on the Group's basic and diluted earnings per share for the current year is insignificant.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS(s)") *(Continued)*

### Amendments to IAS 17 Leases

As part of *Improvements to IFRSs* issued in 2009, IAS 17 *Leases* has been amended in relation to the classification of leasehold land. Before the amendments to IAS 17, the Group was required to classify leasehold land as operating leases and to present leasehold land as prepaid lease payments in the consolidated statement of financial position. The amendments to IAS 17 have removed such a requirement. The amendments require that the classification of leasehold land should be based on the general principles set out in IAS 17, that is, whether or not substantially all the risks and rewards incidental to ownership of a leased asset have been transferred to the lessee.

In accordance with the transitional provisions set out in the amendments to IAS 17, the Group reassessed the classification of unexpired leasehold land as at 1 January 2010 based on the information that existed at the inception of the leases and determined that the amendment has no material impact on the consolidated financial statements.

### New and revised Standards and Interpretations issued but not yet effective

The Group has not early applied the following new and revised IFRSs that have been issued but are not yet effective:

| | |
|---|---|
| IFRSs (Amendments) | Improvements to IFRSs issued in 2010[1] |
| IFRS 7 (Amendments) | Disclosures – Transfers of Financial Assets[3] |
| IFRS 9 | Financial Instruments[4] |
| IAS 12 (Amendments) | Deferred Tax: Recovery of Underlying Assets[5] |
| IAS 24 (as revised in 2009) | Related Party Disclosures[6] |
| IAS 32 (Amendments) | Classification of Rights Issues[7] |
| IFRIC 14 (Amendments) | Prepayments of a Minimum Funding Requirement[6] |
| IFRIC 19 | Extinguishing Financial Liabilities with Equity Instruments[2] |

1 Effective for annual periods beginning on or after 1 July 2010 or 1 January 2011, as appropriate.
2 Effective for annual periods beginning on or after 1 July 2010.
3 Effective for annual periods beginning on or after 1 July 2011.
4 Effective for annual periods beginning on or after 1 January 2013.
5 Effective for annual periods beginning on or after 1 January 2012.
6 Effective for annual periods beginning on or after 1 January 2011.
7 Effective for annual periods beginning on or after 1 February 2010.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS(s)") *(Continued)*

**New and revised Standards and Interpretations issued but not yet effective** *(Continued)*

IFRS 9 *Financial Instruments* (as issued in November 2009) introduces new requirements for the classification and measurement of financial assets. IFRS 9 *Financial Instruments* (as revised in November 2010) adds requirements for financial liabilities and for derecognition.

- Under IFRS 9, all recognised financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are subsequently measured at either amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

- In relation to financial liabilities, the significant change relates to financial liabilities that are designated as at fair value through profit or loss. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the presentation of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was presented in profit or loss.

IFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

The directors anticipate that IFRS 9 that will be adopted in the Group's consolidated financial statements for financial year ending 31 December 2013 and that the application of the new Standard may not have a significant impact on amounts reported in respect of the Group's financial assets and financial liabilities.

The directors of the Company anticipate that the application of other new and revised IFRSs will have no material impact on the consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as explained in the accounting policies set out below. Historical cost is generally based on the fair value of the consideration given in exchange for goods.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

Non-controlling interests in subsidiaries are presented separately from the Group's equity therein.

***Allocation of total comprehensive income to non-controlling interests***

Total comprehensive income and expense of a subsidiary is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. Prior to 1 January 2010, losses applicable to the non-controlling interests in excess of the non-controlling interests in the subsidiary's equity were allocated against the interests of the Group except to the extent that the non-controlling interests had a binding obligation and were able to make an additional investment to cover the losses.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Basis of consolidation *(Continued)*

***Changes in the Group's ownership interests in existing subsidiaries***

*Changes in the Group's ownership interests in existing subsidiaries on or after 1 January 2010*

Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. Where certain assets of the subsidiary are measured at revalued amounts or fair values and the related cumulative gain or loss has been recognised in other comprehensive income and accumulated in equity, the amounts previously recognised in other comprehensive income and accumulated in equity are accounted for as if the Company had directly disposed of the related assets (i. e. reclassified to profit or loss or transferred directly to retained earnings). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 *Financial Instruments: Recognition and Measurement* or, when applicable, the cost on initial recognition of an investment in an associate or a jointly controlled entity.

*Changes in the Group's ownership interests in existing subsidiaries prior to 1 January 2010*

Increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised where appropriate. For decreases in interests in subsidiaries, regardless of whether the disposals would result in the Group losing control over the subsidiaries, the difference between the consideration received and the adjustment to the non-controlling interests was recognised in profit or loss.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Business combinations

***Business combinations that took place on or after 1 January 2010***

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognised and measured in accordance with IAS 12 *Income Taxes* and IAS 19 *Employee Benefits* respectively;

- liabilities or equity instruments related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the Group are measured in accordance with IFRS 2 *Share-based Payment* at the acquisition date; and

- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are measured in accordance with that Standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after re-assessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at their fair value or another measurement basis required by another Standard.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Business combinations *(Continued)*

***Business combinations that took place on or after 1 January 2010** (Continued)*

Where the consideration the Group transfers in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and considered as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with the corresponding adjustments being made against goodwill or gain on bargain purchase. Measurement period adjustments are adjustments that arise from additional information obtained during the measurement period about facts and circumstances that existed as of the acquisition date. Measurement period does not exceed one year from the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IAS 39, or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss being recognised in profit or loss.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control), and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

Changes in the value of the previously held equity interest recognised in other comprehensive income and accumulated in equity before the acquisition date are reclassified to profit or loss when the Group obtains control over the acquiree.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Business combinations *(Continued)*

***Business combinations that took place prior to 1 January 2010***

Acquisition of businesses was accounted for using the purchase method. The cost of the acquisition was measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that met the relevant conditions for recognition were generally recognised at their fair value at the acquisition date.

Goodwill arising on acquisition was recognised as an asset and initially measured at cost, being the excess of the cost of the acquisition over the Group's interest in the recognised amounts of the identifiable assets, liabilities and contingent liabilities recognised. If, after assessment, the Group's interest in the recognised amounts of the acquiree's identifiable assets, liabilities and contingent liabilities exceeded the cost of the acquisition, the excess was recognised immediately in profit or loss.

The minority interest in the acquiree was initially measured at the minority interest's proportionate share of the recognised amounts of the assets, liabilities and contingent liabilities of the acquiree.

Contingent consideration was recognised, if and only if, the contingent consideration was probable and could be measured reliably. Subsequent adjustments to contingent consideration were recognised against the cost of the acquisition.

Business combinations achieved in stages were accounted for as separate steps. Goodwill was determined at each step. Any additional acquisition did not affect the previously recognised goodwill.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Goodwill

Goodwill arising on an acquisition of a business is carried at cost less any accumulated impairment losses, if any, and is presented separately in the consolidated statement of financial position.

For the purposes of impairment testing, goodwill is allocated to each of the cash-generating units (or groups of cash-generating units) that are expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually or more frequently, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a reporting period, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that reporting period. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss in the consolidated statement of comprehensive income. An impairment loss recognised for goodwill is not reversed in subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the amount of profit or loss on disposal.

### Investments in associates

An associate is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in associates are initially recognise in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of profit or losses and other comprehensive income of the associates. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Investments in associates *(Continued)*

Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of IAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 *Impairment of Assets* as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

From 1 January 2010 onwards, upon disposal of an associate that results in the Group losing significant influence over that associate, any retained investment is measured at fair value at that date and the fair value is regarded as its fair value on initial recognition as a financial asset in accordance with IAS 39. The difference between the previous carrying amount of the associate attributable to the retained interest and its fair value is included in the determination of the gain or loss on disposal of the associate. In addition, the Group accounts for all amounts previously recognised in other comprehensive income in relation to that associate on the same basis as would be required if that associate had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income by that associate would be reclassified to profit or loss on the disposal of the related assets or liabilities, the Group reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses significant influence over that associate.

When a group entity transacts with its associate, profits and losses resulting from the transactions with the associate are recognised in the Group' consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Jointly controlled entities**

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of profit or loss and other comprehensive income of the jointly controlled entities. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of a jointly controlled entity recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment.

Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of IAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in a jointly controlled entity. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 *Impairment of Assets* as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

When a group entity transacts with its jointly controlled entity, profits and losses resulting from the transactions with the jointly controlled entity are recognised in the Group's consolidated financial statements only to the extent of interests in the jointly controlled entity that are not related to the Group.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold in the normal course of business, net of discounts and sales taxes.

Revenue from the sale of goods is recognised when all the following conditions are satisfied:

- the Group has transferred to the buyer the significant risks and rewards of ownership of the goods;
- the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Group; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue from sale of goods is recognised when the goods are delivered and title has passed.

Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably. Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Property, plant and equipment

Property, plant and equipment including buildings held for use in the production or supply of goods or services, or for administrative purposes, other than properties under construction as described below are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is recognised so as to write off the cost of items of property, plant and equipment other than properties under construction less their residual values over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Properties in the course of construction for production, supply or administrative purposes are carried at cost, less any recognised impairment loss. Costs include professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Such properties are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the net disposal proceeds and the carrying amount of the asset is included in profit or loss.

### Leasing

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

#### The Group as lessee

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Leasehold land and building

When a lease includes both land and building elements, the Group assesses the classification of each element as a finance or an operating lease separately based on the assessment as to whether substantially all the risks and rewards incidental to ownership of each element have been transferred to the Group. Specifically, the minimum lease payments (including any lump-sum upfront payments) are allocated between the land and the building elements in proportion to the relative fair values of the leasehold interests in the land element and building element of the lease at the inception of the lease.

To the extent the allocation of the lease payments can be made reliably, interest in leasehold land that is accounted for as an operating lease is presented as "prepaid lease payments" in the consolidated statement of financial position and is amortised over the lease term on a straight-line basis. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease is generally classified as a finance lease and accounted for as property, plant and equipment, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

### Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchange prevailing on the dates of the transactions. At the end of the reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are recognised in profit or loss in the period in which they arise.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group (i.e. RMB) at the rate of exchange prevailing at the end of the reporting period, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the year, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity (the exchange reserve).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

### Government grants

Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and that the grants will be received.

Government grants are recognised in profit or loss on a systematic basis over the periods in which the Group recognises as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that the Group should purchase, construct or otherwise acquire non-current assets are recognised as deferred income in the consolidated statement of financial position and transferred to profit or loss over the useful lives of the related assets. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Group with no future related costs are recognised in profit or loss in the period in which they become receivable.

### Retirement benefit costs

Payments to state-managed retirement benefit schemes are charged as expenses when employees have rendered service entitling them to the contributions.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income and expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary difference to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in jointly controlled entities, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realised, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Deferred tax is recognised in profit or loss, except when it relates to items that are recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity respectively.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Intangible assets

#### Research and development expenditures

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development activities (or from the development phase of an internal project) is recognised if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible asset is measured at cost less accumulated amortisation and accumulated impairment losses (if any).

Gains or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in profit or loss in the period when the asset is derecognised.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

### Financial instruments

Financial assets and financial liabilities are recognised on the consolidated statement of financial position when a group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets or financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

### Financial assets

The Group's financial assets are classified into one of the two categories, including loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the market place.

#### *Effective interest method*

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for debt instruments, of which interest income is included in net gains or losses.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Financial instruments *(Continued)*

### Financial assets *(Continued)*

***Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables (including trade and other receivables, amounts due from associates/a jointly controlled entity, pledged bank deposits, restricted cash, bank balances and cash) are carried at amortised cost using the effective interest method, less any identified impairment losses (see accounting policy on impairment loss on financial assets below).

***Available-for-sale financial assets***

Available-for-sale financial assets are non-derivatives that are either designated or not classified as financial assets at fair value through profit or loss ("FVTPL"), loans and receivables or held-to-maturity investments.

Available-for-sale financial assets are measured at fair value at the end of the reporting period. Changes in fair value are recognised in other comprehensive income and accumulated in investment revaluation reserve, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously accumulated in the investment revaluation reserve is reclassified to profit or loss (see accounting policy on impairment loss on financial assets below).

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, they are measured at cost less any identified impairment losses at the end of the reporting period (see accounting policy on impairment loss on financial assets below).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Financial instruments** *(Continued)*

**Financial assets** *(Continued)*

***Impairment of financial assets***

Financial assets are assessed for indicators of impairment at the end of the reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial assets have been affected.

For an available-for-sale equity investment, a significant or prolonged decline in the fair value of that investment below its costs is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- the disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the credit period of 90 to 180 days and observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, an impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Financial instruments** *(Continued)*

**Financial assets** *(Continued)*

***Impairment of financial assets*** *(Continued)*

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

For financial assets measured at amortised cost, if, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Impairment losses on available-for-sale equity investments will not be reversed in profit or loss in subsequent periods. Any increase in fair value subsequent to impairment loss is recognised directly in other comprehensive income and accumulated in investment revaluation reserve.

**Financial liabilities and equity instruments**

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The Group's financial liabilities are generally classified into financial liabilities at FVTPL and other financial liabilities.

***Effective interest method***

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or, where appropriate, a shorter period.

Interest expense is recognised on an effective interest basis for debt instruments.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Financial instruments *(Continued)*

**Financial liabilities and equity instruments** *(Continued)*

***Financial liabilities at fair value through profit or loss***

Financial liabilities at FVTPL of the Group comprise financial liabilities designated at FVTPL on initial recognition.

A financial liability is designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities at FVTPL are measured at fair value, with changes in fair value arising on remeasurement recognised directly in profit or loss in the period in which they arise. The net gain or loss recognised in profit or loss includes any interest paid on the financial liabilities.

***Other financial liabilities***

Other financial liabilities including trade and other payables, amount due to a jointly controlled entity/a related party/associates and borrowings are subsequently measured at amortised cost, using the effective interest method.

***Equity instruments***

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

***Derivative financial instruments***

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at the end of the reporting period. The resulting gain or loss is recognised in profit or loss immediately.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Financial instruments *(Continued)*

**Derecognition**

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in other comprehensive income and accumulated in equity is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

### Share-based payment transactions

**Equity-settled share-based payment transactions**

The fair value of services received determined by reference to the fair value of share options granted at the grant date is recognised as an expense in full at the grant date when the share options granted vest immediately, with a corresponding increase in equity (share option reserve).

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share options reserve will be transferred to retained profits.

### Impairment losses on tangible and intangible assets other than goodwill

At the end of the reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of an asset is estimated in order to determine the extent of the impairment loss, if any.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 4. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group's accounting policies, which are described in note 3, management makes various estimates based on past experience, expectations of the future and other information. The key source of estimation uncertainty that can significantly affect the amounts recognised in the consolidated financial statements is disclosed below.

### Allowances for bad and doubtful debts

The Group makes allowances for bad and doubtful debts based on an assessment of the recoverability of trade receivables. Allowances are applied to trade receivables where events or changes in circumstances indicated that the balances may not be collectible. The identification of bad and doubtful debts requires the use of estimates. Where the expectation of future cash receipts is different from the original estimate, such difference will impact the carrying amounts of trade receivables and doubtful debts expenses in the year in which such estimate is changed. As at 31 December 2010, the carrying amount of trade receivables is RMB3,504,542,000 (net of allowance for bad and doubtful debts of RMB71,955,000) (31 December 2009: carrying amount of RMB2,267,191,000, net of allowance for bad and doubtful debts of RMB49,250,000).

### Allowance for inventories

Management exercises their estimates in making allowance for inventories. Management reviews the inventory listing at the end of each reporting period, and makes allowance for obsolete and slow-moving inventory items identified that no longer suitable for use in operation. As at 31 December 2010, the carrying amount of inventories is RMB1,257,663,000 (net of allowance for inventories of RMB49,201,000) (31 December 2009: carrying amount of RMB1,312,810,000, net of allowance for inventories of RMB39,633,000).

### Fair value of convertible bonds and derivative financial instrument

Management uses their judgement in selecting an appropriate valuation technique to determine the fair values of convertible bonds and derivative financial instrument. Valuation techniques commonly used by market practitioners are applied. For convertible bonds and derivative financial instrument, assumptions are made based on quoted market rates adjusted for specific features of the instruments. Details of the assumptions used are disclosed in notes 32 and 33, respectively.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 5. CAPITAL RISK MANAGEMENT

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimization of the debt and equity balance. The Group's overall strategy remains unchanged from prior year.

The capital structure of the Group consists of net debt, which includes the borrowings disclosed in note 30 and convertible bonds disclosed in note 32, net of cash and cash equivalents and equity attributable to owners of the Company, comprising issued share capital, retained profits and other reserves.

The management of the Group reviews the capital structure regularly and taking into account of the cost and risk associated with the capital. The Group will balance its capital structure through the payment of dividends, new shares issue as well as the issue of new debt or the redemption of the existing debts.

## 6. FINANCIAL INSTRUMENTS

### 6a. Categories of financial instruments

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| **Financial assets** | | |
| Loans and receivables (including cash and cash equivalents) | **6,583,159** | 3,436,612 |
| Available-for-sale investments | **148,646** | 62,500 |
| Derivative financial instrument | **18,392** | 55,911 |
| **Financial liabilities** | | |
| Amortised cost | **5,395,841** | 3,715,596 |
| Financial liabilities designated as at FVTPL | | |
| – convertible bonds (see below) | **1,219,933** | 1,368,949 |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 6. FINANCIAL INSTRUMENTS *(Continued)*

#### 6b. Financial risk management objectives and policies

The Group's major financial instruments include available-for-sale investments, trade and other receivables, amounts due from (to) associates, a jointly controlled entity and a related party, trade and other payables, pledged bank deposits, restricted cash, bank balances and cash, borrowings, convertible bonds and derivative financial instrument. Details of the financial instruments are disclosed in the respective notes. The risks associated with these financial instruments include market risk (currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

**Market risk**

There has been no significant change to the Group's exposure to market risks or the manner in which it manages and measures the risk.

(i) Currency risk

The Group mainly operates in the PRC with transactions substantially entered into in RMB. However, the Group exposed to currency risks which mainly arises from the foreign currency sales and purchases, bank balances and borrowings denominated in foreign currency. Approximately 10% of the Group's sales and 1% of the Group's purchase are denominated in currencies other than the functional currency of the respective group entities.

The carrying amount of the Group's foreign currency denominated monetary assets and monetary liabilities including trade and other receivables, restricted cash, pledged bank deposits, bank balances and cash, trade and other payables, borrowings and derivative financial instrument at the end of the reporting period are as follows:

*Assets*

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---:|---:|
| Hong Kong Dollars (HKD) | **183,613** | 210,056 |
| United States Dollars (USD) | **500,861** | 401,061 |
| Euro Dollars (EUR) | **191,226** | 76,800 |
| Swiss Francs (CHF) | **65** | 61 |
| Japanese Dollars (JPY) | **10,593** | 4,640 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 6. FINANCIAL INSTRUMENTS *(Continued)*

### 6b. Financial risk management objectives and policies *(Continued)*

**Market risk** *(Continued)*

(i) Currency risk *(Continued)*

*Liabilities*

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Hong Kong Dollars (HKD) | **3,275** | 16,079 |
| United States Dollars (USD) | **10,619** | 42,570 |
| Euro Dollar (EUR) | **15,367** | 77,175 |

The Group does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arises.

*Sensitivity analysis*

The Group is mainly exposed to the fluctuation of HKD, USD and EUR against RMB.

The following table details the Group's sensitivity to a 5% (2009: 5%) increase and decrease in RMB against the relevant foreign currencies. 5% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the year end for a 5% change in foreign currency rates. A positive number below indicates an increase in post-tax profit where RMB strengthen 5% against the relevant foreign currencies. For a 5% weakening of RMB against the relevant foreign currencies, there would be an equal and opposite impact on the profit.

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| HKD impact | **(9,017)** | (9,798) |
| USD impact | **(21,316)** | (15,488) |
| EUR impact | **(8,405)** | (181) |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 6. FINANCIAL INSTRUMENTS *(Continued)*

### 6b. Financial risk management objectives and policies *(Continued)*

**Market risk** *(Continued)*

(ii) Interest rate risk

The Group is exposed to fair value interest rate risk in relation to fixed-rate borrowings and pledged bank deposits. The Group is also exposed to cash flow interest rate risk in relation to variable-rate borrowings carried interest at prevailing interest rate and bank balances carried interest at prevailing market deposit rates. The Group currently does not have an interest rate hedging policy. However, the management monitors interest rate exposure and will consider necessary action when significant interest rate exposure is anticipated. Currently, the Group adopts a policy of maintaining an appropriate mix of fixed and floating rate borrowings which is achieved primarily through the contractual terms of borrowings. The position is regularly monitored and evaluated by reference to anticipated changes in market interest rate.

The Group's cash flow interest rate risk is mainly concentrated on the fluctuation of the rate determined by the People's Bank of China arising from the Group's RMB denominated borrowings.

*Sensitivity analysis*

The sensitivity analyses below have been determined based on the exposure to interest rates for variable-rate borrowings at the end of the reporting period. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points (2009: 50 basis points) higher/lower and all other variables were held constant, the Group's profit for the year would decrease/increase by RMB9,931,000 (2009 decrease/increase by: RMB4,046,000).

The Group's sensitivity to interest rates has increased during the current year mainly due to the increase in variable-rate borrowings.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 6. FINANCIAL INSTRUMENTS *(Continued)*

### 6b. Financial risk management objectives and policies *(Continued)*

**Market risk** *(Continued)*

(iii) Other price risk

The Group is exposed to other price risk through its convertible bonds and derivative financial instruments. The management monitors closely the other price risk and will consider hedging the risk exposure should the need arise.

*Sensitivity analysis*

The sensitivity analyses below have been determined based on the exposure to the share price of the Company for convertible bonds and derivative financial instruments assuming all other variables were held constant, at the end of the reporting period.

If the prices of the respective equity instruments had been 5% (2009: 5%) higher/lower:

- profit for the year ended 31 December 2010 would decrease/increase by RMB1,100,000 (2009: decrease/increase by RMB35,383,000) as a result of the changes in fair value of convertible bonds; and

- profit for the year ended 31 December 2010 would increase/decrease by RMB6,300,000 (2009: increase/decrease by RMB10,509,000) as a result of the changes in fair value of derivative financial instrument.

In the management's opinion, the sensitivity analyses are unrepresentative of the inherent market risks as the pricing model used in the fair value valuation of the convertible bonds and derivative financial instrument which involves multiple variables are interdependent.

**Credit risk**

As at 31 December 2010, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to perform an obligation by the counterparties is arising from the carrying amount of the respective recognised financial assets as stated in the consolidated statement of financial position.

In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at the end of the reporting date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 6. FINANCIAL INSTRUMENTS *(Continued)*

### 6b. Financial risk management objectives and policies *(Continued)*

**Credit risk** *(Continued)*

Other than concentration of the credit risk on liquid funds which are deposited with several banks with high credit rating, the Group also has concentration of credit risks with exposure limited to certain counterparties and customers. As at 31 December 2010, five customers engaged in the wind milling industry accounted for approximately 38% (2009: 39%) of the Group's trade receivables. Apart from delegating a team for determining the credit limits, credit approval and other monitoring procedures on customers, the Group had also explored new markets and new customers in order to minimise the concentration of credit risk. Other than the above, no other concentration of credit risk on the Group's trade receivables.

**Liquidity risk**

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and mitigate the effects of fluctuations in cash flows. The management monitors the utilisation of bank borrowings and ensures compliance with loan covenants.

The Group relies on bank borrowings as a significant source of liquidity. As at 31 December 2010, the Group has available unutilised short-term bank loan facilities of approximately RMB8,081 million (2009: RMB5,766 million). Details of which are set out in note 30.

The following table details the Group's remaining contractual maturity for its non-derivative financial liabilities based on the agreed repayment terms. The table has been based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. Specifically, bank loans with a repayment on demand clause are included in the earliest time band regardless of the probability of the banks choosing to exercise their rights. The maturity dates for other non-derivative financial liabilities are based on the agreed repayment dates.

The table includes both interest and principal cash flows.

In addition, the following table details the Group's liquidity analysis for its derivative financial instruments. The tables have been drawn up based on the undiscounted contractual net cash outflows on derivative instruments that settle on a net basis. The liquidity analysis for the Group's derivative financial instruments are prepared based on the contractual maturities as the management consider that the contractual maturities are essential for an understanding of the timing of the cash flows of derivatives.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 6. FINANCIAL INSTRUMENTS *(Continued)*

### 6b. Financial risk management objectives and policies *(Continued)*

**Liquidity risk** *(Continued)*

| | Weighted average effective interest rate | 0 - 30 days | 31 - 90 days | 91 - 365 days | 1 - 5 years | Total undiscounted cash flows | Carrying amount |
|---|---|---|---|---|---|---|---|
| | % | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **2010** | | | | | | | |
| Non-derivative financial liabilities | | | | | | | |
| Trade and other payables | – | 224,677 | 1,306,306 | 603,745 | – | 2,134,728 | 2,134,728 |
| Amount due to a jointly controlled entity | – | 6,665 | – | – | – | 6,665 | 6,665 |
| Amount due to a related party | – | 1,435 | – | – | – | 1,435 | 1,435 |
| Amounts due to associates | – | 1,312 | – | – | – | 1,312 | 1,312 |
| Borrowings | 5.30 | 103,390 | 206,780 | 930,510 | 2,518,921 | 3,759,601 | 3,251,701 |
| Convertible bonds | – | – | – | 1,254,179 | – | 1,254,179 | 1,219,933 |
| | | 337,479 | 1,513,086 | 2,788,434 | 2,518,921 | 7,157,920 | 6,615,774 |
| **2009** | | | | | | | |
| Non-derivative financial liabilities | | | | | | | |
| Trade and other payables | – | 96,852 | 327,654 | 698,677 | – | 1,123,183 | 1,123,183 |
| Amount due to a jointly controlled entity | – | 23,568 | – | – | – | 23,568 | 23,568 |
| Amount due to a related party | – | 531 | – | – | – | 531 | 531 |
| Borrowings | 6.50 | 133,904 | 267,809 | 1,205,139 | 1,044,933 | 2,651,785 | 2,568,314 |
| Convertible bonds | – | – | – | – | 1,254,288 | 1,254,288 | 1,368,949 |
| | | 254,855 | 595,463 | 1,903,816 | 2,299,221 | 5,053,355 | 5,084,545 |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 6. FINANCIAL INSTRUMENTS *(Continued)*

#### 6c. Fair value

The fair value of financial assets and financial liabilities are determined as follows:

- the fair value of other financial assets and financial liabilities (excluding convertible bonds and derivative financial instrument) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices or rates from observable current market transactions as input; and

- the fair value of convertible bonds and derivative financial instrument is determined using option pricing model. Major inputs are disclosed in notes 32 and 33.

The directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the consolidated financial statements approximate their fair values.

**Fair value measurements recognised in the statement of financial position**

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped as Level 3 based on the degree to which the fair value is observable. Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| | Level 3 | |
|---|---|---|
| | **2010** | 2009 |
| | **RMB'000** | RMB'000 |
| **Financial asset at FVTPL** | | |
| Derivative financial instrument | **18,392** | 55,991 |
| **Financial liability at FVTPL** | | |
| Convertible bonds | **1,219,933** | 1,368,949 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 6. FINANCIAL INSTRUMENTS *(Continued)*

### 6c. Fair value *(Continued)*

**Reconciliation of Level 3 fair value measurement of financial asset**

| | Convertible bonds RMB'000 | Derivative financial instrument RMB'000 |
|---|---|---|
| At 1 January 2009 | (931,550) | (292,794) |
| (Loss) gains for the year recognised in profit or loss (Note) | (438,382) | 298,604 |
| Conversion of convertible bonds | 983 | — |
| Payment on partial early termination | — | 50,181 |
| At 31 December 2009 | (1,368,949) | 55,991 |
| Gains (loss) for the year recognised in profit or loss (Note) | 148,916 | (37,599) |
| Conversion of convertible bonds | 100 | — |
| At 31 December 2010 | **(1,219,933)** | **18,392** |

Note: Of the total gains and loss for the year included in profit or loss, gain of RMB148,916,000 and loss of RMB37,599,000 relates to convertible bonds and derivative financial instrument held at the end of the reporting period (2009: loss of RMB438,382,000 and gain of RMB298,604,000 relates to convertible bonds and derivative financial instrument) respectively. The total gains and loss are included in "other gains and loss" (Note 8b).

## 7. REVENUE AND SEGMENTAL INFORMATION

Revenue represents the amounts received and receivable for goods sold, net of sales taxes and return. The Group's operation is the production and sale of gear products.

The Group is organised in one business division only. The Group's chief operating decision maker (the "CODM"), being the Company's Board of Directors, make decisions according to the revenue and operating results of each geographical area by location of customers and the related reports on the aging analysis of trade receivables for the purposes of resources allocation and performance assessment. Accordingly the Group's operating segments are based on geographical location of customers.

No information of liabilities is provided for the assessment of performance of different geographical area. Therefore only segment revenue, segment results and segment assets are presented.

The PRC and Europe (mainly Italy) are two major operating segments reviewed by the CODM while the remaining market locations are grouped together to report to CODM for analysis.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 7. REVENUE AND SEGMENTAL INFORMATION *(Continued)*

### Segment revenue and results

The following is an analysis of the Group's revenue and results by operating segments for the year under review.

| | 2010<br>RMB´000 | 2009<br>RMB´000 |
|---|---|---|
| Revenue | | |
| - PRC | **6,526,235** | 4,808,948 |
| - Europe | **231,242** | 540,139 |
| - Others | **635,172** | 297,958 |
| | **7,392,649** | 5,647,045 |
| Segment profit | | |
| - PRC | **1,894,730** | 1,506,502 |
| - Europe | **66,882** | 178,027 |
| - Others | **183,709** | 98,206 |
| | **2,145,321** | 1,782,735 |
| Other income, gains and losses | **177,873** | (95,077) |
| Finance costs | **(146,842)** | (99,832) |
| Share of results of associates | **479** | 1,904 |
| Share of results of jointly controlled entities | **40,995** | 13,655 |
| Unallocated expenses | **(567,825)** | (437,334) |
| Profit before taxation | **1,650,001** | 1,166,051 |

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 3. Segment profit represents the gross profit (including depreciation of production plants), government grants, sales of scrap materials and distribution and selling expenses earned/incurred by each segment. The remaining items in the profit or loss are unallocated.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 7. REVENUE AND SEGMENTAL INFORMATION *(Continued)*

### Segment assets

| | 2010<br>RMB´000 | 2009<br>RMB´000 |
|---|---|---|
| Segment assets | | |
| - PRC | **3,364,349** | 1,930,710 |
| - Europe | **32,171** | 15,821 |
| - Others | **108,022** | 320,660 |
| Total segment assets | **3,504,542** | 2,267,191 |
| Unallocated assets | **11,426,973** | 7,967,728 |
| Consolidated total assets | **14,931,515** | 10,234,919 |

Only the trade receivables of each segment are reported to the CODM for the purposes of resources allocation and performance assessment. Hence, total segment assets represent the trade receivables of the Group while the unallocated assets represent the assets of the Group excluding trade receivables. The related impairment loss on trade receivables are not reported to the CODM as part of segment results.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 7. REVENUE AND SEGMENTAL INFORMATION *(Continued)*

**Other segment information**

**2010**

| | PRC RMB'000 | Europe RMB'000 | Others RMB'000 | Unallocated RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| Amounts included in the measure of segment profit: | | | | | |
| Allowance for inventories | 8,447 | 299 | 822 | — | 9,568 |
| Depreciation of property, plant and equipment | 256,565 | 9,092 | 24,974 | — | 290,631 |
| Amounts regularly provided to the CODM but not included in the measure of segment profit or segment assets: | | | | | |
| Depreciation of property, plant and equipment | 256,565 | 9,092 | 24,974 | 38,545 | 329,176 |
| Impairment loss on trade receivables | 8,468 | 7,065 | 7,321 | — | 22,854 |
| Impairment loss on intangible assets | 3,213 | — | — | — | 3,213 |

2009

| | PRC RMB'000 | Europe RMB'000 | Others RMB'000 | Unallocated RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| Amounts included in the measure of segment profit: | | | | | |
| Allowance for inventories | 17,017 | 1,843 | 1,016 | — | 19,876 |
| Depreciation of property, plant and equipment | 141,409 | 15,883 | 8,762 | — | 166,054 |
| Amounts regularly provided to the CODM but not included in the measure of segment profit or segment assets: | | | | | |
| Depreciation of property, plant and equipment | 141,409 | 15,883 | 8,762 | 27,443 | 193,497 |
| Impairment loss on trade receivables | 13,178 | 168 | 2,129 | — | 15,475 |
| Impairment loss on intangible assets | 1,416 | — | — | — | 1,416 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 7. REVENUE AND SEGMENTAL INFORMATION *(Continued)*

### Revenue from major product and services

The following is an analysis of the Group's revenue from its major products:

| | Year ended | |
|---|---|---|
| | **31.12.2010** | 31.12.2009 |
| | **RMB'000** | RMB'000 |
| High-speed Heavy-load Gear Transmission Equipment | **24,798** | 29,049 |
| Gear Transmission Equipment for Construction Materials | **668,452** | 794,200 |
| General Purpose Gear Transmission Equipment | **144,740** | 143,271 |
| Gear Transmission Equipment for Bar-rolling, Wire-rolling and Plate-rolling Mills | **550,743** | 467,721 |
| Wind Gear Transmission Equipment | **5,457,532** | 3,805,074 |
| Marine Gear Transmission Equipment | **234,253** | 209,579 |
| Transmission Equipment for High-speed locomotives and Urban Light Rails | **36,310** | 14,279 |
| Computer Numerical Controlled Products | **46,081** | — |
| Others | **229,740** | 183,872 |
| | **7,392,649** | 5,647,045 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 7. REVENUE AND SEGMENTAL INFORMATION *(Continued)*

### Geographical information

The Group's non-current assets of RMB6,603,982,000 (2009: RMB5,051,975,000) are located in the PRC at the end of the reporting period.

### Information about major customers

Revenue from customers of the corresponding years contributing over 10% of the total sales of the Group are as follows:

| | Year ended | |
|---|---|---|
| | **31.12.2010** | 31.12.2009 |
| | **RMB'000** | RMB'000 |
| Customer A[1] | **1,257,611** | 878,374 |
| Customer B[1] | **843,714** | 717,491 |
| Customer C[1] | **746,473** | N/A[2] |

1 Revenue from sale of wind gear transmission equipment in the PRC segment.

2 The corresponding revenue did not contribute over 10% of the total sales of the Group.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 8a. OTHER INCOME

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Bank interest income | 31,093 | 26,228 |
| Interest on available-for-sale investments | — | 3 |
| Government grants (Note) | 31,749 | 14,739 |
| Sales of scrap materials | 101,880 | 45,929 |
| Gain on disposal of property, plant and equipment | 2,338 | — |
| Gain on disposal of available-for-sale investments | — | 8,480 |
| Others | 33,125 | 9,990 |
| | 200,185 | 105,369 |

Note: The amount includes amortisation of deferred income of RMB3,828,000 (2009: RMB4,098,000).

## 8b. OTHER GAINS AND LOSS

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| (Loss) gain on derivative financial instrument | (37,599) | 298,604 |
| Gain (loss) on fair value change on convertible bonds | 148,916 | (438,382) |
| | 111,317 | (139,778) |

## 9. FINANCE COSTS

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Interests on bank borrowings wholly repayable within five years | 194,772 | 118,556 |
| Less: amount capitalised | (47,930) | (18,724) |
| | 146,842 | 99,832 |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 10. TAXATION

| | 2010 RMB'000 | 2009 RMB'000 |
|---|---|---|
| PRC Enterprise Income Tax | | |
| – Current year | 225,035 | 188,430 |
| – Underprovision in prior years | 3,728 | 6,480 |
| | 228,763 | 194,910 |
| Deferred tax (note 31) | 27,780 | 5,363 |
| | 256,543 | 200,273 |

No provision for Hong Kong Profits Tax has been made as the Group has no assessable profit arising in Hong Kong.

Under the Law of the People's Republic of China on Enterprise Income Tax (the "EIT Law") and Implementation Regulation of the EIT Law, the tax rate of the PRC subsidiaries is 25% from 1 January 2008 onwards.

Pursuant to relevant laws and regulation in the PRC, certain subsidiaries in the PRC are exempted from PRC income tax for two years commencing from their first profit-making year, follow by a 50% reduction for the next three years. These tax concessions would expire in 2010.

Nanjing High Speed Gear Manufacturing Co., Ltd. ("Nanjing High Speed"), Nanjing High Accurate Marine Equipment Co., Ltd. ("Nanjing Marine"), Shougao (as defined in note 43) and Nantong are approved for 3 years as enterprises that satisfied the condition as high technology development enterprises and are subject to a preferential tax rate of 15% in 2009 and 2010. The approval was obtained before the year ended 31 December 2007 for Nanjing High Speed and 31 December 2008 for Nanjing Marine, Shougao and Nantong.

Nanjing High Accurate and Nanjing Gaote Gear Box Manufacturing Co., Ltd. ("Nanjing Gaote") are entitled to a 50% relief from the Enterprise Income Tax in both years.

The EIT Law imposes withholding tax upon the distribution of the profits earned by the PRC subsidiaries on or after 1 January 2008 to their overseas shareholders. Deferred tax liabilities of RMB48,895,000 (2009: RMB29,895,000) has been recognised in the consolidated financial statements in respect of the temporary differences attributable to such undistributed profits.

There was no significant unprovided deferred taxation for the year or at the end of the reporting period.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 10. TAXATION *(Continued)*

The tax charge for the year can be reconciled to the profit before taxation per the consolidated statement of comprehensive income as follows:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Profit before taxation | **1,650,001** | 1,166,051 |
| Tax at income tax rate of 25% (2009: 25%) | **412,500** | 291,513 |
| Income taxed at concessionary rate and tax exemption | **(164,418)** | (146,835) |
| Tax effect of share of results of associates and jointly controlled entities | **(10,369)** | (3,890) |
| Tax effect of expenses not deductible for tax purposes | **37,569** | 219,049 |
| Tax effect of income not taxable for tax purposes | **(42,324)** | (175,930) |
| Tax effect of tax losses not recognised | **1,011** | 280 |
| Utilisation of tax losses previously not recognised | **(154)** | (7,594) |
| Underprovision in prior year | **3,728** | 6,480 |
| Tax effect of undistributed earnings of the PRC's subsidiaries | **19,000** | 17,200 |
| Tax charge for the year | **256,543** | 200,273 |

Details of deferred taxation for the year are set out in note 31.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 11. PROFIT FOR THE YEAR

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Profit for the year has been arrived at after charging (crediting): | | |
| Total staff costs, including directors' emoluments (note 12) | 532,600 | 389,034 |
| Less: staff cost included in research and development costs | (17,629) | (32,879) |
| | 514,971 | 356,155 |
| Auditor's remuneration | 4,103 | 3,657 |
| Allowance for inventories (included in cost of sales) | 9,568 | 19,876 |
| Amortisation of intangible assets (included in cost of sales) | 40,230 | 22,677 |
| Cost of inventories recognised as an expense | 5,044,003 | 3,743,251 |
| Depreciation of property, plant and equipment | 329,176 | 193,497 |
| Exchange gain | (117,210) | (12,705) |
| Exchange loss | 148,267 | 43,292 |
| (Gain) loss on disposal of property, plant and equipment | (2,338) | 1,394 |
| Impairment loss on intangible assets | 3,213 | 1,416 |
| Impairment loss on trade receivables | 22,854 | 15,475 |
| Release of prepaid lease payments | 7,036 | 4,492 |

### 12. DIRECTORS' AND EMPLOYEES' EMOLUMENTS

Details of the emoluments paid or payable to directors for both years are as follows:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Directors | | |
| – fee | — | — |
| – salaries and other allowances | 19,889 | 12,274 |
| – retirement benefit plan contributions | 371 | 318 |
| Total emoluments | 20,260 | 12,592 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 12. DIRECTORS' AND EMPLOYEES' EMOLUMENTS *(Continued)*

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Fee | Salaries and allowances | Retirement benefits scheme contributions | Total | Fee | Salaries and allowances | Retirement benefits scheme contributions | Total |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Hu Yueming | – | 3,047 | 53 | 3,100 | – | 2,247 | 53 | 2,300 |
| Chen Yongdao | – | 2,747 | 53 | 2,800 | – | 1,967 | 53 | 2,020 |
| Lu Xun | – | 2,747 | 53 | 2,800 | – | 1,967 | 53 | 2,020 |
| Li Shengqiang | – | 2,747 | 53 | 2,800 | – | 1,967 | 53 | 2,020 |
| Liu Jianguo | – | 2,747 | 53 | 2,800 | – | 1,967 | 53 | 2,020 |
| Liao Enrong | – | 2,747 | 53 | 2,800 | – | 1,967 | 53 | 2,020 |
| Jin Maoji (Appointed on 7 May 2010) | – | 2,747 | 53 | 2,800 | – | – | – | – |
| Chen Shimin | – | 120 | – | 120 | – | 100 | – | 100 |
| Zhu Jun Sheng | – | 120 | – | 120 | – | 40 | – | 40 |
| Jiang Xihe | – | 120 | – | 120 | – | 40 | – | 40 |
| Zhang Wei (Resigned on 7 May 2010) | – | – | – | – | – | 12 | – | 12 |
| | – | 19,889 | 371 | 20,260 | – | 12,274 | 318 | 12,592 |

### Employees

The five highest paid individuals of the Group for both years are all directors, details of their emoluments are set out above.

During the years ended 31 December 2010 and 2009, no emoluments were paid by the Group to any of the directors or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors waived any emoluments during both years.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 13. DIVIDENDS

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Dividends recognised as distribution during the year: | | |
| Dividend of HK25 cents (equivalent to approximately RMB22 cents) per ordinary share as the final dividend for 2008 | – | 274,367 |
| Dividend of HK30 cents (equivalent to approximately RMB26 cents) per ordinary share as the final dividend for 2009 | 327,427 | – |
| | 327,427 | 274,367 |

Final dividend for the year 2010 of HK33 cents, equivalent to RMB28 cents, (2009: HK30 cents, equivalent to RMB26 cents) per ordinary share amounting to an aggregate of approximately RMB382,270,000 (2009: RMB327,427,000) has been proposed by the directors and is subject to approval by the shareholders in the forthcoming annual general meeting.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 14. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the owners of the Company is based on the following data:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| **Earnings** | | |
| Earnings for the purpose of basic earnings per share (Profit for the year attributable to owners of the Company) | **1,383,635** | 966,377 |
| Effect of dilutive potential ordinary shares: | | |
| Fair value changes on convertible bonds (note) | **(148,916)** | — |
| Earnings for the purpose of diluted earnings per share | **1,234,719** | 966,377 |

| | 2010<br>'000 | 2009<br>'000 |
|---|---|---|
| **Number of shares** | | |
| Weighted average number of ordinary shares for the purpose of basic earnings per share | **1,281,332** | 1,245,024 |
| Effect of dilutive potential ordinary shares: | | |
| Share option | **7,956** | 7,476 |
| Convertible bonds | **74,704** | — |
| Weighted average number of ordinary shares for the purpose of diluted earnings per share | **1,363,992** | 1,252,500 |

Note: In 2009, the computation of diluted earnings per share does not assume the conversion of the convertible bonds since their assumed exercise would result in an increase in earnings per share.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 15. PROPERTY, PLANT AND EQUIPMENT

| | Buildings | Plant and machinery | Fixture and equipment | Transportation equipment | Construction in progress | Leasehold improvements | Software | Total |
|---|---|---|---|---|---|---|---|---|
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| COST | | | | | | | | |
| At 1 January 2009 | 378,605 | 1,319,529 | 86,745 | 95,153 | 885,118 | 1,050 | 6,360 | 2,772,560 |
| Additions | – | 3,261 | 2,858 | 4,834 | 1,664,919 | – | 333 | 1,676,205 |
| On acquisition of a subsidiary | – | 1,152 | 311 | 542 | 29 | – | – | 2,034 |
| Transfer | 277,150 | 991,045 | 18,068 | 40,138 | (1,326,401) | – | – | – |
| Disposals | – | (3,144) | (188) | (1,048) | – | – | – | (4,380) |
| At 31 December 2009 | 655,755 | 2,311,843 | 107,794 | 139,619 | 1,223,665 | 1,050 | 6,693 | 4,446,419 |
| Additions | – | 17,013 | 4,898 | 11,119 | 1,216,632 | 39 | 351 | 1,250,052 |
| On acquisition of subsidiaries | 68,653 | 33,776 | 1,364 | 1,010 | 773 | – | 253 | 105,829 |
| Transfer | 350,932 | 904,097 | 25,679 | 61,842 | (1,342,623) | 73 | – | – |
| Disposals | – | (4,924) | (2,763) | (1,358) | – | – | – | (9,045) |
| At 31 December 2010 | 1,075,340 | 3,261,805 | 136,972 | 212,232 | 1,098,447 | 1,162 | 7,297 | 5,793,255 |
| DEPRECIATION | | | | | | | | |
| At 1 January 2009 | 37,514 | 295,322 | 34,387 | 37,528 | – | 970 | 4,899 | 410,620 |
| Provided for the year | 15,777 | 145,350 | 14,726 | 17,091 | – | 80 | 473 | 193,497 |
| Eliminated on disposals | – | (1,314) | (144) | (926) | – | – | – | (2,384) |
| At 31 December 2009 | 53,291 | 439,358 | 48,969 | 53,693 | – | 1,050 | 5,372 | 601,733 |
| Provided for the year | 27,225 | 251,071 | 17,836 | 32,272 | – | 112 | 660 | 329,176 |
| Eliminated on disposals | – | (3,571) | (2,614) | (1,233) | – | – | – | (7,418) |
| At 31 December 2010 | 80,516 | 686,858 | 64,191 | 84,732 | – | 1,162 | 6,032 | 923,491 |
| CARRYING VALUES | | | | | | | | |
| At 31 December 2010 | 994,824 | 2,574,947 | 72,781 | 127,500 | 1,098,447 | – | 1,265 | 4,869,764 |
| At 31 December 2009 | 602,464 | 1,872,485 | 58,825 | 85,926 | 1,223,665 | – | 1,321 | 3,844,686 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 15. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

The above items of property, plant and equipment other than construction in progress are depreciated on a straight line basis, after taking into account their estimated residual value, at the following rates per annum:

| | |
|---|---|
| Buildings | 2.8% - 6.5% |
| Plant and machinery | 9.7% - 19.4% |
| Fixture and equipment | 9.7% - 19.4% |
| Transportation equipment | 16.2% |
| Leasehold improvements | the shorter of the lease terms or 33.3% |
| Software | 20% |

## 16. PREPAID LEASE PAYMENTS

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Medium-term land use rights in the PRC | **407,858** | 276,610 |
| Analysed for reporting purpose as: | | |
| Current assets | **8,554** | 5,784 |
| Non-current assets | **399,304** | 270,826 |
| | **407,858** | 276,610 |

The amount represents land use rights for leasehold interest in land situated in the PRC with usage rights of 50 years.

Included in medium-term prepaid lease payments are land use rights with carrying amount of RMB233,660,000 (31 December 2009: RMB119,363,000) which are located in the PRC. The Group is in the process of obtaining the land use right certificates.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 17. GOODWILL

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| COST AND CARRYING VALUES | | |
| At 1 January | 12,091 | — |
| Arising on acquisition of subsidiaries | 5,624 | 12,091 |
| At 31 December | 17,715 | 12,091 |

For the purposes of impairment testing, the carrying values of goodwill have been allocated to three groups of cash generating units ("CGUs"), as follows:

| | Goodwill | |
|---|---|---|
| | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Manufacture and sales of propellers ("Unit A") | 12,091 | 12,091 |
| Engineering processing and manufacturing ("Unit B") | 2,991 | — |
| Manufacture and sales of diesel engines ("Unit C") | 2,633 | — |
| | 17,715 | 12,091 |

The recoverable amounts of the above CGUs been determined based on a value in use calculation. That calculation uses cash flow projections based on financial budgets approved by management covering a five-year period, and discount rate of 10.65%, 6.1% and 6.1% for Unit A, Unit B and Unit C, respectively. Other key assumptions for the value in use calculations relate to the estimation of cash inflows/outflows which include budgeted sales and gross margin, such estimation is based on these units' past performance and management's expectations for the market development. Management believes that any reasonably possible change in any of these assumptions would not cause the aggregate carrying amount of these CGUs to exceed the aggregate recoverable amount of the CGUs. As a result, the management determined that there are no impairment loss to be recognised.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 18. INTANGIBLE ASSETS

| | Development costs RMB'000 |
|---|---:|
| COST | |
| At 1 January 2009 | 90,648 |
| Additions | 70,493 |
| At 31 December 2009 | 161,141 |
| Additions | 129,021 |
| On acquisition of subsidiaries | 3,387 |
| At 31 December 2010 | 293,549 |
| AMORTISATION AND IMPAIRMENT | |
| At 1 January 2009 | 29,443 |
| Charge for the year | 22,677 |
| Impairment loss recognised for the year | 1,416 |
| At 31 December 2009 | 53,536 |
| Charge for the year | 40,230 |
| Impairment loss recognised for the year | 3,213 |
| At 31 December 2010 | 96,979 |
| CARRYING VALUES | |
| At 31 December 2010 | 196,570 |
| At 31 December 2009 | 107,605 |

The above intangible assets have finite useful lives, over which the assets are amortised. The amortisation period for development costs incurred for the Group's self-developed new products is 5 years. During the year ended 31 December 2010, an impairment loss of approximately RMB3,213,000 (2009: RMB1,416,000) was recognised due to termination of the development project.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 19. INTERESTS IN ASSOCIATES

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Cost of unlisted investments in associates | **57,695** | 24,000 |
| Share of post-acquisition results | **(951)** | (3,611) |
| | **56,744** | 20,389 |

Included in the cost of interests in associates is goodwill of RMB10,022,000 (2009: nil) arising on acquisitions of associates during the current year.

As at 31 December 2010 and 2009, the Group had interests in the following associates:

| Name of entity | Form of business structure | Place of establishment/ principal place of operation | Class of shares held | Proportion of nominal value of registered capital held by the Group | | Principal activity |
|---|---|---|---|---|---|---|
| | | | | 2010 | 2009 | |
| 南京高精船舶傳動系統有限公司<br>Nanjing High Accurate Marine Propulsion Co., Ltd. (Formerly known as 南京采埃孚船用傳動系統有限公司 ZF Nanjing Marine Propulsion Co., Ltd.) ("Nanjing Marine Propulsion") | Sino-foreign equity joint venture | The PRC | Registered | N/A (Note) | 40% | Manufacture and sales of gear transmission equipment |
| 南京朗勁風能設備製造有限公司<br>Nanjing Longwin Windpower Equipment Manufacturing Co., Ltd. ("Nanjing Longwin") | PRC equity joint-venture | The PRC | Registered | 40% | 40% | Manufacture and sales of wind power transmission equipment and fittings |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 19. INTERESTS IN ASSOCIATES *(Continued)*

| Name of entity | Form of business structure | Place of establishment/ principal place of operation | Class of shares held | Proportion of nominal value of registered capital held by the Group | | Principal activity |
|---|---|---|---|---|---|---|
| | | | | 2010 | 2009 | |
| 南京蘇陽光電薄膜有限公司<br>Nanjing Suyang Photoelectric Thin Film Co., Ltd. | PRC equity joint-venture | The PRC | Registered | 25% | – | Manufacture and sales photoelectric thin film |
| 江蘇博明物流有限公司<br>Jiangsu Boming Logistic Co., Ltd. ("Jiangsu Boming") | PRC equity joint-venture | The PRC | Registered | 20% | – | Logistic |
| 長源（南京）鑄造有限公司<br>Chang Yuan (Nanjing) Casting Co. Ltd. | PRC equity joint-venture | The PRC | Registered | 30% | – | Manufacture and sales metal casting |

Note: As detailed in note 36(ii), on 30 November 2010, the Group acquired additional 60% equity interest in Nanjing Marine Propulsion, which was a 40% associate of the Group as at 31 December 2009. Accordingly, Nanjing Marine Propulsion became a wholly owned subsidiary of the Company.

The summarised financial information in respect of the Group's associates is set out below:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Total assets | 301,883 | 131,562 |
| Total liabilities | (146,692) | (80,589) |
| Net assets | 155,191 | 50,973 |
| Group's share of net assets of associates | 46,752 | 20,389 |
| Revenue | 117,091 | 59,085 |
| (Loss) profit for the year | (876) | 4,760 |
| Group's share of results of associates for the year | 479 | 1,904 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 20. INTERESTS IN JOINTLY CONTROLLED ENTITIES

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Cost of unlisted investments in jointly controlled entities | 558,620 | 558,620 |
| Share of post-acquisition results | 65,542 | 24,547 |
| | 624,162 | 583,167 |

Included in the cost of investment in jointly controlled entities is goodwill of RMB17,920,000 arising on acquisition of a jointly controlled entity in prior years.

As at 31 December 2010 and 2009, the Group had interests in the following jointly controlled entities:

| Name of entity | Form of business structure | Place of establishment/ principal place of operation | Class of share held | Proportion of nominal value of registered capital held by the Group | Proportion of voting power held | Principal activity |
|---|---|---|---|---|---|---|
| 南京高精工程設備有限公司<br>Nanjing High Accurate Construction Equipment Co., Ltd. ("Nanjing Construction") | Sino-foreign equity joint venture | The PRC | Registered | 50% | 50% | Engineering processing and manufacturing |
| 江蘇省宏晟重工集團有限公司<br>Jiangsu Hongsheng Heavy Industries Group Co., Ltd. ("Jiangsu Hongsheng") | Sino-foreign equity joint venture | The PRC | Registered | 50.01% | 50.01% (note) | Manufacture and sales of forged steel and fittings |

Note: The Group holds 50.01% of the registered capital of Jiangsu Hongsheng and controls 50.01% of the voting power in general meeting. However, under the joint venture agreement, Jiangsu Hongsheng is jointly controlled by the Group and the other party because the financial and operating decisions relating to the activity of Jiangsu Hongsheng require the unanimous consent of the Group and the other party sharing the control. Therefore, Jiangsu Hongsheng is classified as a jointly controlled entity of the Group.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 20. INTERESTS IN JOINTLY CONTROLLED ENTITIES *(Continued)*

The summarised financial information in respect of the Group's interests in the jointly controlled entities attributable to the Group's interest therein which are accounted for using equity method is set out below:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Current assets | **564,704** | 378,529 |
| Non-current assets | **571,814** | 423,093 |
| Current liabilities | **436,241** | 190,408 |
| Non-current liabilities | **94,035** | 45,967 |
| Income recognised in profit or loss | **782,895** | 492,699 |
| Expense recognised in profit or loss | **741,900** | 479,044 |

## 21. AVAILABLE-FOR-SALE INVESTMENTS

The amount represents the investments in unlisted equity securities issued by private entities established in the PRC and are held by the Group as non-current assets. They are measured at cost less impairment at the end of the reporting period because the range of reasonable fair value estimates is so significant that the directors of the Company are of the opinion that their fair values cannot be measured reliably.

## 22. DEPOSIT FOR LAND LEASE AND PREPAYMENT FOR ACQUISITION OF PROPERTY, PLANT AND EQUIPMENT

Balance at 31 December 2009 represented deposit for land lease with total consideration of approximately RMB107 million which has been fully paid in relation to the acquisition of a land lease situated in the PRC and the transfer is subject to the approval of the PRC government. In 2010, RMB380 million has been paid during the current year for new land leases.

For prepayment for acquisition of property, plant and equipment, capital commitment of the remaining payment was disclosed in note 38.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 23. INVENTORIES

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Raw materials | 449,212 | 367,353 |
| Work in progress | 407,327 | 693,343 |
| Finished goods | 401,124 | 252,114 |
| | 1,257,663 | 1,312,810 |

### 24. TRADE AND OTHER RECEIVABLES

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Notes receivable | 1,273,633 | 424,940 |
| Accounts receivable | 1,953,787 | 1,516,501 |
| Bills receivable | 349,077 | 375,000 |
| Less: allowance for doubtful debts | (71,955) | (49,250) |
| Total trade receivables | 3,504,542 | 2,267,191 |
| Advances to suppliers | 223,301 | 255,299 |
| Value added tax recoverable | 51,088 | 13,653 |
| Others | 31,873 | 77,117 |
| Total trade and other receivables | 3,810,804 | 2,613,260 |

The Group generally allows a credit period of 90 days to 180 days to its trade customers. The following is an aged analysis of the trade receivables based on invoice date, net of allowance for doubtful debts, at the reporting date:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| 0 - 90 days | 2,304,890 | 1,657,578 |
| 91 - 120 days | 663,406 | 148,121 |
| 121 - 180 days | 290,714 | 94,501 |
| 181 - 365 days | 99,450 | 131,791 |
| Over 365 days | 146,082 | 235,200 |
| | 3,504,542 | 2,267,191 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 24. TRADE AND OTHER RECEIVABLES *(Continued)*

The trade receivable balances of RMB3,259,010,000 (2009: RMB1,900,200,000) are neither past due nor impaired at the end of the reporting period for which the Group has not provided for impairment loss since they are mainly the customers with good quality. No impairment loss was made on advance to suppliers since they are with good credit quality.

Included in the Group's trade receivable balances are debtors with aggregate carrying amount of RMB245,532,000 (2009: RMB366,991,000) which are past due at the end of the reporting period for which the Group has not provided for impairment loss, as there has not been a significant change in credit quality and the Group believes that the amounts are still recoverable as there are continuing subsequent settlement. The Group does not hold any collateral over these balances.

**Ageing of trade receivables which are past due but not impaired**

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| 181 - 365 days | **99,450** | 131,791 |
| Over 365 days | **146,082** | 235,200 |
| Total | **245,532** | 366,991 |

**Movement in the allowance for doubtful debts**

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Balance at beginning of the year | **49,250** | 33,775 |
| Impairment losses recognised on receivables | **22,854** | 15,475 |
| Amounts written off as uncollectible | **(149)** | — |
| Balance at end of the year | **71,955** | 49,250 |

Included in the allowance for doubtful debts are individually impaired trade receivables with an aggregate balance of RMB71,955,000 (2009: RMB49,250,000) which have either been placed under liquidation or in financial difficulties. The Group does not hold any collateral over these balances.

During the year, the Group discounted certain bills receivable to banks with recourse. The Group continues to recognise the full carrying amount of the receivables as the Group is still exposed to credit risk to these receivables. At 31 December 2010, the carrying amount of the bills discounted is RMB349,077,000 (2009: RMB375,000,000). The carrying amount of the associated liability which represented the cash received from discounted bills (see note 30) is RMB349,077,000 (2009: RMB375,000,000).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 25. AMOUNT(S) DUE FROM/TO ASSOCIATE(S)

As at 31 December 2009, amount related to trade balance with Nanjing Marine Propulsion and aged within 120 days. The amount was unsecured, interest-free and within the credit period of 180 days.

It has been accounted for upon the acquisition of Nanjing Marine Propulsion.

The amounts due to associates relate to trade balance with Nanjing Longwin and Jiangsu Boming and aged within 120 days. The amounts are unsecured, interest-free and repayable within 180 days.

## 26. AMOUNT DUE FROM/TO A JOINTLY CONTROLLED ENTITY

The amount due from a jointly controlled entity relates to trade balance with Jiangsu Hongsheng and aged within 120 days. The amount is unsecured, interest-free and within the credit period of 180 days.

The amount due to a jointly controlled entity relates to trade balance with Nanjing Construction and aged within 120 days. The amount is unsecured, interest-free and repayable within 180 days.

## 27. AMOUNT DUE TO A RELATED PARTY

The amount represents amount due to Nanjing Yuhuatai District Saihong Bridge Street Office 南京雨花台區賽虹橋街道區辦事處 ("Nanjing Yuhuatai"), a holding company of a non-controlling shareholder of a subsidiary. The balance is unsecured, non-interest bearing and repayable on demand.

## 28. BANK BALANCES AND CASH/PLEDGED BANK DEPOSITS

Bank balances carry interest at prevailing market deposit rates which range from 0.36% to 1% (2009: 1% to 3%) per annum. The pledged bank deposits carry fixed interest rate of 2.5% (2009: 3%) per annum.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 29. TRADE AND OTHER PAYABLES

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Accounts payable | **960,245** | 506,112 |
| Notes payable (Note) | **750,361** | 300,459 |
| Total trade payables | **1,710,606** | 806,571 |
| Advances from customers | **399,700** | 395,015 |
| Purchase of property, plant and equipment | **276,585** | 214,217 |
| Payroll and welfare payables | **81,388** | 69,754 |
| Accrued expenses | **9,570** | 9,400 |
| Value added tax payable | **62,449** | 38,460 |
| Others | **72,333** | 32,641 |
| | **2,612,631** | 1,566,058 |

Note: Notes payable are secured by the Group's bank deposits of RMB766,839,000 (2009: RMB451,389,000).

The following is an aged analysis of trade payables based on invoice date at the end of the reporting period:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| 0 - 30 days | **645,049** | 675,963 |
| 31- 60 days | **308,554** | 83,986 |
| 61 - 180 days | **721,167** | 29,449 |
| 181 - 365 days | **21,032** | 9,127 |
| Over 365 days | **14,804** | 8,046 |
| | **1,710,606** | 806,571 |

The credit period on purchases of goods is 30 - 120 days. The Group has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 30. BORROWINGS

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Bank loans | **2,902,624** | 2,193,314 |
| Bills discounted with recourse | **349,077** | 375,000 |
| | **3,251,701** | 2,568,314 |
| Secured | **361,651** | 439,203 |
| Unsecured | **2,890,050** | 2,129,111 |
| | **3,251,701** | 2,568,314 |
| Carrying amount repayable*: | | |
| On demand or within one year | **1,208,651** | 1,556,273 |
| More than one year, but not exceeding two years | **2,043,050** | 1,012,041 |
| | **3,251,701** | 2,568,314 |
| Less: Amounts due within one year shown under current liabilities | **(1,208,651)** | (1,556,273) |
| Amounts due over one year | **2,043,050** | 1,012,041 |

* The amounts due are based on scheduled repayment dates set out in the loan agreements.

The Group's borrowings include RMB865,624,000 (2009: RMB1,235,314,000) fixed-rate borrowings and RMB2,386,077,000 (2009: RMB1,333,000,000) variable-rate borrowings which carry interest rates based on the rate of People's Bank of China Prescribed Interest Rate.

The exposure of the Group's fixed-rate borrowings and the contractual maturity dates (or reset dates) are as follows:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Fixed-rate borrowings: | | |
| Within one year | **859,574** | 1,175,274 |
| In more than one year but not more than two years | **6,050** | 60,040 |
| | **865,624** | 1,235,314 |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 30. BORROWINGS *(Continued)*

The ranges of effective interest rates (which are also equal to contracted interest rates) on the Group's borrowings are as follows:

| | 2010<br>% | 2009<br>% |
|---|---|---|
| Fixed-rate borrowings | **3.51 - 7.97** | 3.51 - 7.97 |
| Variable-rate borrowings | **3.54 - 5.76** | 4.86 - 5.76 |

As at 31 December 2010, the Group's borrowings that are denominated in currencies other than RMB (the functional currency of relevant group entities) are USD1,133,000, which are equivalent to RMB7,659,000 (2009: HKD14,917,000, EUR5,204,000 and USD6,000,000, which are equivalent to RMB13,231,000, RMB50,972,000 and RMB40,991,000, respectively). All other bank borrowings are denominated in RMB.

As at 31 December 2010, the Group had loan facilities from banks of RMB11,333 million (2009: RMB8,334 million), of which RMB8,081 million (2009: RMB5,766 million) was not yet drawn down. Among the undrawn loan facilities at 31 December 2010, RMB6,996 million and RMB1,085 million will mature in 2011 and 2012, respectively.

The above secured bank borrowings at the end of the reporting period were secured by pledged bank deposits of RMB766,839,000 (2009: RMB451,389,000).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 31. DEFERRED TAX

The followings are the major deferred tax (assets) liabilities recognised by the Group and movements thereon during the year:

| | Doubtful debts allowance RMB'000 | Inventories allowance RMB'000 | Capitalisation of research and development RMB'000 | Revaluation on investment RMB'000 | Withholding tax RMB'000 | Deferred income RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|---|
| At 1 January 2009 | (3,524) | (2,380) | 10,782 | 460 | 12,695 | (1,280) | 16,753 |
| Charge (credit) to profit or loss | (3,150) | (2,891) | 8,074 | – | 17,200 | (13,870) | 5,363 |
| Credit to other comprehensive income | – | – | – | (460) | – | – | (460) |
| At 31 December 2009 | (6,674) | (5,271) | 18,856 | – | 29,895 | (15,150) | 21,656 |
| Charge (credit) to profit or loss | (5,635) | (4,964) | 18,415 | – | 19,000 | 964 | 27,780 |
| **At 31 December 2010** | **(12,309)** | **(10,235)** | **37,271** | **–** | **48,895** | **(14,186)** | **49,436** |

Note: The development costs were deductible for tax purpose in the year they were incurred while they were capitalised and subject to amortisation in the consolidated financial statements.

The following is the analysis of the deferred tax balances for financial reporting presentation purposes:

| | 2010 RMB'000 | 2009 RMB'000 |
|---|---|---|
| Deferred tax assets | (36,730) | (27,095) |
| Deferred tax liabilities | 86,166 | 48,751 |
| | 49,436 | 21,656 |

At 31 December 2010, the Group has unused tax losses of RMB3,566,000 (2009: RMB138,000) available for offset against future profits. No deferred tax asset has been recognised in respect of such losses due to the unpredictability of future profit streams. The unused tax losses that can be carried forward up to five years from the year in which the loss was originated to offset future taxable profits.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 31. DEFERRED TAX *(Continued)*

Under the EIT Law, starting from 1 January 2008, 10% withholding income tax is imposed on dividends relating to profits earned by the companies established in the PRC in the calendar year 2008 onwards to their foreign shareholders. For investors incorporated in Hong Kong which hold at least 25% of equity interest of those PRC companies, a preferential rate of 5% will be applied. Deferred tax has been provided for in respect of the temporary differences attributable to such profits. The Group has applied the preferential rate of 5% as all the Company's subsidiaries in the PRC are directly held by an investment holding company incorporated in Hong Kong.

### 32. CONVERTIBLE BONDS

On 14 May 2008, the Company issued RMB denominated USD settled zero coupon convertible bonds with an aggregate principal amount of RMB1,996.3 million. The convertible bonds are convertible at the option of bond holders into fully paid shares with a par value of US$0.01 each of the Company at a conversion price of HK$17.78 per share, which was subsequently adjusted to HK$17.2886 as a result of the payment of final dividend for 2007 and 2008 and further adjusted to HK$16.9817 as a result of payment of final dividend for 2009 as required according to the conditions of the convertible bonds with a fixed exchange rate of HK$1.00 to RMB0.8968 for conversion, but will be subject to adjustment for, among other things, subdivision or consolidation of shares, bonus issues, rights issues, distribution and other dilutive events. If the bonds have not been converted, they will be redeemed on 14 May 2011 at an amount equal to the USD equivalent of its principal amount in RMB multiplied by 109.3443%. The Company, however, has the option to mandatorily convert all or some only of the convertible bonds provided that: (i) the closing price of the shares, for 20 out of 30 consecutive trading days, was at least 120% of the early redemption amount in effect on such trading days divided by the conversion ratio; or (ii) at least 90% of the convertible bonds have been redeemed, purchased, converted or cancelled. Due to the existence of a cash settlement option in the event of conversion, whereby the Company can settle in cash in lieu of delivery of the relevant shares by paying cash to the bondholders, the convertible bonds are regarded as financial liabilities with embedded derivatives for the conversion and redemption options and the entire convertible bonds were designated as financial liabilities at FVTPL.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 32. CONVERTIBLE BONDS *(Continued)*

The movement of convertible bonds for 2009 and 2010 is set out below:

| | RMB'000 |
|---|---|
| As at 1 January 2009 | 931,550 |
| Conversion of convertible bonds | (983) |
| Loss on fair value changes on convertible bonds | 438,382 |
| As at 31 December 2009 | 1,368,949 |
| Conversion of convertible bonds | (100) |
| Gain on fair value changes on convertible bonds | (148,916) |
| As at 31 December 2010 | 1,219,933 |

During the year ended 31 December 2009, 64,497 ordinary shares of US$0.01 each of the Company were issued upon conversion of convertible bonds with an aggregate principal amount of RMB1,000,000 (equivalent to HK$1,115,076) at the conversion price of HK$17.2886 in August 2009.

During the year ended 31 December 2010, 6,566 ordinary shares of US$0.01 each of the Company were issued upon conversion of convertible bond with an aggregate principal amount of RMB100,000 (equivalent to HK$111,508) at the conversion price of HK$16.9817 in June 2010.

At 31 December 2010, the principal amount payable at maturity is RMB1,147,000,000 (2009: RMB1,147,100,000).

| | **31.12.2010**<br>**RMB'000** | 31.12.2009<br>RMB'000 |
|---|---|---|
| Difference between carrying amount and maturity amount | | |
| At fair value | **1,219,933** | 1,368,949 |
| Amount payable at maturity | **1,254,179** | 1,254,288 |
| | **(34,246)** | 114,661 |

The change in fair value attributable to change in credit risk is insignificant.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 32. CONVERTIBLE BONDS *(Continued)*

The fair value of the convertible bond instrument containing the debt component and the embedded derivatives is measured using effective interest method and Binomial Option Pricing Model respectively. The valuation of the fair values were carried out by Greater China Appraisal Limited, an independent asset appraisal firm of professional valuers.

The inputs into the Binomial Option Pricing Model at the respective valuation dates are as follows:

| | **31 December 2010** | 31 December 2009 |
|---|---|---|
| Share price | **HK$12.04** | HK$18.96 |
| Exercise price | **HK$16.9817** | HK$17.2886 |
| Risk-free rate of interest | **0.29%** | 0.39% |
| Dividend yield | **2.49%** | 1.32% |
| Time to expiration | **0.37 years** | 1.37 years |
| Volatility | **29.05%** | 81.94% |
| Borrowing rate of issuer | **7.88%** | 16.65% |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 33. DERIVATIVE FINANCIAL INSTRUMENT/RESTRICTED CASH

Concurrently with the issuance of the RMB denominated USD settled zero coupon convertible bonds as disclosed in note 32, the Company entered into a cash settled equity swap transaction (the "Equity Swap") with Morgan Stanley & Co. International plc (the "Equity Swap Counterparty") for 81.4 million shares of the Company up to a value of HK$1,113 million (equivalent to approximately RMB982 million). The Company is required to deposit the corresponding initial exchange amount of RMB982 million (equivalent to HK$1,113 million) with the Equity Swap Counterparty as restricted cash for the Equity Swap which carried no interest.

The Equity Swap will mature on 14 May 2011, at which time the Company will receive a payment from the Equity Swap Counterparty if the final price of the Company's share is higher than the initial price or will settle the payment to the Equity Swap Counterparty if the final price is lower than the initial price. The initial price is HK$13.6783 (equivalent to approximately RMB12.27) and the final price will be determined with reference to the volume weighted average price of the Company's share on the date of settlement. Besides, the Equity Swap will be settled on termination date subject to early termination option of either parties upon occurrence of certain early termination events.

During the year ended 31 December 2009, the Company has early terminated the Equity Swap in respect of 68,758,000 shares out of total 81,370,707 shares, equivalent to 84.5% of the Equity Swap.

The partial termination of the Equity Swap was settled at RMB50 million which was determined by reference to the difference between the market share price at the date of partial early termination and initial price.

The fair values of the derivative financial instrument outstanding at the end of the respective reporting periods are measured using Black-Scholes Option Pricing Model. The valuation of the fair value was carried out by Greater China Appraisal Limited, an independent asset appraisal firm of professional valuers.

The inputs into the Black-Scholes Option Pricing Model at the respective valuation dates are as follows:

| | **31 December 2010** | 31 December 2009 |
|---|---|---|
| Initial price | **HK$13.68** | HK$13.68 |
| Share price | **HK$12.04** | HK$18.96 |
| Risk-free rate of interest | **0.29%** | 0.39% |
| Dividend yield | **2.49%** | 1.32% |
| Time to expiration | **0.37 years** | 1.37 years |
| Volatility | **29.05%** | 81.94% |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 34. DEFERRED INCOME

The amount represented the conditional grants received from the PRC government for the Group's technology development and will be released to income over the useful lives of the development costs.

## 35. SHARE CAPITAL

| | Number of shares (in thousand) | Amount US$'000 | Equivalent to RMB'000 |
|---|---|---|---|
| **Ordinary shares of US$0.01 each** | | | |
| **Authorised:** | | | |
| At 1 January, 2009, 31 December 2009 and 2010 | 3,000,000 | 30,000 | 234,033 |
| **Issued and fully paid:** | | | |
| At 1 January 2009 | 1,245,000 | 12,450 | 94,629 |
| Conversion of convertible bonds | 64 | — | 4 |
| At 31 December 2009 | 1,245,064 | 12,450 | 94,633 |
| Conversion of convertible bonds (Note (a)) | 7 | — | 1 |
| Issue of shares on placement of shares (Note (b)) | 130,000 | 1,300 | 8,711 |
| At 31 December 2010 | 1,375,071 | 13,750 | 103,345 |

Notes:

(a) During the year ended 31 December 2010, 6,566 ordinary shares of the Company of US$0.01 each were issued upon conversion of convertible bonds with an aggregate principal amount of RMB100,000 (equivalent to HK$111,508) at the conversion price of HK$16.9817 in June 2010. The shares issued rank pari passu with the then existing shares in all respects.

(b) On 21 September 2010, 130,000,000 new ordinary shares of US$0.01 each were issued at HK$17.38 per share pursuant to a placing agreement dated 10 September 2010 entered into between the Company and a placing agent and a subscription agreement dated 10 September 2010 between the Company and Fortune Apex Limited. The net proceeds of approximately HK$2,223 million was used as general working capital of the Group.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 36. ACQUISITION OF SUBSIDIARIES

### For the year ended 31 December 2010

During the year ended 31 December 2010, the Group acquired certain subsidiaries as below:

(i) On 19 January 2010, the Group acquired 58% equity interest in Sky Electronic (as defined in note 2) at a cash consideration of RMB13,200,000. Sky Electronic is principally engaged in engineering processing and manufacturing and was acquired with the objective of further diversification.

(ii) On 30 November 2010, the Group acquired additional 60% issued share capital of a former 40% associate, Nanjing Marine Propulsion (as defined in note 19), at a cash consideration of RMB13,920,000. Nanjing Marine Propulsion is engaged in the manufacture and sales of gear transmission equipment. Nanjing Marine Propulsion was acquired so as to continue the expansion of the Group's gear transmission equipment operations.

(iii) On 2 December 2010, the Group injected RMB142,000,000 in Nantong (as defined in note 2) for 65.88% equity interest in Nantong. Nantong is engaged in the manufacture and sales of diesel engine. Nantong was acquired with the objective of further diversification.

The total acquisition-related costs amounting to RMB245,000 have been excluded from the costs of acquisitions and have been recognised as an expense in the year, within the "other expenses" line item in the consolidated statement of comprehensive income.

The above transactions were accounted for using the purchase method of accounting.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 36. ACQUISITION OF SUBSIDIARIES *(Continued)*

Assets acquired and liabilities recognised at the date of acquisition are as follows:

| | Sky Electronic RMB'000 | Nanjing Marine Propulsion RMB'000 | Nantong RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| Property, plant and equipment | 6,810 | 6,826 | 92,193 | 105,829 |
| Available-for-sale investments | 227 | — | 10,715 | 10,942 |
| Prepaid lease payments | — | — | 2,351 | 2,351 |
| Intangible assets | — | — | 3,387 | 3,387 |
| Inventories | 10,828 | 17,191 | 97,365 | 125,384 |
| Trade and other receivables | 16,260 | 675 | 62,977 | 79,912 |
| Bank balances and cash | 1,927 | 15,260 | 190,479 | 207,666 |
| Trade and other payables | (13,629) | (16,213) | (169,420) | (199,262) |
| Tax liabilities | (4,821) | — | — | (4,821) |
| Borrowings | — | — | (78,500) | (78,500) |
| | 17,602 | 23,739 | 211,547 | 252,888 |

The receivables acquired (which principally comprised trade receivables) with a fair value of RMB79,912,000 had gross contractual amounts of RMB82,074,000. The best estimate at acquisition date of the contractual cash flows not expected to be collected is RMB2,162,000.

*Non-controlling interests*

The non-controlling interests of 42% and 33.22% in Sky Electronic and Nantong respectively recognised at the acquisition date were measured at their proportionate share of the fair value of the corresponding net identifiable assets of Sky Electronic and Nantong at the acquisition date.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 36. ACQUISITION OF SUBSIDIARIES *(Continued)*

***Goodwill arising on acquisition***

| | Sky Electronic RMB'000 | Nanjing Marine Propulsion RMB'000 | Nantong RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| Consideration transferred | 13,200 | 13,920 | 142,000 | 169,120 |
| Plus: Non-controlling interests | 7,393 | — | 72,180 | 79,573 |
| Fair value of interests in associates previously held | — | 9,819 | — | 9,819 |
| Less: Net assets acquired | (17,602) | (23,739) | (211,547) | (252,888) |
| Goodwill arising on acquisition | 2,991 | — | 2,633 | 5,624 |

Goodwill arose on the acquisition of Sky Electronic and Nantong because the acquisition included the assemble workforce of Sky Electronic and Nantong and some potential contracts which are still under negotiation with prospective new customers as at acquisition date. These assets could not be separately recognised from goodwill because they are not capable of being separated from the Group and sold, transferred, licensed, rented or exchanged, either individually or together with any related contracts.

None of the goodwill on this acquisition is expected to be deductible for tax purposes.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 36. ACQUISITION OF SUBSIDIARIES *(Continued)*

***Net cash outflow (inflow) on acquisition of subsidiaries***

| | Sky Electronic RMB'000 | Nanjing Marine Propulsion RMB'000 | Nantong RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| Cash consideration paid | 13,200 | 13,920 | 142,000 | 169,120 |
| Less: cash and cash equivalent balances acquired | (1,927) | (15,260) | (190,479) | (207,666) |
| | 11,273 | (1,340) | (48,479) | (38,546) |

Included in the profit and revenue for the year are a loss of RMB5,280,000 and RMB64,652,000 respectively attributable to the additional business generated by the new subsidiaries acquired.

Had the acquisition been completed on 1 January 2010, total group revenue for the period would have been RMB7,674 million, and profit for the period would have been RMB1,398 million. The pro forma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2010, nor is it intended to be a projection of future results.

In determining the 'pro-forma' revenue and profit of the Group had Sky Electronic, Nanjing Marine Propulsion and Nantong been acquired at the beginning of the current year, the directors have calculated depreciation of plant and equipment acquired on the basis of the fair values arising in the initial accounting for the business combination rather than the carrying amounts recognised in the pre-acquisition financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 36. ACQUISITION OF SUBSIDIARIES *(Continued)*

**For the year ended 31 December 2009**

On 24 September 2009, the Group injected RMB50,000,000 into a company, Zhenjiang Tongzhou Propeller Co., Ltd. 鎮江同舟螺旋槳有限公司 ("Tongzhou") for 76.33% equity interest in Tongzhou. This acquisition has been accounted for using the purchase method. The amount of goodwill arising as a result of the acquisition was RMB12,091,000. Tongzhou is engaged in the business of manufacturing and sales of propellers and it was a supplier to the Group prior to the capital injection.

The directors consider that the carrying amount of the net assets acquired in the transaction is approximate to the fair value, and the goodwill arising, are as follows:

| | Acquiree's carrying amount before combination RMB'000 |
|---|---|
| Net assets acquired: | |
| Property, plant and equipment | 2,034 |
| Inventories | 8,528 |
| Trade and other receivables | 5,234 |
| Bank balances and cash | 51,019 |
| Trade and other payables | (15,146) |
| Tax liabilities | (4) |
| Borrowings | (2,000) |
| | 49,665 |
| Non-controlling interests | (11,756) |
| Goodwill | 12,091 |
| | 50,000 |
| Total consideration satisfied by: | |
| Cash | 50,000 |
| Net cash inflow arising on acquisition: | |
| Cash consideration paid | (50,000) |
| Bank balances and cash acquired | 51,019 |
| | 1,019 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 36. ACQUISITION OF SUBSIDIARIES *(Continued)*

Tongzhou contributed RMB1.6 million to the Group's profit for the period between the date of acquisition and 31 December 2009.

If the acquisition had been completed on 1 January 2009, total group revenue for the year would have been approximately RMB5.7 billion, and the profit for the year would have been RMB967.4 million. The pro forma information is for illustrative purposes only and is not necessarily an indication of revenue and profits of the Group that actually would have been achieved had the acquisition been completed on 1 January 2009, nor is it intended to be a projection of future results.

## 37. SHARE-BASED PAYMENT TRANSACTIONS

The Company's share option scheme (the Scheme), was adopted pursuant to a resolution passed on 8 June 2007 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 8 June 2017. Under the Scheme, the Board of Directors of the Company may grant options to:

(i) any full-time or part-time employees, executives or officers of the Company or any of its subsidiaries;

(ii) any directors (including non-executive directors and independent non-executive directors) of the Company or any of its subsidiaries;

(iii) any advisers, consultants, suppliers, customers and agents to the Company or any of its subsidiaries; and

(iv) such other persons who, in the sole opinion of the Board of Directors, will contribute or have contributed to the Group. The assessment criteria of which are:

- contribution to the development and performance of the Group;
- quality of work performed for the Group;
- initiative and commitment in performing his/her duties; and
- length of service or contribution to the Group

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 37. SHARE-BASED PAYMENT TRANSACTIONS *(Continued)*

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point of time, without prior approval from the Company's shareholders to refresh the said limit to not exceed 30% of the issued share capital of the Company from time to time. The number of shares issued and to be issued in respect of which options granted and may be granted to any individual in any one year is not permitted to exceed 1 % of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders. Options granted to substantial shareholders or independent non-executive directors or any of their associates in excess of 0.1% of the Company's share capital or with a value in excess of HK$ 5 million must be approved in advance by the Company's shareholders.

Option granted must be taken up within 12 months of the date of grant, upon payment of HK$1 per grant. Options may be exercised at any time after the date upon which the option is deemed to be granted and accepted and prior to the 10th anniversary of the date of grant. The exercise price is determined by the directors of the Company, and must be at least the higher of (i) the closing price of the Company's shares on the date of grant, (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

The following table discloses movements of the Company's share options held by employees during the year:

| Date of grant | Exercise price HK$ | Exercisable period | Outstanding at 1.1.2009 | Granted during the year | Outstanding and exercisable at 31.12.2009 and 31.12.2010 |
|---|---|---|---|---|---|
| 6 November 2008 | 5.6 | 6.11.2008 to 6.11.2013 | 12,000,000 | — | 12,000,000 |

The estimated fair value of the options on the date of grant is RMB30,030,000 and has been fully recognised in the employee benefit expenses in profit or loss for the year ended 31 December 2008.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 37. SHARE-BASED PAYMENT TRANSACTIONS *(Continued)*

The fair value was calculated using the Binomial Option pricing model. The inputs into the model were as follows:

| | 6 November 2008 |
|---|---|
| Closing share price at date of grant | HK$5.60 |
| Exercise price | HK$5.60 |
| Expected volatility | 57.99% |
| Expected life | 5 years |
| Risk-free rate | 1.79% |
| Expected dividend yield | 1.43% |
| Fair value per option | HK$2.5025 |

Expected volatility was determined by using the historical volatility of the Company's share price over the previous trading days which equivalent to the assumed life of the share option. The expected life used in the model has been estimated, based on management's best estimate for the effects of non transferability, exercise restrictions and behavioural considerations.

The Binomial Option pricing model has been used to estimate the fair value of the options. The variables and assumptions used in computing the fair value of the share options are based on the directors' best estimate. The value of an option varies with different variables of certain subjective assumptions.

## 38. CAPITAL COMMITMENTS

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Commitments contracted for but not provided in the consolidated financial statements in respect of: | | |
| – land leases | 10,000 | — |
| – property, plant and equipment | 499,021 | 666,806 |
| | 509,021 | 666,806 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 39. OPERATING LEASES

Minimum lease payments paid under operating leases during the year:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Leasehold land and office premises | 2,899 | 4,001 |

At the end of the reporting period, the Group had outstanding commitments payable under non-cancellable operating leases in respect of leasehold land and office premises which fall due as follows:

| | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|---|---|
| Within one year | 3,470 | 3,041 |
| In the second to fifth year inclusive | 8,282 | 12,165 |
| After five years | 492 | 42,292 |
| | 12,244 | 57,498 |

Operating lease payments represent rentals payable by the Group for leasehold land and office premises. The leasehold land is negotiated for a fixed term of 10 years. The leases of the office premises are negotiated for an average term of 2 years. Rentals are fixed over the lease terms.

## 40. RETIREMENT BENEFIT PLANS

The employees of the Group are members of a state-managed retirement pension scheme operated by the local government. The Group is required to contribute a specified percentage of their payroll costs to the retirement pension scheme to fund the benefits. The only obligation of the Group with respect to the retirement pension scheme is to make the specified contributions. The costs charged to profit or loss during the year were RMB92,706,000 (2009: RMB57,121,000). All the contributions had been paid over to the scheme as at the end of the reporting period.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 41. RELATED PARTY DISCLOSURES

### (I) Related party transactions

During the year, the Group entered into the following transactions with related parties:

| Name of company | Relationship | Nature of transactions | 2010 RMB'000 | 2009 RMB'000 |
|---|---|---|---|---|
| Nanjing Longwin | Associate | Purchase of goods | **79,784** | 18,200 |
| Nanjing Marine Propulsion (Note) | Associate | Sales of goods | **11,167** | 31,135 |
| | | Rental income | **–** | 1,218 |
| | | Other income | **–** | 175 |
| Nanjing Yuhuatai | Holding company of non-controlling shareholder of a subsidiary | Rental expenses | **–** | 1,431 |
| Jiangsu Hongsheng | Jointly controlled entity | Sales of goods | **44,664** | 54,628 |
| | | Purchase of goods | **34,649** | 41,414 |
| Nanjing Construction | Jointly controlled entity | Sales of goods | **100,206** | 11,237 |
| | | Purchase of goods | **13,658** | 6,351 |
| | | Rental income | **–** | 180 |
| | | Other income | **–** | 39 |

Note: As detailed in note 19, Nanjing Marine Propulsion, a former associate, became a subsidiary of the Company on 30 November 2010. The amount represents the transactions between the Group and Nanjing Marine Propulsion prior to 30 November 2010.

### (II) Related party balance

Details of the Group's outstanding balances with related parties are set out on the consolidated statement of financial position and in notes 25, 26 and 27.

### (III) Compensation of key management personnel

Other than the emolument paid to the directors of the Company, who are also considered as the key management of the Group as set out in note 12, the Group did not have any other significant compensation to key management personnel.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 42. FINANCIAL INFORMATION OF THE COMPANY

| | Note | 2010 RMB'000 | 2009 RMB'000 |
|---|---|---|---|
| **Assets** | | | |
| Investments in subsidiaries | | 2 | 2 |
| Fixture and equipment | | 173 | 239 |
| Derivative financial instrument | | 18,392 | 55,991 |
| Other receivables | | 391 | 391 |
| Amounts due from subsidiaries | | 4,866,171 | 3,582,155 |
| Restricted cash | | 146,798 | 151,904 |
| Bank balances and cash | | 161,407 | 2,091 |
| | | 5,193,334 | 3,792,773 |
| **Liabilities** | | | |
| Other payables | | 3,275 | 2,847 |
| Amounts due to subsidiaries | | 1,312 | 1,222 |
| Financial liabilities designated as at fair value through profit or loss | | | |
| – convertible bonds | | 1,219,933 | 1,368,949 |
| | | 1,224,520 | 1,373,018 |
| | | 3,968,814 | 2,419,755 |
| **Capital and reserves** | | | |
| Share capital | | 103,345 | 94,633 |
| Reserves | (i) | 3,865,469 | 2,325,122 |
| | | 3,968,814 | 2,419,755 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 42. FINANCIAL INFORMATION OF THE COMPANY *(Continued)*

Note:

(i) Reserves

| | Share premium RMB'000 | Deemed capital contribution reserve RMB'000 | Retained profits (accumulated losses) RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| At 1 January 2009 | 2,372,884 | 77,651 | 291,815 | 2,742,350 |
| Loss for the year | — | — | (143,840) | (143,840) |
| Dividend paid | — | — | (274,367) | (274,367) |
| Conversion of convertible bonds | 979 | — | — | 979 |
| At 31 December 2009 | 2,373,863 | 77,651 | (126,392) | 2,325,122 |
| Loss for the year | — | — | (39,454) | (39,454) |
| Dividend paid | — | — | (327,427) | (327,427) |
| Conversion of convertible bonds | 99 | — | — | 99 |
| Issue on shares on placement of shares | 1,907,129 | — | — | 1,907,129 |
| At 31 December 2010 | 4,281,091 | 77,651 | (493,273) | 3,865,469 |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 43. PARTICULARS OF SUBSIDIARIES OF THE COMPANY

Details of the Company's subsidiaries at 31 December 2010 and 2009 are as follows:

| Name of subsidiary | Place and date of incorporation/ establishment/ operation | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company | | | | Principal activities |
|---|---|---|---|---|---|---|---|
| | | | Direct | | Indirect | | |
| | | | 2010 % | 2009 % | 2010 % | 2009 % | |
| Nanjing High Accurate (3) 南京高精齒輪集團有限公司 | PRC 16 August 2001 | RMB553,500,000 | – | – | 100 | 100 | Manufacture and sales of gear, gear box and fittings |
| Nanjing High Speed (2) 南京高速齒輪製造有限公司 | PRC 8 July 2003 | RMB90,000,000 | – | – | 100 | 100 | Manufacture and sales of gear, gear box and fittings |
| Nanjing Ningkai Mechanical Co., Ltd. ("Ningkai") (2) 南京寧凱機械有限公司 | PRC 19 November 2002 | RMB41,077,000 | – | – | 85.83 | 85.83 | Engineering processing and manufacturing |
| Nanjing Gaote (3) 南京高特齒輪箱製造有限公司 | PRC 26 November 2003 | US$42,393,264 | – | – | 100 | 100 | Sales of gear, gear box and fittings |
| Nanjing Dongalloy (2) 南京寧嘉機電有限公司 | PRC 26 September 1994 | RMB5,317,125 | – | – | 100 | 100 | Sales of gear and fittings |
| Yongte (2) 南京永特齒輪箱製造有限公司 | PRC 30 July 1990 | RMB70,000,000 | – | – | 100 | 100 | Manufacture of gear, gear box and fittings |
| Nanjing Ningtai Property Management Co., Ltd. (2) 南京寧泰物業管理有限公司 | PRC 25 August 2003 | RMB300,000 | – | – | 100 | 87.24 | Property management |
| Nanjing Marine (2) 南京高精船用設備有限公司 | PRC 2 February 2007 | RMB96,000,000 | – | – | 100 | 100 | Inactive |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

### 43. PARTICULARS OF SUBSIDIARIES OF THE COMPANY *(Continued)*

| Name of subsidiary | Place and date of incorporation/ establishment/ operation | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company | | | | Principal activities |
|---|---|---|---|---|---|---|---|
| | | | Direct | | Indirect | | |
| | | | 2010 % | 2009 % | 2010 % | 2009 % | |
| Nanjing High Accurate Heavy Duty Gear Manufacturing Co., Ltd. (2) 南京高精重載齒輪製造有限公司 | PRC 30 April 2008 | RMB40,300,000 | – | – | 100 | 100 | Manufacture and sales of shipping drive equipment |
| Nanjing Ninghongjian Mechanical Co., Ltd. (2) 南京寧宏建機械有限公司 | PRC 15 March 2007 | RMB20,000,000 | – | – | 100 | 100 | Engineering processing and manufacturing |
| Nanjing High Accurate Drive Equipment Manufacturing Group Co., Ltd. (1) 南京高精傳動設備製造集團有限公司 | PRC 27 March 2007 | USD237,500,000 | – | – | 100 | 100 | Manufacture and sales of gear box and fittings |
| Nanjing Zhongchuan Shipping Drive Equipment Co., Ltd. (3) 南京中傳船舶設備有限公司 | PRC 10 June 2008 | RMB33,300,000 | – | – | 100 | 100 | Manufacture and sales of shipping drive equipment |
| CHSTE (Beijing) Shougao Metallurgical Engineering & Equipment Co., Ltd. ("Shougao") (2) 北京中傳首高冶金成套設備有限公司 | PRC 25 April 2008 | RMB30,000,000 | – | – | 51 | 51 | Metallurgical engineering and manufacturing |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 43. PARTICULARS OF SUBSIDIARIES OF THE COMPANY *(Continued)*

| Name of subsidiary | Place and date of incorporation/ establishment/ operation | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company Direct 2010 % | Direct 2009 % | Indirect 2010 % | Indirect 2009 % | Principal activities |
|---|---|---|---|---|---|---|---|
| Nanjing Gaochuan Electrical & Mechanical Autocontrol Equipment Co., Ltd. (2) 南京高傳機電自動控制設備有限公司 | PRC 22 October 2009 | RMB260,000,000 | – | – | 100 | 100 | Manufacture and sales of gear box and fittings |
| Nanjing Nanchuan Laser Equipment Co., Ltd. (2)(4) 南京南傳激光設備有限公司 | PRC 9 October 2010 | RMB30,000,000 | – | N/A | 77 | N/A | Manufacture and sales of laser equipment |
| Nanjing Marine Propulsion(1) 南京高精船舶傳動系統有限公司 | PRC 5 July 2006 | RMB30,000,000 | – | N/A | 100 | 40 | Manufacture and sales of gear transmission equipment |
| Nantong(2) 南通柴油機股份有限公司 | PRC 22 November 1958 | RMB205,192,350 | – | N/A | 66.78 | N/A | Manufacture and sales of diesel engines |
| Sky Electronic(3) 南京四開電子企業有限公司 | PRC 27 February 1993 | RMB5,780,680 | – | N/A | 82 | N/A | Engineering processing and manufacturing |
| Tongzhou(2) 鎮江同舟螺旋槳有限公司 | PRC 24 November 2005 | RMB50,000,000 | – | – | 76.33 | 76.33 | Manufacture and sales of propellers |
| Zhong-Chuan Heavy Duty Machine Tool Corporation Limited(1)(4) 中傳重型機床有限公司 | PRC 15 November 2010 | USD35,802,000 | – | N/A | 100 | N/A | Manufacture and sales of heavy duty machine tools |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the year ended 31 December 2010*

## 43. PARTICULARS OF SUBSIDIARIES OF THE COMPANY *(Continued)*

| Name of subsidiary | Place and date of incorporation/ establishment/ operation | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company | | | | Principal activities |
|---|---|---|---|---|---|---|---|
| | | | Direct | | Indirect | | |
| | | | 2010 % | 2009 % | 2010 % | 2009 % | |
| Goodgain Group Limited | British Virgin Islands ("BVI") 22 March 2005 | USD100 | 100 | 100 | – | – | Investment holding |
| Eagle Nice Holdings Limited | BVI 22 March 2005 | USD100 | 100 | 100 | – | – | Inactive |
| China Transmission Holdings Limited 中傳控股有限公司 | Hong Kong 7 November 2007 | HK$100 | – | – | 100 | 100 | Investment holding |
| Century Well Holdings Limited 英威集團有限公司 | Hong Kong 9 January 2008 | HK$100 | – | – | 100 | 100 | Inactive |
| NGC Transmission Equipment (America) Inc. | USA 7 August 2008 | USD1,500,000 | – | – | 100 | 100 | Sales of gear and fittings |

Note:

(1) wholly-foreign owned enterprise established in the PRC

(2) domestic enterprise established in the PRC

(3) sino-foreign owned enterprise established in the PRC

(4) these subsidiaries were established/incorporated during the year

None of the subsidiaries had any debt securities outstanding at the end of the year or at any time during the year.

# FINANCIAL SUMMARY

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | 2006<br>RMB'000 | 2007<br>RMB'000 | 2008<br>RMB'000 | 2009<br>RMB'000 | **2010**<br>**RMB'000** |
| RESULTS | | | | | |
| Revenue | 1,184,307 | 1,904,816 | 3,439,220 | 5,647,045 | **7,392,649** |
| Profit for the year | 90,228 | 306,444 | 692,652 | 965,778 | **1,393,458** |

| | As at 31 December | | | | |
|---|---|---|---|---|---|
| | 2006<br>RMB'000 | 2007<br>RMB'000 | 2008<br>RMB'000 | 2009<br>RMB'000 | **2010**<br>**RMB'000** |
| ASSETS AND LIABILITIES | | | | | |
| Total assets | 2,222,583 | 4,785,580 | 8,477,856 | 10,234,919 | **14,931,515** |
| Total liabilities | (1,691,355) | (1,677,713) | (4,743,211) | (5,784,567) | **(7,417,174)** |
| | 531,228 | 3,107,867 | 3,734,645 | 4,450,352 | **7,514,341** |
| Attributable to: | | | | | |
| Equity owners of the Company | 526,999 | 3,104,545 | 3,731,086 | 4,420,937 | **7,392,730** |
| Non-controlling interests | 4,229 | 3,322 | 3,559 | 29,415 | **121,611** |
| | 531,228 | 3,107,867 | 3,734,645 | 4,450,352 | **7,514,341** |

Note: The financial information for each of the years ended 31 December 2006 has been prepared upon the reorganisation as if the group structure, at the time when the Company's shares were listed on the Stock Exchange, had been in existence throughout the years concerned. The results for the years ended 31 December 2006, and the assets and liabilities as at 31 December 2006 have been extracted from the Company's prospectus dated 20 June 2007.