沈機集團昆明機床股份有限公司

SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED

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

Annual Report 2010

CONTENT

IMPORTANT NOTICE

1. The Board of Directors, Supervisory Committee, Directors, Supervisors and Senior Management Officers of the Company have declared that the information in this report does not contain any false information, misleading statements or material omissions. The Board of Directors of the Company also jointly and severally accepts full responsibility for the truthfulness, accuracy and completeness of the content of the report.

2. All Directors of the Company attended the board meeting.

3. Zonzun Accounting Office Limited and KPMG have issued unqualified opinions in their auditor's reports respectively.

4.

Name of chairman of the Company	Gao Minghui
Name of chief financial officer of the Company	Pi Jianguo
Name of head of accounting department (accounting supervisor)	Zhao Qiongfen

   Mr. Gao Minghui, Chairman, Mr. Pi Jianguo, Chief Financial Officer, and Ms. Zhao Qiongfen, head of accounting department (Accounting Supervisor), have declared that they assured for the truthfulness and completeness of the financial statements in the Annual Report.

5. Any appropriation of non-operating fund by the controlling shareholder and its related parties?
   No

6. Any external guarantee provided not in compliance with the required decision-making procedures?
   No

OVERVIEW OF THE COMPANY

1. COMPANY INFORMATION

Name of the Company (Chinese)	沈機集團昆明機床股份有限公司
Abbreviated Name of the Company (Chinese)	昆明機床
Name of the Company (English)	SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED
Abbreviated Name of the Company (English)	kmtcl
Legal Representative	Mr. Gao Minghui

2. CONTACT PERSON AND CONTACT INFORMATION

	Secretary to the Board	Securities Affairs Representative
Name	Mr. Luo Tao	Ms. Wang Bihui
Correspondence address	23 Ciba Road, Kunming City, Yunnan Province, the PRC	23 Ciba Road, Kunming City, Yunnan Province, the PRC
Telephone number	86-871-6166612	86-871-6166623
Facsimile number	86-871-6166288	86-871-6166288
E-mail	luotao@kmtcl.com.cn	wangbh@kmtcl.com.cn

3. BASIC INFORMATION

Registered address	23 Ciba Road, Kunming City, Yunnan Province, the PRC
Post code of registered address	650203
Business address	23 Ciba Road, Kunming City, Yunnan Province
Post code of business address	650203
Website	www.kmtcl.com.cn
E-mail	dsh@kmtcl.com.cn

4. PLACE OF INFORMATION DISCLOSURE AND DOCUMENT INSPECTION

Designated newspapers for publishing	China Securities Daily, Shanghai Securities News and Securities Times
Designated internet websites by CSRC for publishing annual report	http://www.sse.com.cn, http://kmtcl.com.cn and http://www.hkex.com.hk
Annual report available at	Office Building, 23 Ciba Road, Kunming City, Yunnan Province, the PRC

OVERVIEW OF THE COMPANY

5. SHARE LISTING

Class of Shares	Stock Exchange	Short Name	Stock Code	Short name before the change
		Particulars of the Company's Shares		
A Shares	Shanghai Stock Exchange	Kunming Machine	600806	
H Shares	The Stock Exchange of Hong Kong Limited	Kunming Machine	0300	

6. OTHER RELEVANT INFORMATION

Date of incorporation	19th October 1993
Place of registration	Yunnan Commercial and Industrial Administration Bureau
Date of First Change of Registration	29th March 2002
Place of First Change of Registration	Yunnan Commercial and Industrial Administrative Bureau
Business Registration Number	530000400000458
Tax Registration Number	530111622602196
Organization Code	62260219-6
Date of Second Change of Registration	1st December 2007
Date of Third Change of Registration	11th October 2010
Appointed auditor in the PRC	Zonzun Accounting Office Limited
Address	4/F, Guoxing Building, 22 Capital Road South, Haiding District, Beijing, the PRC
Appointed auditor outside the PRC	KPMG (Hong Kong CPA)
Address	8/F, Prince's Building, 10 Chater Road, Central, Hong Kong

FINANCIAL AND OPERATING HIGHLIGHTS

I. PRINCIPAL ACCOUNTING DATA

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

Unit: RMB

Item	Amount
Operating profit	188,947,210.69
Profit for the year	200,860,445.41
Net profit attributable to the equity shareholders of the Company	178,324,801.52
Net profit excluding non-recurring items attributable to the equity shareholders of the Company	167,747,132.71
Net cash flow from operating activities	129,272,783.34

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

Unit: RMB'000

Item	Amount
Profit from operations	195,385
Profit and total comprehensive income for the year	173,508
Profit and total comprehensive income for the year attributable to equity shareholders of the Company	178,370

II. DIFFERENCE BETWEEN THE PRC GAAP AND HONG KONG GAAP

Unit: RMB'000

Item	Net Profit	Net Assets
Consolidated results in accordance with the PRC GAAP	178,325	1,374,125
Add: Gain on investment in jointly controlled entity(ies)	–	(8,869)
Amortisation of goodwill	–	(1,428)
Adjustment on deferred gain	49	–
Others	(4)	185
Consolidated results in accordance with Hong Kong GAAP	178,370	1,364,013

III. NON-RECURRING ITEMS AND AMOUNTS EXCLUDED

Unit: RMB

Non-recurring item	Amount
Gain on disposal of non-current assets	666,520.12
Government grants included in current gains and losses (other than those closely related to the normal operating activities of the Company and those subject to a standard fixed amount or an ongoing lum sum amount in accordance with the government's policies)	6,700,335.00
Gain or loss from debt restructuring	2,568,942.39
Other non-operating income and expenses other than the above	1,977,437.21
Effect of income tax	(1,335,565.91)
Total	10,577,668.81

FINANCIAL AND OPERATING HIGHLIGHTS

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

1. In accordance with the PRC GAAP

Principal accounting data	2010	2009	Increase/ Decrease (%)	2008
Revenue	**1,597,705,267.19**	1,372,196,639.36	16.43	1,563,105,398.47
Profit for the year	**200,860,445.41**	247,973,519.88	(19.00)	318,923,343.07
Net profit attributable to equity shareholders of the Company	**178,324,801.52**	215,847,994.25	(17.38)	276,564,904.31
Net profit excluding non-recurring items attributable to equity shareholders of the Company	**167,747,132.71**	193,475,241.55	(13.30)	250,747,388.75
Net cash flow from operating activities	**129,272,783.34**	105,749,466.18	22.24	120,047,854.09

	As at 31st December 2010	As at 31st December 2009	Increase/ Decrease (%)	As at 31st December 2008
Total assets	**2,247,730,361.63**	2,024,433,625.56	11.03	1,911,770,243.50
Owners' interest attributable to the parent company (or shareholders' equity)	**1,374,125,279.42**	1,217,014,036.12	12.92	1,041,230,512.25

Principal accounting data	2010	2009	Increase/ Decrease (%)	2008
Basic earnings per share	**0.34**	0.41	(17.38)	0.52
Diluted earnings per share	**0.34**	0.41	(17.38)	0.52
Basic earnings per share excluding non-recurring items	**0.32**	0.36	13.30	0.36
Return on net assets (weighted average) (%)	**13.75**	19.06	Decreased by 5.31 percentage points	27.18
Return on net assets based on net profit excluding non-recurring items (weighted average) (%)	**12.98**	19.25	Decreased by 6.27 percentage points	24.64
Net cash flow per share from operating activities	**0.24**	0.20	22.24	0.23

	As at 31st December 2010	As at 31st December 2009	Increase/ Decrease (%)	As at 31st December 2008
Net assets per share attributable to equity shareholders of the Company	**2.59**	2.29	12.92	1.96

2. In accordance with the Hong Kong GAAP

	2010	2009	Increase/ Decrease (%)	2008	2007	2006
Revenue ('000)	**1,588,301**	1,366,877	16.20	1,544,932	1,259,867	818,085
Profit for the year attributable to equity shareholders of the Company ('000)	**178,370**	215,710	(17.31)	276,565	241,452	102,529
Total assets ('000)	**2,241,302**	2,011,470	11.43	1,909,520	1,764,718	1,256,360
Total liabilities ('000)	**820,246**	742,709	10.44	813,684	821,368	557,262
Shareholders' equity ('000)	**1,364,013**	1,206,856	13.02	1,031,210	869,359	627,907
Earnings per share	**0.336**	0.406	(17.24)	0.521	0.455	0.193
Net assets per share	**2.57**	2.27	13.22	1.94	1.64	1.18
Return on net assets (%)	**13.08**	17.87	(4.79)	26.82	27.77	16.33
Net cash flow per share from operating activities	**0.21**	0.23	(8.70)	0.21	0.54	0.12

FINANCIAL AND OPERATING HIGHLIGHTS

V. RETURN ON NET ASSETS AND EARNINGS PER SHARE DISCLOSED ACCORDING TO DISCLOSURE REQUIREMENT SET OUT IN ISSUE NO. 9 OF "THE CONTENT AND FORMAT OF DISCLOSURE INFORMATION BY LISTED COMPANIES" ISSUED BY CSRC

	Return on net assets (%)		**Earnings per share** (RMB)	
Profit for the reporting period	**Fully diluted**	**Weighted average**	**Basic earnings per share**	**Diluted earnings per share**
Net profit attributable to equity shareholders of the Company	12.98	13.75	0.34	0.34
Net profit excluding non-recurring items attributable to equity shareholders of the Company	12.21	12.98	0.32	0.32

VI. MOVEMENT IN SHAREHOLDERS' EQUITY AND REASONS FOR THE CHANGE DURING THE REPORTING PERIOD

1. In accordance with the PRC GAAP

Unit: RMB'000

Item	**Share Capital**	**Capital Reserve**	**Surplus Reserve**	**Undistributed Profit**	**Total shareholders' equity**
Opening balance	424,864.88	133,519.54	90,251.00	568,378.61	1,278,773.48
Increase for the year	106,216.22	–	18,773.82	178,324.80	173,463.32
Decrease for the year	–	106,216.22	–	39,987.38	21,213.56
Closing balance	531,081.10	27,303,32	109,024.82	706,716.03	1,431,023.24

2. In accordance with the Hong Kong GAAP

Unit: RMB'000

Item	**Share Capital**	**Share premium**	**Capital reserve**	**Statutory surplus reserve**	**Undistributed profit**	**Total shareholders' equity**
Opening balance	424,865	113,887	10,225	91,287	566,592	1,206,856
Share issuance	106,216	(106,216)	–	–	–	–
Profit for the year	–	–	–	–	178,370	178,370
Withdrawal of surplus fund	–	–	–	18,774	(18,774)	–
Distribution of dividends for prior years	–	–	–	–	(21,213)	(21,213)
Closing balance	531,081	7,671	10,225	110,061	704,975	1,364,013

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

I. CHANGES IN SHARE CAPITAL

1. Table of changes in share capital of the Company

Unit: Share

	Beginning of the year		Increase/Decrease during the year (+/-)				End of the year	
	Number of shares	Proportion (%)	Issue of new shares/ bonus shares	Transfer from capital reserve	Others	Sub-total	Number of shares	Proportion (%)
A. Shares subject to selling restrictions								
1. State-owned shares	–	–	–	–	–	–	–	–
2. State-owned legal person shares	153,596,550	36.15	–	38,399,137	–	38,399,137	191,995,687	36.15
3. Other domestic shares	–	–	–	–	–	–	–	–
Including:								
Shares owned by domestic non-state-owned legal person	–	–	–	–	–	–	–	–
Shares owned by domestic nature person	–	–	–	–	–	–	–	–
4. Foreign owned shares								
Including:								
Shares owned by foreign legal person	–	–	–	–	–	–	–	–
Shares owned by foreign nature person	–	–	–	–	–	–	–	–
Total shares subject to selling restrictions	153,596,550	36.15	–	38,399,137	–	38,399,137	191,995,687	36.15
B. Circulating shares not subject to selling restrictions								
1. RMB ordinary shares	158,552,483	37.32	–	39,638,121	–	39,638,121	198,190,604	37.32
2. Domestic listed foreign shares	–	–	–	–	–	–	–	–
3. Overseas listed foreign shares	112,715,850	26.53	–	28,178,962	–	28,178,962	140,894,812	26.53
4. Others	–	–	–	–	–	–	–	–
Total circulating shares not subject to selling restrictions	271,268,333	63.85	–	67,817,083	–	67,817,083	339,085,416	63.85
C. Total number of shares	424,864,883	100	–	106,216,220	–	106,216,220	531,081,103	100

Approval for Change in Share Capital: The Company's proposed plan of bonus issue by capitalization of the capital reserve for 2009 was considered at the 15th meeting of the 6th session of the Board held on 24th March 2010 and approved at the 2009 Annual General Shareholders' Meeting held on 23rd June 2010. On 2nd July 2010, the Company received the Letter of Approval from the Department of Commerce of Yunnan Province Concerning its Consent to the Bonus Issue by Capitalization of the Capital Reserve by Shenji Group Kunming Machine Tool Company Limited (Yun Nan Sheng Shang Wu Ting Yun Shang Zi [2010] No. 130, under which it is consented that the total share capital of the Company increases from 424,864,883 shares to 531,081,103 shares. Effective from 15th July 2010 for A-shares and 2nd August 2010 for H-shares, the Company's total share capital has been enlarged to 531,081,103 shares, of which the Shenyang Machine Tool (Group) Co., Ltd. holds 133,222,774 shares, or 25.08% of the total, Yunnan Industrial Investment Holding Group Co. Ltd. holds 58,772,913 shares, or 11.07% of the total, A-share public shareholders hold 198,190,604 shares, or 37.32% of the total, and H-share public shareholders holds 140,894,812, or 26.53% of the total.

Zonzun Accounting Office Limited has produced a capital verification report (Zonzun [2010] No. 2001) for the change in share capital.

Please refer to the financial and operating highlights for the effect of changes in share capital on the financial data including earnings per share and net assets per share for the fiscal year and accounting period.

2. Changes in selling restricted shares

Unit: Share

Name of shareholders	Number of selling restricted shares at the beginning of the year	Number of selling restricted shares released for the year	Increase in the number of selling restricted shares	Number of selling restricted shares at the end of the year	Reasons for selling restrictions	Date of release of selling restrictions
Shenyang Machine Tool (Group) Co., Ltd.	106,578,219	133,222,774	26,644,555	–	Committed to hold as stated in the agreement	31st December 2010
Yunnan Industrial Investment Holding Group Co. Ltd.	47,018,331	58,772,913	11,754,582	–	Committed to hold as stated in the agreement	31st December 2010
Total	153,596,550	191,995,687	38,399,137	–		

Notes:

1) Shenyang Machine Tool (Group) Co., Ltd., a shareholder of the Company was interested in 106,578,219 shares of the Company before the change in capital share and 133,222,774 shares of the Company after the change in capital share, with no change in the proportion. The above shares held by such company were released from trading restrictions as of 1st January 2011.

2) Yunnan Industrial Investment Holding Group Co. Ltd., a shareholder of the Company was interested in 47,018,331 shares of the Company before the change in capital share and 58,772,913 shares of the Company after the change in capital share, with no change in the proportion. The above shares held by such company were released from trading restrictions as of 1st January 2011.

II. ISSUANCE AND LISTING OF SECURITIES

1. Issuance of securities in the past three years

As at the end of this reporting period, no securities were issued and listed by the Company in the past three years.

2. Changes in total share capital and share structure

Please refer to the changes in share capital and relevant details.

3. Information of existing employee shares

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

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

III. SHAREHOLDERS AND BENEFICIAL CONTROLLERS

1. Number of shareholders and shares held by them

Unit: Share

Total number of shareholders as at the end of the reporting period	44,902 (including 44,781 holders of A shares and 121 holders of H shares)

Shares held by the top ten shareholders

Name of shareholders	Nature of shareholders	Proportion (%)	Total number of shares held	Increase/ Decrease during the reporting period	Number of selling restricted shares held	Number of shares pledged or frozen
HKSCC Nominees Limited	Foreign legal person	25.49	135,358,845	–	–	Unknown
Shenji Machine Tool (Group) Co., Ltd.	State-owned legal person	25.08	133,222,774	–	–	No
Yunnan Industrial Investment Holding Group Co. Ltd.	State-owned legal person	11.07	58,772,913	–	–	No
Kunming Jinghua Co.	Domestic non-state-owned legal person	2.39	12,680,000	–	–	Unknown
China Pacific Insurance (Group) Co., Ltd. – Bonus – Group Bonus	Others	1.10	5,839,779	–	–	No
China Agricultural Bank – Zhongyou Core Growth Equity Securities Investment Fund	Others	1.05	5,588,560	–	–	Unknown
China Construction Bank – Huabao Xingye Multi-strategies Growth Securities Investment Fund	Others	0.94	5,000,000	–	–	Unknown
China Life Insurance Co. Ltd. – Bonus – Individual Bonus – 005L – FH002 Shanghai	Others	0.63	3,366,570	–	–	Unknown
China Life Insurance Co. Ltd. – Traditional – General Insurance Products – 005L – CT001 Shanghai	Others	0.51	2,715,805	–	–	Unknown
Bank of China Co. Ltd. – Golden Eagle Industry Advantage Equity Securities Investment Fund	Others	0.45	2,372,422	–	–	Unknown

Selling unrestricted shares held by the top ten shareholders

Name of shareholders	Number of selling unrestricted shares	Type of shares
HKSCC Nominees Limited	135,358,845	Overseas listed foreign shares
Kunming Jinghua Co.	12,680,000	RMB ordinary shares
China Pacific Insurance (Group) Co., Ltd. – Bonus – Group Bonus	5,839,779	RMB ordinary shares
China Agricultural Bank – Zhongyou Core Growth Equity Securities Investment Fund	5,588,560	RMB ordinary shares
China Construction Bank – Huabao Xingye Multi-strategies Growth Securities Investment Fund	5,000,000	RMB ordinary shares
China Life Insurance Co. Ltd. – Bonus – Individual Bonus – 005L – FH002 Shanghai	3,366,570	RMB ordinary shares
China Life Insurance Co. Ltd. – Traditional – Traditional – General Insurance Products – 005L – CT001 Shanghai	2,715,805	RMB ordinary shares
Bank of China Co. Ltd. – Golden Eagle Industry Advantage Equity Securities Investment Fund	2,372,422	RMB ordinary shares
Wang Yanlin	2,240,000	RMB ordinary shares
CHAN KWOK TAI EDDIE	2,000,000	Overseas listed foreign shares

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Explanation of the connected relationship or acting in concert relationship among the above shareholders

There is no connected relationship among the top ten shareholders of selling unrestricted circulating shares, legal person shareholders and state-owned legal person shareholders. The Company was not notified of any connected relationship or acting in concert relationship regulated by "Information Disclosure Management Procedure to Changes of Shareholding of Listed Company" among the above holders of selling unrestricted circulating shares of the Company. Among the top ten shareholders, there is no connected relationship among the holders of selling restricted circulating shares. The Company was not notified of any connected relationship between the holders of selling restricted circulating shares and the public shareholders; and any relationship among the public shareholders.

Other than the substantial shareholders disclosed above, as at 31st December, 2010, there were no other shareholders whose shareholdings exceeded the amount required to be disclosed under Article 60 of "Administration of the Issuing and Trading of Shares Provisional Regulations" of the PRC and Issue no.2 of "The Content and Format of Disclosure of Information of the Listed Companies" (amended in 2005) and the register of substantial shareholders maintained under the requirement of reporting; and under Section 16(1) of the Securities and Futures Ordinance under the Hong Kong Exchanges and Clearing Limited, the Company was not notified of any interests representing 10% or more of the issued share capital of the Company.

Among top ten shareholders, there are three shareholders holding 5% or more of the Company's shares. They are HKSCC Nominees Limited, which holds the overseas listed foreign shares; Shenyang Machine Tool (Group) Co., Ltd., which holds the state-owned legal person shares; and Yunnan Industrial Investment Holding Group Co., Ltd., which holds state-owned legal person shares. All of the shares held by these shareholders are not pledged, frozen, mortgaged, nor designated.

Notes:

1) HKSCC Nominees Limited holds shares on behalf of clients. The Company did not receive any notification that any H shareholder held more than 10% in total share capital of the Company. Holders of H Shares who held more than 5% of total issued H Shares were as follows: on 17th February 2011, the Company received a notification that FIL Limited held 8,360,000 H Shares of the Company, representing 5.93% of total issued H Shares of the Company and 1.57% of total share capital of the Company.

2) Save as disclosed above, the Directors were not notified by any person (who is not a Director or a chief executive officer) who owns the interest or short position in the shares or underlying shares of the Company and shall be disclosed to the Company in compliance with the requirements contained in Divisions 2 and 3 of Part XV of Securities and Future Ordinance ("SFO"), or the interest or short position that shall be included in the prescribed register in accordance with section 336 of SFO.

3) As at 31st December 2010, none of the Directors and the Supervisors had any interests or short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which have been notified to the Company and the Hong Kong Stock Exchange pursuant to Division 7 and 8 of Part XV of the SFO, including interests or short positions which the Directors or the Supervisors are taken or deemed to have under such provisions of the SFO, or which are required to be and are recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code.

This issue was announced in according to the regulation – Notice Of Supervising The Shareholders Of Listed Companies Implementing The Rules On Lessening Terminated Selling Restricted Shareholding issued by Shanghai Stock Exchange.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

2. Number of shares held by the top ten shareholders of selling restricted shares and the conditions of selling restriction

Unit: Share

No.	Name of shareholders of selling restricted shares	Number of selling restricted shares held	Trading of selling restricted shares: Date of trading	Trading of selling restricted shares: Number of additional shares to be traded	Conditions of selling restriction
1.	Shenyang Machine Tool (Group) Co., Ltd.	133,222,774	31st December 2010	–	Committed to hold as stated in the agreement
2.	Yunnan Industrial Investment Holding Group Co., Ltd.	58,772,913	31st December 2010	–	Committed to hold as stated in the agreement

Note: The selling restricted shares held by Shenyang Machine Tool (Group) Co., Ltd. and Yunnan Industrial Investment Holding Group Co., Ltd. were released from trading restrictions as of 1st January 2011.

3. Strategic investors or general legal persons as top ten shareholders as a result of placing of new shares

Name of strategic investors or general legal person	Commencement of agreed holding	Expiry of agreed holding
Shenyang Machine Toll (Group) Co., Ltd.	1st December 2006	31st December 2010
Yunnan Industrial Investment Holding Group Co., Ltd.	31st December 2005	31st December 2010

Note: Committed to hold until 31 December 2010.

4. Controlling shareholder and beneficial controller

(1) Legal controlling shareholder

Unit: RMB'000

Name	Legal representative	Date of incorporation	Registered capital	Principal activities
Shenyang Machine Tool (Group) Co., Ltd.	Guan Xiyou	18th December 1995	712,840	Manufacturing of metal cutting machines, CNC machines and mechanical equipment

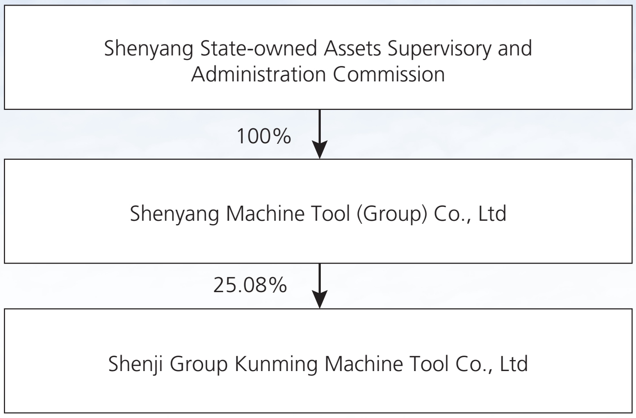
(2) Legal beneficial controller

Name: Shenyang State-owned Assets Supervision and Administration Commission

(3) Changes in controlling shareholder and beneficial controller

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

(4) Shareholding and controlling relationships between the Company and the beneficial controller



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

Unit: RMB'000

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

Note: Yunnan Industrial Investment Holding Group Co., Ltd. was formerly known as Yunnan State-owned Assets Operation Co., Ltd..

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

I. DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Name	Title	Gender	Age	Date of appointment	Number of shares held as at 1st January 2010	Number of shares held as at 31 December 2010	Reasons for the change	Remuneration and allowances received	Total emoluments received during the reporting period (RMB'0000) (before tax)	Remuneration and allowances received from shareholder's business unit or other associated business unit
Gao Minghui	Chairman, Executive director	Male	47	30th December 2006 to 31st October 2011	–	–	–	Yes	54.25	Yes
Li Zhenxiong	Vice chairman	Male	48	23rd March 2007 to 31st October 2011	–	–	–	No	–	Yes
Zhang Xiaoyi	Vice chairman, Executive director General manager	Male	46	31st October 2008 to 31st October 2011 29th April 2008 to 31st October 2011	–	–	–	Yes	72.00	No
Ye Nong	Executive director Vice general Manager	Male	50	23rd June 2010 to 31st October 2011 30th December 2006 to 31st October 2011	–	–	–	Yes	60.00	No
Pi Jianguo	Executive director Financial controller	Male	39	23rd March 2007 to 31st October 2011 30th December 2006 to 31st October 2011	– –	– –	– –	Yes	52.95	No
Guan Xin	Non-executive director	Male	42	23rd June 2010 to 31st October 2011	–	–	–	Yes	2.30	Yes
Wang Xing	Non-executive director	Male	45	23rd March 2007 to 31st October 2011	–	–	–	Yes	4.26	Yes
Zhang Tao	Non-executive director	Male	40	31st October 2008 to 31st October 2011	–	–	–	No	–	Yes
Wayne Yu	Independent non-executive director	Male	47	16th June 2005 to 15th June 2011	–	–	–	Yes	17.14	No
Liu Minghui	Independent non-executive director	Male	46	23rd March 2007 to 31st October 2011	–	–	–	Yes	11.43	No
Chen Ying	Independent non-executive director	Male	57	23rd March 2007 to 31st October 2011	–	–	–	Yes	11.43	No
Li Dongru	Independent non-executive director	Female	55	29th June 2007 to 31st October 2011	–	–	–	Yes	11.43	No
Shao Li	Chairman of the Supervisory Committee	Male	52	31st October 2008 to 31st October 2011	–	–	–	Yes	46.45	No
Fan Hong	Supervisor	Male	47	31st October 2008 to 31st October 2011	–	–	–	No	–	Yes
Xiang Rong	Supervisor elected by staff	Male	45	31st October 2008 to 31st October 2011	–	–	–	Yes	31.10	No
Zhu Xiang	Vice general manager	Male	45	20th August 2007 to 31st October 2011	–	–	–	Yes	51.42	No
Zhou Guoxing	Vice general manager	Male	48	10th April 2006 to 31st October 2011	–	–	–	Yes	44.70	No
Xu Kunping	Vice general manager	Male	41	10th February 2009 to 31st October 2011	–	–	–	Yes	48.75	No
Luo Tao	Secretary to the Board	Male	35	28th May 2008 to 31st October 2011	–	–	–	Yes	39.32	No
Sun Kai	Non-executive director	Male	44	30th September 2006 to 12th May 2010	–	–	–	Yes	1.59	Yes
Zhang Weiming	Supervisor	Male	53	23rd March 2007 to 29th October 2010	–	–	–	Yes	2.30	Yes
Gao Xingang	Supervisor	Male	40	31st October 2008 to 18th March 2011	–	–	–	Yes	2.76	Yes

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Major working experience of Directors, Supervisors and Senior Management in the past 5 years:

1. **Gao Minghui**, male, born in 1963, holding a bachelor degree and postgraduate qualification. He is currently the chairman of the Board, executive director and committee secretary of Communist Party of China ("CPC") of the Company. He graduated from the Northeastern University majoring in engineering in 1988. Mr. Gao was a researcher, deputy manager and manager of the Research and Development Department of Shenyang First Machine Tool Factory. Then he was the deputy chief engineer, assistant to general manager, deputy general manager, and general manager of Shenyang First Machine Tool Factory. Starting from January 2002, he had also been as the deputy general manager of Shenyang Machine Tool Co., Ltd.. He had been the chairman of the board of directors of Yunnan Machine Tool Factory (now known as Yunnan CY Group Co., Ltd. since the change of name in 2006) from August 2004. Since 2006, he had been the chairman of Shenyang Machine Tool (Group) Co., Limited. He was appointed as the director of the Company on 30th October 2006, and the Chairman of the Company on 30th December 2006. During 23rd October 2007 to 29th April 2008, he was also the general manager of the Company. His tenure of appointment will expire on 31st October 2011.

2. **Li Zhenxiong**, male, born in May 1962, holding a bachelor degree and is an assistant economist. He is currently the vice-chairman of the Company. Mr. Li joined Kunming Machine Tool Factory in 1985 and worked as the technician for construction and the head of construction team. During October 1993 to July 2002, he was the general manager and secretary to the committee of CPC of Kunming Kunji Group Construction Company. Since August 2002, he has acted as the general manager assistant, member of party committee, vice general manager and general manager of Kunming Kunji Group Company. He is now the vice general manager of Yunnan Industrial Investment Holding Group Co., Ltd.. His tenure of appointment will expire on 31st October 2011.

3. **Zhang Xiaoyi**, male, born in April 1964, holding master postgraduate qualification and a bachelor degree and is a senior engineer. He is currently the vice-chairman, executive director, general manager and deputy secretary to the Committee of CPC of the Company. Mr. Zhang joined Kunming Machine Tool Factory in 1985. He has extensive experience in machinery design and technology management. He worked as the deputy manager, manager of the technical center of the Company, general manager assistant and chief engineer, vice general manager of the Company. From 29 April 2008 till now, he has been the general manager of the Company. His tenure of appointment will expire on 31st October 2011.

4. **Ye Nong**, male, born in November 1960, holding postgraduate qualification and is an engineer. Mr. Ye currently is the vice general manager of the Company. During February 2000 to May 2002, he was the manager of the Technology Department of Shenyang Machine Tool (Group) and the vice president of Shenyang Machine Tool Design Institute. During May 2002 to December 2003, he was the manager of the Quality Control Department of Zhongjie Machine Tool Co., Ltd. He was the manager of Production Department of Zhongjie Machine Tool Co., Ltd. from December 2003 to June 2006. Since June 2006, he has worked for the Company as general manager assistant and vice general manager. On 23rd June 2010, he was appointed as the director of the Company. His tenure of appointment of vice general manager will expire on 31st October 2011.

5. **Pi Jianguo**, male, born in July 1971, holding a bachelor degree and is a certified public accountant, certified assets estimator, certified tax commissioner and senior accountant. He is currently the executive director and chief financial officer of the Company. During October 1999 to January 2002, Mr. Pi worked in the Industrial Department of Chuxiong State-owned Assets Company. During January 2002 to April 2005, he was the vice manager of the Auditing Department of Yunnan Huitong Accounting Firm. During May to December, 2005, he worked for Yunnan State-owned Assets Operation Co., Ltd. His tenure of appointment will expire on 31st October 2011.

6. **Guan Xin**, male, born in May 1968, holding a master post-graduate diploma, senior economist. Mr. Guan started his career in August 1990. From February 2005 to August 2009, Mr. Guan was the director of securities unit, general manager assistant, head of financial department, secretary to the board, vice general manager of Shenyang Machine Tool Co., Ltd.. Meanwhile, he was the director of the Strategic Investment Unit of Shenyang Machine Tool (Group) Co., Ltd. From August 2009 to November 2009, he was the general manager assistant and the head of finance and investment unit of Shenyang Machine Tool (Group) Co., Ltd. Since November 2009, he has been the vice general manager of Shenyang Machine Tool (Group) Co., Ltd. On 23rd June 2010, he was appointed as the director of the Company. His tenure of appointment will expire on 31st October 2011.

7. **Wang Xing**, male, born in 1965. He graduated from Harbin University of Science and Technology majoring in auditing in 1989. He is currently an undergraduate of the MPACC at Dongbei University of Finance and Economics. In 1989, he was with the Auditing Department of Shenyang First Machine Tool Factory. In early 1996, he worked for the Finance Department of Shenyang Machine Tool (Group) Co., Ltd. Later that year he joined the liquidation team of Shenyang Third Machine Tool Factory. In January 2001, he acted as the vice general manager and the head of Finance Department of Zhong Jie Machine Tool Co., Ltd. At the end of 2003, he worked as the vice general manager and the head of Finance Department of Shenyang CNC Machine Tool Co., Ltd. From 2006, he was the director and the head of Finance Department of Shenyang Machine Tool (Group) Co., Ltd. Since March 2007, he has held the positions of vice general manager and the head of Finance Department of Yunnan CY (Group) Co., Ltd. On 23rd March 2007, he was appointed as the director of the Company. His tenure of appointment will expire on 31st October 2011.

8. **Zhang Tao**, male, born in June 1970, holding a bachelor degree and is an engineer. Mr. Zhang graduated from the Department of Architecture of Yunnan Industrial University majoring in city roads and bridges in 1991. During July 1991 to December 1993, he worked as the technician and subsequently the assistant engineer for the Kunming railroad second maintenance team under Chengdu Railroad Bureau. During December 1993 to May 1996, he was the secretary to the office of Kunming Railroad Bureau. During May 1996 to June 2004, he worked as the vice manager, manager and the vice chairman of the Labor Union of Yunnan Guangda Railroad Co., Ltd. During June 2004 to March 2008, he held the positions of office manager, secretary to the board, general manager assistant and vice chief engineer at Dianxi Railroad Co., Ltd. Since March 2008, he has been the vice manager of Investment Department of Yunnan Industrial Investment Holding Group Co., Ltd. His tenure of appointment will expire on 31st October 2011.

9. **Wayne Yu**, male, born in 1963, holding a doctorate degree in finance and is a tutor of doctoral students. He is a professor of the Faculty of Accounting and Finance at Hong Kong Polytechnic University and an associate dean of the Graduate School of Business of Hong Kong Polytechnic University; the Chief Editor of "China Accounting and Finance Review"; and specialized professor of the Faculty of Accounting at Shanghai University of Finance and Economics. During 1998 to 1999, he was an associate professor of the Faculty of Business at Queen's University in Canada; during 1996 to 1998, he was an associate professor of the Faculty of Management at University of Lethbridge in Canada; during 1994 to 1995, he was a visiting professor of the Faculty of Management at Xi'an Jiaotong University; during 1992 to 1996, he was a part-time demonstrator of the Faculty of Business at University of Alberta in Canada. His tenure of appointment will expire on 15th June 2011.

10. **Liu Minghui**, male, born in 1964, is a professor and tutor of doctoral students and certified public accountant. During August 1987 to May 2000, he was an assistant lecturer, lecturer, associate professor and professor in Dongbei University of Finance and Economics. Since May 2000, he has been a tutor of doctoral students. During March 2001 to January 2004, he was the head of Jinqiao Faculty of Business at Dongbei University of Finance and Economics. During January 2004 to October 2004, he was the general manager of Dongbei University of Finance and Economics Magazine Company. From October 2004, he has held the positions of vice president of Dalian Newspaper Group and president of Dalian Publisher. He is also the director, vice-secretary general of China Accounting Association, a president of a branch of Cost Accounting Association, a president of a branch of Cost Accounting Association, director of China Auditing Association etc. His tenure of appointment will expire on 31st October 2011.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

11. **Chen Ying**, male, born in 1953, is a senior engineer. During 1997 to 1999, he was the chairman and general manager of Yunnan Transformer Co., Ltd. During 1999 to 2003, he was the chairman of Yunnan Transformer Electric Co., Ltd. During 2000 to 2003, he was the chairman and general manager of Kunming Securamid Electric Co., Ltd. During 2003 to 2004, he was the Mayor Assistant of Kunming City. During 2004 to 2006, he was the vice mayor of Kunming City. Since April 2006, he has been the chairman of Yunnan Transformer Electric Co., Ltd. His tenure of appointment will expire on 31st October 2011.

12. **Li Dongru**, female, born in 1955, Han nationality, a member of the Committee of CPC, professor-level senior engineer, holding postgraduate qualification. Ms Li. is working at the China Machinery Industry Federation (the "Federation"). Starting from January 2001, she has been the manager of the Science and Technology Department of the Federation and is responsible for the management of the machinery industry. During the periods of the Ninth-Five and Tenth-Five year plans, she organized or managed several state-level science and technology development large projects such as "數控技術與裝備工程化的研究與開發" and "新一代數控系統平臺的開發研究" etc.. Her tenure of appointment will expire on 31st October 2011.

13. **Shao Li**, male, Han nationality, born in 1958, holding a master degree and is deputy researcher. He is currently the deputy secretary to the Committee of CPC of the Company and chairman of the Supervisory Committee. Mr. Shao joined the Second Light Industry Bureau of Kunming City in February 1984 as a deputy office manager. In May 1987, he worked for Publicity Department under the Committee of CPC in Kunming City as the office manager, and subsequently the assistant to the director of the department. In December 1992, he worked for Research Center of Kunming City Government as a deputy director. In August 2000, he worked for the Enterprises Union Department under the Committee of CPC in Yunnan Province as the deputy office manager and subsequently the director of the research center. In February 2003, he worked for Yunnan State-owned Assets Supervision and Administration Commission as the director of Policy and Statute Department. Since October 2007, Mr. Shao has been the deputy secretary to the Committee of CPC of the Company. His tenure of appointment will expire on 31st October 2011.

14. **Fan Hong**, male, born in June 1963, holding a bachelor degree and is an engineer. Mr. Fan graduated from Jiangxi University of Finance & Economics majoring in finance in 1987. During July 1987 to September 1992, he worked for the Provincial Department of Finance of Yunnan. During August 1992 to February 2005, he worked as the department manager for Yunnan International Trust and Investment Company. Since February 2005, he has held the positions of trust department manager, risk control department manager and policy and statute department manager. His tenure of appointment will expire on 31st October 2011.

15. **Xiang Rong**, male, born in April 1965, holding a bachelor degree. He is currently the supervisor elected by staff, secretary to the Committee of CPC and director of the Committee of CPC Affairs Department. During August 2003 to May 2005, Mr. Xiang was a member of the Committee of the CPC of Kunming Kunji Group, integrated office manager, and the director of the Committee of CPC Affairs Department. During May 2005 to December 2007, Mr. Xiang was a member of the Committee of the CPC of Kunming Kunji Group, chairman of the Union and the manager of the integrated office, responsible for the Union, the Committee of CPC Affairs Department and Retirement Management Department. On 31st October 2008, he was appointed as the supervisor of the Company. His tenure of appointment will expire on 31st October 2011.

16. **Zhu Xiang**, male, born in April 1966, holding master postgraduate qualification and is a senior engineer. He is currently the vice general manager. He joined Kunming Machine Tool Factory in 1988. He has extensive experience in machine tool products design and sales management. He has held the positions of vice director of Assembly Sub-Plant of Kunming Machine Tool Factory, deputy director of the Technology Centre, vice manager of the Sales Department, manager of Sales Company, general manager assistant, and from 20th August 2007, the vice general manager of the Company. His tenure of appointment will expire on 31st October 2011.

17. **Zhou Guoxing**, male, born in November 1962, holding a master degree and is a senior engineer. He is currently the vice general manager of the Company. Mr. Zhou joined Kunming Machine Tool Factory in 1987 and has extensive experience in machine tool design and production management. He was the manager of the Laboratory of the Company; vice manager and manager of the Technical Center; deputy chief engineer; manager of the Manufacture Center; general manager assistant and the head of the assembly sub-plant; chief engineer and from 10th April 2006, the vice general manager of the Company. His tenure of appointment will expire on 31st October 2011.

18. **Xu Kunping**, male, born in November 1969, holding a bachelor degree and currently engaged in postgraduate study for a master degree, a senior engineer. He is currently the vice general manager of the Company, responsible for the marketing efforts. Mr. Xu joined Kunming Machine Tool Factory in 1991 and has extensive experience in machine tool R&D and design, technical management and sales management. From 1993, he was the designer, machine room manager, vice director, director and general manager assistant of the Technical Center. Since 24th March 2010, he has been the vice general manager of the Company. His tenure of appointment will expire on 31st October 2011.

19. **Luo Tao**, male, born in July 1975, holding a bachelor degree and postgraduate qualification. He is currently the secretary to the Board of the Company and affiliate member of the Hong Kong Institute of Chartered Secretaries. Starting from October 2005, he has held the positions of assistant secretary to the Board and the manager of the office of the Board of the Company, manager of the office of general manager and securities affairs representative. Since April 2008, he has been the secretary to the Board of the Company. His tenure of appointment will expire on 31st October 2011.

20. **Sun Kai**, male, born in 1966, holding a master degree and postgraduate qualification and is a senior accountant. He graduated from Dongbei University of Finance & Economics majoring in finance in 1989. He worked as the deputy manger of the Import and Export Department of Liaoning Provincial Medical Appliance Company; general manager assistant of Liaoning Trust and Investment Company; head of Finance Section of Liaoning Province Government; manager of the Finance and Accounting Department, secretary to the board, director and vice general manager of Shenyang Machine Tool Co., Ltd.. He had held the positions of director and vice general manager of Shenyang Machine Tool (Group) Co., Ltd. since 2006. On 30th October 2006, he was appointed as the director of the Company. Mr. Sun has resigned from his position as non-executive director and member of the audit committee. The Board of the Company has accepted his resignation. His term of appointment will expire on 11th May 2011.

21. **Zhang Weiming**, male, born in 1957, holding postgraduate qualification and is a senior economist. He graduated from the Party School of the Liaoning Committee of CPC majoring in economics management in 1997. He is currently the vice chairman and secretary to the Committee of CPC of the Comppany. Since 1983, he had been the secretary to the Youth League of Shenyang Lubricating Oil Pump Plant, secretary to the Enterprises Management Bureau of Shenyang Municipal Government, Vice Director of Economic Planning Department of Shenyang Municipal Government etc. From January 2003, he has held the positions of vice secretary to the Committee of CPC, secretary to the Disciplinary Inspection Committee, and chairman of the Labor Union of Shenyang Machine Tool (Group) Co., Ltd. Mr. Zhang has resigned from his position as supervisor. The Board of the Company and the Supervisory Committee have accepted his resignation. His tenure of appointment expired on 29th October 2010.

22. **Gao Xingang**, male, born in 1970, holding a bachelor degree and is a senior accountant. He graduated from Dongbei University of Finance & Economics majoring in accounting in 1990. Starting from 1994, he had been the accountant of Liaoning Trust and Investment Company and the head of the Financial Department of an enterprise under Liaoning Trust and Investment Company. Since 2004, he had been the associate director of the Financial Department of Shenyang Machine Tool (Group) Co., Ltd., head of the Financial Department and chief financial officer of the Whole Machine Business Department of Shenyang Machine Tool Co., Ltd. Since June 2008, he has been the director of the Internal Audit Department of Shenyang Machine Tool (Group) Co., Ltd. His tenure of appointment expired on 18th March 2011.

II. POSITIONS IN SHAREHOLDER'S BUSINESS UNIT

Name	Shareholder's business unit	Position	Remuneration and allowances received
Li Zhenxiong	Yunnan Industrial Investment Holding Group Co., Ltd.	Vice general manager	Yes
Guan Xin	Shenyang Machine Tool. (Group) Co., Ltd.	Vice general manager	Yes
Zhang Tao	Yunnan Industrial Investment Holding Group Co., Ltd.	Vice manager of Investment Department	Yes
Fan Hong	Yunnan Industrial Investment Holding Group Co., Ltd.	Policy and statute department manager	Yes
Zhang Weiming	Shenyang Machine Tool. (Group) Co., Ltd.	Vice chairman and secretary to the Committee of CPC	Yes

Positions in Other Business Units

Name	Other business unit	Position	Remuneration and allowances received
Gao Minghui	Shenyang Machine Tool (Group) Kunming Co., Ltd.	Chairman	Yes
	Yunnan CY Group Co., Ltd.	Chairman	Yes
	Kunming Kunji General Machine Co., Ltd.	Chairman	Yes
Zhang Xiaoyi	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Vice chairman	Yes
	TOS Kunming Machine Tool Manufacturing Co., Ltd.	Vice chairman	Yes
	Kunji Transportation Co., Ltd.	Chairman	No
Ye Nong	TOS Kunming Machine Tool Manufacturing Co., Ltd.	Director	Yes
Pi Jianguo	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Director	Yes
	Fujian Kunji Conventional Machine Tool Co., Ltd.	Director	Yes
Wang Xing	Yunnan CY Group Co., Ltd.	Vice general manager	Yes
	Shenyang Machine Tool (Group) Kunming Limited	Vice general manager	Yes
	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Director	Yes
Wayne Yu	Faculty of Finance at Hong Kong Polytechnic University	Professor, CFA	Yes
	Faculty of Accounting at Shanghai University of Finance and Economics	Specialized professor	Yes
Liu Minghui	Dalian Newspaper Group	Vice president	Yes
	Dalian Publisher	President	Yes
Chen Ying	Yunnan Transformer Co., Ltd.	Chairman	Yes
Li Dongru	China Machinery Industry Federation	Vice secretary-general	Yes
Zhou Guoxing	TOS Kunming Machine Tool Manufacturing Co., Ltd.	Member of controlling committee	Yes
	Fujian Kunji Conventional Machine Tool Co., Ltd.	Chairman	Yes
Zhu Xiang	Kunming Kunji General Machine Co., Ltd.	Director and general manager	Yes
	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Director	Yes
	Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Director	Yes
Luo Tao	Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Director	Yes

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

III. EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

1. The procedures for the determination of directors, supervisors and senior management's emoluments: The emoluments of directors and supervisors of the Company will be considered and approved at the shareholders' meeting; the emoluments of senior management officers are determined based on the terms of reference of the senior management officers in accordance with the remuneration policies formulated by the Remuneration and Assessment Committee of the Company, and assessed with reference to the profit indicators, operating indicators and business development indicators accomplished by the senior management officers for the year, and the improvement in quality of the assets of the Company. The results of the performance assessment results for the year, together with rewards and penalties proposed by the Remuneration and Assessment Committee, will be implemented with the approval from the Board.

2. Basis for emoluments of directors, supervisors and senior management officers

   (1) general information of the emoluments of domestic directors and supervisors;

   (2) general information of the emoluments of Hong Kong directors and supervisors;

   (3) emoluments of senior management officers are based on the domestic industry practice and emoluments of the comparable listed companies in the region;

IV. CHANGE OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

Name	Position	Change	Reason for the change
Ye Nong	Executive director and vice general manager	New appointment	
Guan Xin	Non-executive director	New appointment	
Sun Kai	Non-executive director and member of the audit committee	Resignation	Job reallocation
Zhang Weiming	Supervisor	Resignation	Post reallocation
Gao Xingang	Supervisor	Resignation	Job reallocation

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

V. COMPANY STAFF

No. of existing staff	2,576
No. of retirees whose retirement pension shall be borne by the Company	1,200

Areas of specialization

Areas of specialization	Number of Employees
Of which: Production worker	1,633
Skilled technician	403
Sales and marketing	55
Finance	50
Administration	148
General services	34
Early retirement	191
Staff pending for duties	57
Others	5

Education level

Education level	Number of Employees
Qualifications	
Of which: Postgraduate	15
University graduate	408
College diploma	401
Diploma	372
High school or vocational school	693
Junior high school or below	687
Title	
Of which: Senior	55
Intermediate	134
Junior	249

CORPORATE GOVERNANCE STRUCTURE

I. CORPORATE GOVERNANCE

The Company strictly complies with the "Company Law", the "Securities Laws", relevant laws and regulations issued by the CSRC and the Listing Rules of Shanghai Securities Exchange (上海證券交易所的有關規定) to establish a modern enterprise system, continuously improve its corporate governance and regulate the operations of the Company. Various systems of the Company are substantially in compliance with the requirements of the "Corporate Governance Standards of Listed Company" promulgated by the CSRC and the State Economic and Trade Commission. The Company will continue to improve and strengthen the internal control system in the course of ordinary operation so as to strive for the highest standards of corporate governance.

II. INDEPENDENT DIRECTORS AND THEIR DUTIES

1. Attendance of Independent Directors at the Board Meetings

Please refer to the board meetings for the year and attendance for details.

2. Objections raised by Independent Directors

During the reporting period, there were no objections raised by independent directors at the board meetings and other non-board meetings for the year.

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

Operations	The Company has established an independent and complete system of procurement, production and sales with its operations completely independent of the controlling shareholder and its own operating capacity.
Personnel	The human resources and payroll management of the Company are completely independent of the controlling shareholder. No emoluments are received by the operating personnel of the Company from the shareholders' business unit or other business unit.
Assets	The Company and the controlling shareholder have clearly defined rights to the assets where the assets of the Company are completely independent of the controlling shareholder with legal person property rights.
Organizational structure	The organizational structure of the Company is independent of the controlling shareholder where the Company and the controlling shareholder do not share the same line function.
Finance	The Company has established an independent system for accounting and finance management with separate bank accounts.

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

General plan for the establishment of internal control system

In accordance with the regulatory requirements on the listed companies under the Company Law, the Securities Law, the Listing Rules of Shanghai Securities Exchange and the Internal Control Guidelines of the Shanghai Securities Exchange on Listed Companies, the Company has established and put in place a sound and effective internal control system. In establishing and implementing the internal control system, the Company has taken into the fundamental factors as follows: objective setting; internal environment; risk assessment; regulatory activities; information & communication; internal supervision. Based on the fundamental system, the Company's internal control system involves the formulation of corporate governance structure, rules of procedures, organizational structure and terms of reference of each department, fundamental management system, duties, workflow procedures and quality manual, covering all aspects from daily and usual production, operation and management. The internal control system is comprehensive with well-defined structure.

Establishment of a sound work plan in the internal control system and its implementation

The Company has engaged an intermediary to conduct jointly tests and assessments on the present status of the internal control with the Company. Based on the features of the corporate structure and business procedures, the Company can also identify the major risks of internal control and set up objectives of internal control, rationalize internal procedures, spot defects and make improvement. The Company has outlined the annual work plan based on the key issues and accomplished them. Currently, the Company continues to make rectification to strive for excellence.

Establishment of the inspection and supervision department for internal control

The Board office of the Company is the daily operation office of the Audit Committee. In addition, the Company has also established the audit department, which is responsible for regular or special audit work on the Company; and assessment and random inspection of the implementation of the internal control system.

Internal supervision and self-assessment on internal control

The Articles of Association of the Company sets out the provisions on internal audit and the Implementation Rules of Audit Committee and Internal Audit System are formulated. The audit department will conduct regular or special audit work on the Company. In 2010, the audit department commenced the accounting and audit work, internal audit on the Company, and participated in the 2010 self assessment on internal control performed by KPMG.

The Board's work arrangement on internal control

The Board of the Company reviews the internal control assessment report and makes advice for improvement. The Company has also engaged an audit firm to make assessment on the internal control of the Company. The Board has established the Audit Committee and formulated the Implementation Rules on the Audit Committee under the Board. The daily operation office of the Audit Committee is the Board office, responsible for implementing the advice on internal control development of the Company given by the Audit Committee.

Improvement of internal control system associated with financial audit

In accordance with the relevant laws and regulations under the Accounting Law, the General Rules Governing Enterprise Financial Affairs and the Enterprise Accounting System, the Company has established an accounting and audit mechanism and set up a more reasonable and regulated audit system through ERP instruments. The Company has complied with the relevant financial management requirements and formulated the relevant systems, which set out strict requirements on internal control procedures relating to finance, and the system has been put in place effectively.

V. DISCLOSURE OF THE BOARD'S SELF-ASSESSMENT REPORT AND THE REVIEW OPINIONS OF THE AUDITORS ON THE COMPANY'S INTERNAL CONTROL

1. The Company disclosed the Board's self-assessment report on the Company's internal control.

The Board of the Company conducted the self-assessment on the internal control during 2010 and no material defects were discovered in terms of the design or implementation of the internal system. As of 31st December 2010, the Company maintained effective internal control in all material aspects pursuant to the "Basic Standard for Enterprise Internal Control" and relevant requirements. (See the Appendix to the Annual Report published on the website of the Company (www.kmtcl.com.cn) and the website of Shanghai Stock Exchange (www.sse.com.cn) on 23rd March 2011 for details).

2. The auditors issued the review opinions on the internal control of the Company.

In order to improve internal control, the Company engaged its H-share auditor to review the internal control assessment in relation to the 2010 financial statements and consolidated financial statements prepared according to the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of Hong Kong Companies Ordinance, as included in Shenji Group Kunming Machine Tool Company Limited's 2010 Self-assessment Report on the Internal Control prepared by the Board of the Company, and produce the review opinions on Shenji Group Kunming Machine Tool Company Limited's 2010 Self-assessment Report on the Internal Control. Such opinions are intended for use by the management of the Company only and shall not be relied upon by any other person or for any other purpose. The Company's H-share auditor accepts no responsibility or liability for any consequences arising from the opinions being relied upon by any other person. (See the appendix to the annual report published on the website of the Company (www.kmtcl.com.cn) and the website of Shanghai Stock Exchange (www.sse.com.cn) on 23rd March 2011 for details).

VI. ASSESSMENT OF THE SENIOR MANAGEMENT OFFICERS AND REWARDS

The resolution on the determination of the remuneration of the management for the year was considered and approved by the Remuneration and Assessment Committee of the Company with reference to the accomplishment of the profit indicators and other operation indicators for the year, pursuant to which the remuneration of senior management for 2011 was raised by 6%.

CORPORATE GOVERNANCE STRUCTURE

VII. THE COMPANY DISCLOSED THE REPORT ON SOCIAL RESPONSIBILITIES

(See the report on social responsibilities of the Company published on the website of the Company (www.kmtcl.com.cn) and the website of Shanghai Stock Exchange (www.sse.com.cn) on 23rd March 2011 for details).

VIII. ESTABLISHMENT OF ACCOUNTABILITY SYSTEM FOR MATERIAL ERRORS IN ANNUAL REPORT INFORMATION DISCLOSURE

The Company has formulated the Measures on the Accountability for Material Errors in Annual Report Information Disclosure, which set out the provisions on the accountability subject, procedures, conditions and types. The implementation of such measures can enhance the level of annual report information disclosures and the quality of the Company's information disclosure.

CORPORATE GOVERNANCE REPORT

1. CORPORATE GOVERNANCE PRACTICE

The Company complies with the relevant provisions as set out in the "Code on Corporate Governance Practices" ("Code") of the Appendix 14 to the Listing Rules of the Stock Exchange of Hong Kong Limited and strives to improve its level of corporate governance. The implementation of the provisions as set out in the Code is as follow:

A. Directors

A.1 Board Meetings

The Company holds at least one board meeting each quarter. 9 board meetings were held during 2010 and 7 of them were in written resolutions, please refer to page 29 for details of directors' attendance. The secretary to the Board would consult each director for discussion issues and include them in the agenda for every board meeting to be held. During the reporting period, the notice and preliminary agenda were distributed to the directors at least 14 days before the date of meeting.

All directors keep close contact with the Company Secretary. The Company Secretary is responsible for ensuring that the compliance of the operations of Board with the procedures and advising on the corporate governance and compliance issues. The minutes of the board meetings are compiled and kept by the Company Secretary. Minutes are passed to each director for reference within a reasonable period after the meeting. Directors may seek for professional advice at the cost of the Company.

If a substantial shareholder or a director has a conflict of interest in respect of any material matters, a board meeting shall be held. The subject director shall abstain from voting and be excluded from the quorum of the meeting.

A.2 Chairman and Chief Executive Officer

The positions of Chairman and Chief Executive Office were held by Mr. Gao Minghui and Mr. Zhang Xiaoyi respectively.

A.3 Composition of the Board

The Company discloses the composition of members of Board in its communications by the director category including Chairman, Executive Directors, Independent Non-Executive Directors and Non-Executive Directors. The Board currently comprises 4 independent non-executive directors, representing 1/3 of the total number of directors. During 2010, 4 directors took up the role of management, representing more than 1/3 of the total number of directors. This enabled the Board to strictly review and monitor the management procedures of the Company. In order to enrich the shareholders' understanding of the directors and the composition of the Board of the Company, the Company has published the role of directors and their responsibilities in related media.

A.4 Appointment, Election and Removal

The directors of the Company (including non-executive directors) have specific term of appointment. According to the Articles of Association, directors are elected at shareholders' meeting for a term of three years, subject to re-election upon expiry. However, the term of appointment for independent non-executive directors shall not exceed 6 years. The appointment of all directors of the Company shall be approved by the shareholders.

A.5 Directors' Responsibilities

In order to ensure the directors' sufficient understanding of the operations and businesses of the Company, each newly appointed director is given a comprehensive induction materials kit upon appointment. This kit sets out the business profile of the Company, responsibilities and obligations of directors and other legal requirements. Apart from that, each non-executive director will receive strategic proposals, business reports, and economics activities analysis regularly in order to execute their functions effectively (including making recommendations at board meetings). The non-executive directors shall give directions in the event of any potential interest conflicts; act as members of the committees under the Board; and carefully assess the performance of the issuer.

The Company Secretary is responsible for ensuring that all directors receive the latest updates on the Listing Rules and other statutory requirements.

A.6 Provision and Usage of Information

In order to ensure that obligations are duly performed and informed decision are made the directors of the Company, the agenda and relevant documents of the board meetings are distributed to all directors within ten days before the date of the meeting. The directors may meet the senior management officers formally or informally before the board meetings. The directors and committee members may review the relevant documents and minutes of the board meetings.

B.1 Remuneration of Director and Senior Management Officers

Since the establishment of Remuneration and Assessment Committee of the Company, the remuneration and assessment of directors, supervisor and senior management officers are based on rules of procedure of such committee. Independent professional advice may be sought if necessary in accordance with the stated procedures at the cost of the Company.

C. Accountability and Auditing

C.1 Financial Reporting

The directors would regularly receive integrated reports including strategic proposals, latest updates on various operations, financial objectives, plans and measures from the management. In the annual or interim report, or other announcements regarding price sensitive information and other disclosable financial information, the Board would make a balanced, clear and reasonable review for the Company's state of affairs and prospects.

C.2 Internal Control

The Supervisory Committee of the Company exercises its supervisory rights independently in accordance with laws and regulations to safeguard the legal rights of shareholders, the Company and employees. The number of members and composition of the Supervisory Committee shall comply with the laws and regulations. During 2010, 2 meetings were held and full attendances were recorded in every meeting where the supervisors supervised on behalf of the shareholders the financial conditions of the Company and the performance of obligations of directors and senior management officers and their compliance, and sat in on the board meetings to perform the duties of the Supervisory Committee in a diligent manner.

The Board is responsible for the establishment and maintenance the internal control system of the Company for reviewing the financial, operational and supervisory control procedures so as to safeguard the interests of the shareholders and the assets of the Company. The Board may delegate the authority to the management for implementation of the internal control system. The Audit Committee is responsible for reviewing its effectiveness.

The Internal Audit Department regularly conducts inspection, supervision and assessment on the risks relating to and the importance of various businesses and procedures and when necessary. In addition, corresponding internal management system and procedures are established for monitoring, operation, construction, finance and administration. Inspection will be carried out on a random basis.

C.3 Audit Committee

Since its establishment, the Audit Committee has functioned its important role of improving the financial reporting and the transparency of financial arrangement. The Company attaches great attention to the documentation of minutes of the Audit Committee. The minutes draft is prepared by a designated person and will be delivered to the members of the committee within a reasonable period. The draft is prepared for collecting the comments from the members and will be kept as minutes once finalized.

D. Transfer of Right of the Board

D.1 Management Function

The Board and the management of the Company both have clearly defined terms of reference and their respective functions are set out in the Articles of Association.

D.2 Committees under the Board

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

E. Communication with Shareholders

E.1 Effective Communication

The Board endeavours to maintain communications with its shareholders. During the Annual General Meeting in 2009, all Executive Directors, and part of the Non-Executive Directors and senior management officers attended the meeting to communicate with its shareholders.

E.2 Voting by poll

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

2. SECURITIES TRANSACTION OF DIRECTORS

During the reporting period, the Company adopted the "Model Code for Securities Transactions by Directors of Listed Issuers" ("Model Code") of the Appendix 10 to the Listing Rules of the Stock Exchange of Hong Kong Limited as regulation for securities transaction of directors. The directors and supervisors of the Company complied with the Model Code and standards on securities transaction of directors as stated in its code of conduct during the reporting period.

3. BOARD OF DIRECTORS

(1) Composition of the Board

Currently, there are 12 directors in the Company and 4 of them are independent non-executive directors. This is the sixth session of Board of Directors since the establishment of the Company. The term of directors begins from 1st November, 2008 or the date of appointment to the date of next election of directors.

9 board meetings (7 of them were in written resolutions) were held during the year and members of the board meetings are as follows:

Name	Position	Required attendance	Attended in person	Attended via electronic communication	Attended by representative	Absence	Failed to be present at two meetings in a row
Gao Minghui	Chairman and executive director	9	2	7	0	0	No
Li Zhenxiong	Vice chairman and non-executive director	9	2	7	0	0	No
Zhang Xiaoyi	Vice chairman and executive director	9	2	7	0	0	No
Guan Xin	Non-executive director	5	1	4	0	0	No
Wang Xing	Non-executive director	9	2	7	0	0	No
Ye Nong	Executive director	5	1	4	0	0	No
Pi Jianguo	Executive director	9	2	7	0	0	No
Zhang Tao	Non-executive director	9	2	7	0	0	No
Wayne Yu	Independent non-executive director	9	2	7	0	0	No
Liu Minghui	Independent non-executive director	9	2	7	0	0	No
Chen Ying	Independent non-executive director	9	2	7	0	0	No
Li Dongru	Independent non-executive director	9	1	7	1	0	No
Sun Kai	Non-executive director	4	1	3	0	0	No

No. of board meetings held during 2010	9
Including: No. of meetings held on-site	2
No. of meetings held via electronic communication	7
No. of meetings held on-site with electronic communication	0

During the reporting period, the directors attended substantially all the board meetings. Representatives were appointed to attend the board meetings and express opinions on the behalf of directors if the directors were unable to attend the board meetings due to office duties.

In addition, according to the Article of Association, notice of a regular board meeting shall be given to all directors at least 10 days before the board meeting. In the course of practical operations, the Company complied with the requirements under the Appendix 14A.1.3 to the Listing Rules of the Stock Exchange of Hong Kong Limited where all notices of the regular board meetings were despatched 14 days before the board meetings.

The secretary to the Board is responsible for distributing the details of the regular board meetings (including the information of the committees under the Board) to the directors no later than 5 days before the date of meetings to ensure that all directors understand the issues to be considered at the meetings.

Details of any temporary board meetings held based on the needs of the management of the Company in the form of communication shall be despatched to all directors by means of e-mail and facsimile, and shall allow sufficient time for directors' consideration. The secretary to the Board shall respond to the directors' queries in a timely manner and take proper actions to assist the directors to ensure compliance with the requirements such as the Company Law, Articles of Association and Listing Rules.

Minutes of the board meetings shall be signed by the directors and the minutes-taker attending the meetings, and maintained over a long period of time for inspection by the directors if necessary.

Where the directors consider that material conflicts of interests arise in respect of the connected transactions discussed, the directors involved shall take measures of side-stepping and abstain from voting in respect of such matters.

(2) Appointment of Directors

Each director of the Company is elected for a term of three years, subject to re-election upon expiry. The term of appointment of the independent non-executive directors shall not exceed six years. The Company shall enter into a Directors' Service Contract with the directors for a term of three years where the term of appointment of any additional directors during the term is less than three years. The appointment or removal of directors shall be approved at the shareholders' meeting. The appointment or removal of directors during 2010 is set out in "Change of Directors, Supervisors and Senior Management Officers" on page 20 of the Annual Report.

(3) Duties of the Board

The duties and responsibilities of the Board are clearly defined and set out in the Articles of Association of the Company.

Details of the work of the board and its board committees are set out in "ORDINARY OPERATIONS OF THE BOARD" on page 44.

(4) Nature and Independence of Independent Directors

Members of independent board committee have different professional backgrounds. They have professional expertise, sound qualifications and extensive experience in the areas of corporate management, financial accounting and manufacturing of machine tools.

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

(5) Implementation of Measures for Ensuring the Performance of Directors' Responsibilities

The secretary to the Board shall give all the directors relevant materials and updates on the statutory, regulatory and other ongoing responsibilities that the directors of the listed companies shall comply in a timely manner to ensure thorough understanding of their responsibilities, consistent execution of the procedures of the Board and proper compliance with applicable laws and regulations. The Board of the Company is entitled to engage independent professional bodies for such duties based on its power of authority for the performance of its responsibilities or business needs at the reasonable expense of the Company.

(6) Relationship between the Members of the Board

There is no relationship between the members of the Board, particularly between the chairman and the general manager, in terms of finance, business, family and others.

4. CHAIRMAN AND GENERAL MANAGER

The roles of chairman and general manager shall not be taken by the same person with clearly segregated duties. The chairman is responsible for the management of the affairs of the Board such as inspecting the implementation progress of the issues approved by the Board. The general manager is responsible for management of operations of the Company and implementation of strategies formulated by the Board. The duties and responsibilities of the general manager are clearly defined and set out in the Articles of Association of the Company.

5. **TERM OF NON-EXECUTIVE DIRECTORS: According to the Articles of Association, Rules of Procedure for the General Meetings of the Shareholders, and Rules of Procedure for the Meetings of the Board of Directors, the term of the non-executive directors under the sixth session of the Board will expire on 31st October 2011.**

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

Details are as follows:

No.	Committee	Major responsibilities	Chairman	Committee members	Annual meeting and work details
1.	Strategic Committee	Conducting research and providing suggestions on the Company's strategic planning, significant investment and financing issues, significant usage of capital and asset utilization	Gao Minghui	Gao Minghui, Li Zhenxiong, Zhang Xiaoyi, Li Dongru and Wang Xing	Conducted research and analysis on the changes in the machine tool market and on the product mix adjustment
2.	Audit Committee	Issuing work reports based on regularly reporting, annual performance results and implementation of the internal control system	Wayne Yu	Wayne Yu, Liu Minghui, Sun Kai (resigned) and Wang Xing (elected)	Convened special auditing meetings for annual report, interim report and internal control system
3.	Nomination Committee	Formulating policies for directors' nomination including nomination procedures, handling steps and criteria for selection of director candidates	Liu Minghui	Liu Minghui, Chen Ying and Zhang Tao (elected)	Reviewed and nominated senior management officers for appointment or removal for the year
4.	Remuneration and Assessment Committee	Formulating remuneration policy for executive directors, assessing performance of executive directors and approving clauses in directors' service contract	Chen Ying	Chen Ying, Wayne Yu, Sun Kai (resigned) and Liu Minghui (elected)	Formulated assessment and appraisal system based on operational objectives

Notes: The chairman of the Company's Strategic Committee is Mr. Gao Minghui, Chairman and executive director;

The chairman of the Company's Audit Committee is Mr. Wayne Yu, independent non-executive director;

The chairman of the Company's Nomination Committee is Mr. Liu Minghui, independent non-executive director;

The chairman of the Company's Remuneration and Assessment Committee is Mr. Chen Ying, independent non-executive director.

7. DIRECTORS' AND SUPERVISORS' CONTRACTS

None of the Directors or Supervisors has entered into any service contract which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

8. DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

In 2010, none of the Directors or Supervisors had a material interest in the contracts entered into with the Company, its controlling company or subsidiaries of its controlling company.

9. AUDITOR'S FEE

The auditor's fee for 2010 included the following:

An amount of RMB500,000 was paid to Zonzun Accounting Office Limited, the domestic accounting firm.

An amount of RMB2,400,000 was paid to KPMG, the foreign accounting firm.

The major factors for the basis of determination of the auditor's fee paid by the Company are as follows:

(1) General remuneration offered for auditing service in PRC;

(2) General remuneration offered for auditing service in Hong Kong;

(3) General work load on audit work for the previous accounting period;

(4) General work load on audit work for the previous engagement.

10. RIGHTS OF SHAREHOLDERS

The Company maintains good communication with its shareholders. The major communication channels include the Annual General Meeting, website and email of the Company, office facsimile and telephone of the secretary to the Board to enable shareholders to express their opinions or exercise their rights.

11. RESPONSIBILITY FOR FINANCIAL STATEMENTS

The Directors are responsible for the preparation of accounts for each financial year which shall present a true and fair view of the state of affairs, results and cash flow of the Group during such period.

The duties of the external auditor of the Company, KPMG, are set out on page 149 in the annual report; whereas the duties of Zonzun Accounting Office Limited are set out on page 59 in the annual report.

SHAREHOLDERS' MEETING

I. ANNUAL GENERAL MEETING ("AGM")

Meeting session	AGM date	Publishing newspaper resolved for information disclosure	Publishing date resolved for information disclosure
2009 AGM	23rd June 2010	China Securities Daily, Shanghai Securities News and Securities Times	24th June 2010

DIRECTORS' REPORT

I. BUSINESS REVIEW DURING THE REPORTING PERIOD

1. Overview of Operations during the Reporting Period:

In 2010, China sustained its resilient momentum under a more balanced economic growth mode. Compared with the initial counter-crisis stage, China achieved a positive shift from the policy-driven to the market-driven growth mode during the year, leading to a fledging pattern under which investment, consumption and export were synergized to fuel economic growth towards the goal of "changing economic growth mode and optimising economic structure". According to the statistics on 226 key associated enterprises in China's machine tool industry for the period from January to December 2010, CNC products accounted for 52.5% of metal-cutting machine tools in terms of production value. The production volume of metal-cutting machine tools and CNC metal-cutting machine tools posted a year-on-year increase of 35.2% and 54.7% respectively, while the average selling price of CNC metal-cutting machine tools dropped noticeably by 14.4%. Domestic general low-end machine tool market was rapidly recovering, especially with surging demand in the first half year, while the percentage of mid– to high-end machine tools declined, and the large-scale and heavy machine tool market was sluggish and on the downside. Some enterprises focusing on heavy machine tools posted a slow or even negative growth in revenue from product sales. The product homogeneous tendency and increasingly keen price competitions implied opportunities and challenges as well.

Due to the changes in macro economic conditions, the Company was unable to complete all annual business targets set by the Board in 2010, mainly due to the fact that: 1) as a result of changed product demand structure, the Company's floor-type boring machines recorded a decrease in sales volumes with sales revenue of RMB599 million, a year-on-year decrease of 24.90%, and horizontal boring machines recorded sales revenue of RMB563 million, a year-on-year increase of 78.26%; 2) due to increasingly intensified market competitions especially the increasing number of new competitors, the average selling prices of the Company's floor-type boring machine series and horizontal boring machines recorded year-on-year decreases of 18% and 4% respectively; 3) major material costs increased by approximately 20% on the average due to the hiking prices of raw materials; and 4) the Company's strategic development was significantly hampered by an apparent bottleneck on its own productive resources for further increasing product and sales scale, whilst the unfavourable outsourcing conditions posed difficulties for the Company to rapidly resume mass production of horizontal boring machines.

Addressing the complicated market dynamics, the business units strengthened execution force and cooperative engagement capability, and implemented the accountability mechanism with heightened confidence and unified global awareness under the proper leadership of the Board and senior management. The Company earnestly and effectively carried out various business activities including launching the "Dual-acceleration Project" and advancing the "Competitive Product Programme" to win the "Three Battles". With smooth business operations as a whole, the Company maintained sound profitability and attained progresses and breakthroughs in the following aspects:

(1) Marketing:

The Company spared no efforts in competing for contract orders to firmly consolidate the market presence of floor-type boring machines, regain the position of horizontal boring machines, break the ice for table-type machines and extend the market share of gantry milling machines. Orders were obtained for 21 sets of CNC gantry milling machines, representing a major breakthrough in sales, of which 17 sets were delivered.

(2) Production:

By continuously optimising production process, the Company effectively enhanced process control and refined management practice. With the capacity of horizontal boring machines promptly resumed, the Company accomplished trial manufacturing of new products including high-speed precision CNC horizontal boring machines and large-scale CNC gantry milling machines, and completed the production of ancillary parts for precision horizontal processing centers, a major project on technology of the State.

(3) *Technology*

While shrewdly scheduling major projects on technology of the State for 2009, the Company successfully applied for the major projects on technology for 2010 and smoothly completed the application for national enterprise technology center. Meanwhile, the Company strengthened the team building of technological talents, sped up adjustment to product mix and pressed forward the intellectual property protection work.

(4) *Quality Control:*

Adhering to management innovation, the Company comprehensively carried out the refining, assessment and implementation of quality targets. Efforts were taken in enhancing consistency and reliability of machine tools with the focuses on ensuring profitability and growth and advancing brand building.

(5) *Technological Renovation:*

The Company promoted technological renovation and the construction of production bases in a proactive and prudent manner along with its strategic development and the adjustment to product mix.

(6) *Financial and Human Resources Management:*

With a view to re-establishing the product costs auditing system, the Company accelerated the establishment of the internal control system and the information technology system. As such, the overall corporate management standards were upgraded.

2. Major products accounting for 10% or above of the total operating income or gross profits

Unit: RMB'000

Business or product	Operating income	Operating expenses	Gross profit margin	Percentage change in operating income	Percentage change in operating expenses	Percentage change in gross profit margin
Sales and processing of machine tool products	1,355,563.45	963,773.55	28.90%	21.29%	31.36%	decreased by 5.45 percentage points
Sales, installation and technical services of highly efficient compressors	200,791.36	179,117.43	10.79%	29.04%	41.47%	decreased by 7.84 percentage points

During the year, with the recovery of the machine tool market from the impact of the financial crisis in 2009, the Company achieved reasonable sales. Accordingly, the sales of general machine tool products recorded a substantial increase over the same period last year. The gross profit margin was lower than a year ago due to changes in the sales mix, intensifying competition in low value-added general machine tool products and higher raw material prices.

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

Unit: RMB'000

Item	2009	Proportion (%)	2010	Proportion (%)	Increase/ Decrease (%)
Raw materials	527,078.92	58.33	**673,585.53**	**57.94**	27.80
Direct labor costs	66,596.46	7.37	**71,032.23**	**6.11**	6.66
Benefit expenses	34,066.30	3.77	**31,272.78**	**2.69**	(8.20)
Fuel	8,132.54	0.90	**0.00**	**0**	
Power	11,837.36	1.31	**0.00**	**0**	
Manufacturing costs	157,680.90	17.45	**250,182.27**	**21.52**	58.66
Internal processing expenses	9,939.77	1.10	**0.00**	**0**	
External processing expenses	88,283.23	9.77	**136,484.19**	**11.74**	54.60
Total	903,615.48	100	**1,162,557.00**	**100**	28.66

During the Reporting Period, the operating costs increased by RMB258,942,000 or 28.66% over that in the same period last year, mainly attributable to the shrinking market demand for machine tools as a result of the impact of the financial crisis on the machine tool market in the same period last year. During the year, with the recovery of the machine tool market, the Company achieved reasonable sales. Accordingly, the sales of general machine tool products recorded a substantial increase over the same period last year.

During the Reporting Period, the consolidated gross profit margin was 27%, representing a decrease of 7 percentage points as compared to 34% in the same period last year, which was due to:

(1) substantial growth in the sales of general machine tool products over the same period last year, changes in the sales mix, intensifying competition in low value-added general machine tool products and higher raw material prices;

(2) higher prices of certain basic raw materials;

(3) lower prices of certain products as a result of intensifying market competition.

4. Analysis of sales of major products of the Company:

Unit: RMB'000

Business segments or product	Turnover for 2009	Turnover for 2010	Increase/ Decrease (%)
Business segments			
General facilities production	449,293	**574,708**	27.91
Specified facilities production	408,543	**545,100**	33.43
Transportation facilities production	–	**66,662**	–
Electric mechanical equipment production	155,314	**79,340**	(48.92)
Other production	155,578	**101,460**	(34.79)
Products			
Horizontal boring and milling machines	315,672	**562,723**	78.26
Floor-type boring and milling machines	798,018	**599,292**	(24.90)
Table-type boring and milling machines	–	**125,433**	–
Gantry boring and milling machine tool	–	**59,244**	–
Others	55,038	**20,576**	(62.61)
Total	1,168,728	**1,367,268**	16.99

5. Major suppliers and customers

The total purchases from the top 5 suppliers for 2010 amounted to RMB169,651,000, representing 26.47% of the total purchase for the year. In particular, the largest supplier Siemens (German-based) accounted for RMB65,269,000 or 10.18% of the total purchases for the year; and the second largest supplier Kunming Sanhe Agricultural Means of Production Co., Ltd. (昆明三禾農業生產資料有限公司) accounted for RMB33,831,000 or 5.28% of the total purchases for the year.

The total sales revenue of the top 5 customers for 2010 amounted to RMB228,870,000, representing 14.32% of the total sales revenue for the year. In particular, the largest customer Sany Heavy Machinery accounted for RMB103,671,000 or 6.49% of the total sales for the year.

6. Analysis of the material changes in asset structure and proportion during the reporting period

Unit: RMB

Item		Closing balance	Opening balance	Amount Increase/ Decrease	Increase/ Decrease (%)
A	Bills receivable	115,906,620.42	186,485,466.36	(70,578,845.94)	(37.85)
B	Other receivables	16,619,229.09	19,826,304.26	(3,207,075.17)	(16.18)
C	Inventory	752,776,010.82	610,288,482.06	142,487,528.76	23.35
D	Construction in progress	122,304,905.59	99,821,730.63	22,483,174.96	22.52
E	Receipts in advance	414,725,123.22	374,213,169.95	40,511,953.27	10.83
F	Selling expenses	108,183,773.43	70,358,799.54	37,824,973.89	53.76
G	Investment gain	9,859,063.47	12,314,282.02	(2,455,218.55)	(19.94)
H	Non-operating income	14,068,307.88	29,559,518.15	(15,491,210.27)	(52.41)
I	Asset impairment loss	1,356,465.78	28,459,221.26	(27,102,755.48)	(95.23)

Analysis:

A. The decrease in bills receivables was due to the large percentage of payment by bank promissory notes for the amounts due to suppliers for the period;

B. The decrease in the other receivables was due to the reimbursement of business trip expenses and refund of security deposits for the period;

C. The increase in inventory was due to the expansion of production to satisfy the sales needs as a result of the increase in sales of the Company for the period;

D. The increase in construction in progress was due to the construction of heavy casting base started during the year;

E. The increase in receipts in advance was due to the prepayments received from customers as a result of the increase in contracted sales for the period;

F. The increase in selling expenses was due to the sharp increase in transportation fees for the period;

G. The decrease in investment gain was due to the decrease in profits of associates from TOS for the period.

H. The decrease in non-operating income was due to the absence of extraordinary gain as compared to the refund of the 50% of the value-added tax of CNC machine tools in the prior period;

I. The decrease in asset impairment loss was due to the change in accounting estimates of bad debt for the period.

7. Analysis of material changes in major financial data during the reporting period

Unit: RMB'000

Item	Closing balance	Opening balance	Amount Increase/ Decrease	Increase/ Decrease (%)
Total assets	2,247,730.36	2,024,433.63	223,296.73	11.03
Operating profit	188,947.21	220,419.93	(31,472.72)	(14.28)
Net profit attributable to the holders of the Company	178,324.80	215,847.99	(37,523.19)	(17.38)

Analysis:

A. The increase in total assets was due to the expansion of the asset size as the production and operations of the Company for the period continued to maintain satisfactory growth. The total assets increased by RMB223,296,736.07. Of which, current assets increased by RMB170,578,396.52, net value of fixed assets increased by RMB22,832,463.05 and net value of construction in progress increased by RMB22,483,174.96;

B. The operating profit decreased by RMB31,059,999.02 over that in the same period last year, mainly attributable to the shrinking market demand for machine tools as a result of the impact of the financial crisis on the machine tool market in the same period last year. During the year, with the recovery of the machine tool market, the Company achieved reasonable sales. Accordingly, the sales of general machine tool products recorded a substantial increase over the same period last year. The decrease in gross profit margin was due to changes in the sales mix, intensifying competition in low value-added general machine tool products and higher raw material prices;

C. The decrease in operating profit directly resulted in the decrease in net profit attributable to the holders of the Company.

8. Analysis of cash flow structure and its material changes, and reasons for net profit fluctuation during the reporting period

Item	Closing balance	Opening balance	Amount Increase/ Decrease	Increase/ Decrease (%)
Net cash flow from operating activities	129,272,783.34	105,749,466.18	23,523,317.16	22.24%
Net cash flow from investment activities	(64,334,762.84)	(109,148,298.29)	44,813,535.45	41.06%
Net cash flow from financing activities	(48,136,523.76)	(43,586,037.40)	(4,550,486.36)	(10.44%)

Analysis:

A. Net cash flow from operating activities increased over that in the prior period, which was mainly because of the increase in sales revenue and certain bills receivables due for payment during the reporting period;

B. Net cash flow from investment activities increased, which was because of less outflow as compared to the large amount of payment for purchase of equipment in the prior period;

C. Net cash flow from financing activities decreased, which was mainly because of the repayment of RMB29 million bank loans by the parent company.

9. Discussion and analysis of important issues relating to the operations of the Company, including the utilization of the Company's facilities, securing of purchase orders, product sales or inventory turnover and changes in the profile of key technicians

The amount of new contracts for 2010 amounted to RMB1,751 million and 64.66% was attributable to CNC products. There was a temporary accumulation of inventory of a few CNC machine tool products but no change in the profile of key technicians.

10. Review of operations and business analysis for major controlling companies and invested companies

Unit: RMB'000

Name	Nature of business	Major products or services	Registered capital	Total assets	Net profit/ (loss)
Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Manufacturing	Energy saving compressor and turbo machines	50,000	395,685	(7,549)
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Manufacturing	Laser prototyping machine	60,000	122,066	2,502
Winko Machines Co., Ltd.	Manufacturing	Intelligent color display computerized embroidery machine and rotary table	20,230	2,914	1,360
TOS Kunming Machine Tool Manufacturing Co., Ltd.	Manufacturing	Development, design, production and sales of self-produced machine tool series products and accessories	5,000,000 Euros	181,383	18,550
Kunji Transportation Co., Ltd.	Transportation	General cargo transportation	500	1,132	48
Kunming Kunji General Machine Co., Ltd.	Manufacturing	Development, design and sales of machine tool products and accessories	3,000	33,557	(3,093)
Fujian Kunji Conventional Machine Tool Co., Ltd.	Manufacturing	Development, design, production and sales of self-produced machine tool series products and accessories	5,000	8,270	(1,419)

II. OUTLOOK ON FUTURE DEVELOPMENT OF THE COMPANY

In 2011, world economy is expected to range with a mildly upward trend. In the opening year for its 12th Five-year Plan, China will adopt more proactive fiscal policies and prudent monetary policies while maintaining the continuity and stability of its macro-economic policies, seeking to optimise economic structure and forge ahead the seven major emerging industries. For machinery industry, the production and sales growths are expected at around 15%. Yet with the increasing raw materials and labour costs, there will be more intensified competitions in the machine tool market of the PRC. The Company will continue to follow the direction for development of "large-scale, precise, complex and full-spectrum" machine tool products. In pursuit of the concepts of "extending traditions, maintaining features, adjustment and transition, and growing and strengthening the capabilities" and the guidelines of "focusing on technological innovation, striving to achieve adjustments and transition and emphasizing on both scale and efficiency", the Company is committed to making achievements in the following seven aspects:

1. Winning the "Three Battles": the Company expects to uplift its production and sales scale to a new level, foster CNC gantry milling machines into a new growth source, and accomplish the acceptance check for major projects on technology with small-scale production. Achieving the "Four Breakthroughs": the Company will seek to expand its business scale, swiftly explore new market sectors, attain progress in international cooperation and deepen the "Competitive Product Programme", so as to carry forward its precision manufacturing heritage.

2. Placing the top priority on competing for contract orders, the Company will strengthen major marketing channels and its after-sale service system based on major customers, aiming to turn the table for overseas market.

3. The Company will continue to optimise production process, promote the TPS production organization model and construct the processing islands for case body and precision bearing equipment. While making full play of the assembly breakdown approach and establishing standard workflows, the Company will support and cultivate core outsourcing partners.

4. Leveraging on the opportunity of applying for national enterprise technology center, the Company will strengthen the building of technological innovation platform and capability. In particular, the Company expects to increase the efficiency of collaboration among enterprises, colleges and research institutes, improve the talent cultivation mechanism and earnestly carry out major projects on technology of the State. Also, the Company will accelerate the adjustment to product mix, step up new product development, and improve market services and production on-site services.

5. The Company will complete the migration of quality management system to improve quality control, and extend quality inspection to outsourcing partners and the field of production installation and commissioning.

6. The Company will press on fundamental management, improve internal control system and promote the information technology project Phase II. With strict control over product costs, the Company will conduct the value chain study to expand profit margin. Meanwhile, the Company will improve its remuneration and performance assessment system, and coordinate the relations between the staff, shareholders and the society to build up a harmonious enterprise.

7. Taking all-around consideration of the development plans for machine tools and the existing production and operation conditions, the Company will actively and prudently expedite the construction progress of the heavy equipment plant and cast base projects.

8. Operating objective for 2011:

Unit: RMB100 million

Item	Operating Income	Net Profit Attributable to the Parent Company
2010 operating results	15.98	1.78
2011 operating objectives	18	2.1

III. INVESTING ACTIVITIES

1. Information of invested companies

Name	Place of registration	Scope of business	Registered capital RMB'000	Investment Proportion	Nature	Date of investment	Relationship with the Company
Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. ("Xi'an Ser")	Xi'an city	Design, development and sales of turbo machines, energy saving sintering fans, compressor equipment, research and re-modification of imported equipment and its parts, automated control system engineering, CNC engineering, mechanical and chemical equipment, meter technology development, whole machine production and sales	50,000	45.00%	Limited liability	2001.12	Subsidiary
Kunming Kunji General Machine Co., Ltd.	Kunming city	Development, design and sales of machine tool products and accessories	3,000	100.00%	Limited liability (wholly owned by legal person)	2007.10	Subsidiary
Winko Machines Co., Ltd. ("Winko")	Kunming city	Development, application and system integration of hardware and software; retail, wholesale and distribution of general machinery and electronic machines	20,230	96.74%	Limited liability	2002.11	Subsidiary
TOS Kunming Machine Tool Manufacturing Co., Ltd. ("TOS Kunming")	Kunming city	Development, design, production and sales of self-produced machine tool series products and accessories; development of high-tech products, transfer of self-developed technology, provision of technical services and technical advisory; provision of repairs and processing of machine tool products for third parties	5,000,000 Euros	50.00%	Limited liability	2005.4	Jointly controlled entity
Changsha Ser Turbo Equipment Co., Ltd. ("Changsha Ser")	Changsha city	Production and sales of centrifugal compressors, centrifugal blowers, sintering fans and its accessories	10,000	100%	Limited liability	2004.01	Subsidiary of Xi'an Ser
Hangzhou Ser Gas Engineering Co., Ltd. ("Hangzhou Ser")	Hanzhou city	Contracting: design, development, sales and technology support of gas equipment engineering, compressors, sintering fans, whole sintering fan equipment, low-temperature machines, automated control system equipment and its parts; wholesale and retail: mechanical and electrical products, building materials, hardware tools, metal materials; operation of import/export businesses; all legally valid projects not subject to review and approval	1,200	51.00%	Limited liability	2004.04	Subsidiary of Xi'an Ser
Kunji Transportation Co., Ltd. ("Kunji Transportation")	Kunming city	General cargo transportation	500	100%	Limited liability	2006.10	Subsidiary
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite")	Xi'an city	Laser prototyping machine	60,000	23.34%	Limited liability	2006.09	Associate
Fujian Kunjii Conventional Machine Tool Co., Ltd.	Nanan city	Development, design, production and sales of self-produced machine tool series products and accessories	5,000	50.00%	Limited liability	2008.01	Subsidiary

IV. RAISED FUND

1. Use of proceeds from raised fund

During the reporting period, there were no proceeds from new raised funds, nor any proceeds from previous raised funds being utilized for the year.

2. Use of proceeds from non-raised fund

It was considered and approved at the 2009 annual general meeting of the Company the following proposal:

Given the market demand and the requirements for the optimization of the product mix, the Company proposed to kick off the first stage construction of the heavy processing and assembling plant and ancillary equipment under the phase one of the heavy casting base project by investing RMB314,930,000 to resolve the bottleneck of the manufacturing plant, facilities and equipment of large and heavy machine tools. It is preliminarily expected that the construction works will be completed by 2011. After the completion, the existing production capacity will be increased. Of the investment amount of RMB198,500,000 in 2010:

1. RMB149,570,000 was for the investment in the heavy processing and assembling plant;

2. RMB39,930,000 for other expenses; and

3. RMB9,000,000 for preparation expenses.

V. REASONS FOR AND IMPACTS OF THE CHANGE OF ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES OR CORRECTIONS OF MATERIAL ACCOUNTING ERRORS

1. Reasons for the change of accounting policies and accounting estimates

The Company's sales revenue increased rapidly for the recent years, along with the significant change in product structure. The original applicable rate of bad debt provision for accounts receivable cannot reflect such changes. According to the practical accounts receivable collection for these years, the applicable rate of bad debt provision for accounts receivable has changed since 30th June 2010 for the following reasons:

(1) The sales proportion of digital machine tool products increased from 20% in 2002 to 70% in 2009; whereas digital floor-type boring and milling machine replaced the conventional boring and milling machine to become the leading products. However, the after extension of sales installation and commissioning period and service period of the floor-type boring and milling machine for around three months in average than those of conventional boring and milling machine, the collection period is extended.

(2) Historical figures for the aged analysis of the accounts receivable of the Company for the last four years:

	2006	2007	2008	2009
Within one year	82,007,539.24	110,201,209.19	145,465,388.98	114,077,418.48
1-2 years	12,854,514.11	20,659,851.95	35,395,967.04	56,243,055.13
2-3 years	7,232,469.05	7,171,514.21	12,004,296.22	25,588,781.11
Over 3 years	17,002,579.40	19,709,632.61	24,172,509.56	31,533,873.78
Total	119,097,101.79	157,742,207.96	217,038,161.80	227,443,128.50

Based on the above table, the Company estimates that:

A. 89% of the accounts receivable due 1-2 years can be collected with a bad debt possibility of not more than 11%;

B. 47% of the accounts receivable due 2-3 years can be collected with a bad debt possibility of not more than 54%;

C. 14% of the accounts receivable due over 3 years can be collected with a bad debt possibility of more than 86%.

According to the historical figures over the past four years, the original applicable rate of bad debt provision for the accounts receivable is obviously higher than that of the practical bad debt that is likely to be incurred.

(3) Comparison of the applicable rate for the bad debt provision for accounts receivable before and after the change in accounting estimates

Based on the changes in the Company's operating conditions, the empirical figures on the collection of accounts receivable and the estimates of the bad debt rate, the Company has made the following changes in the accounting estimates of the applicable rate of bad debt provision for accounts receivable:

Year	**Applicable rate before the change**	**Applicable rate after the change**
Within one year	5%	5%
1-2 years	50%	30%
2-3 years	100%	60%
Over 3 years	100%	95%

The adjusted bad debt provision applicable rate is still higher than the possibility of the practical bad debt that is likely to be incurred, and is higher than that of the similar listed companies in the same industry.

2. Impact of the change in accounting estimates on the Company

The change in accounting estimates only relates to the applicable rate of the bad debt provision for accounts receivable and shall be treated with the prospective application method under the PRC GAAP. The change in accounting estimates has resulted in the decrease in bad debt provision for the period of RMB42,107,196.35, increase in net accounts receivable of RMB42,107,196.35, decrease in impairment on assets of RMB42,107,196.35, increase in operating profit of RMB42,107,196.35, increase in total profit of RMB42,107,196.35, decrease in deferred income tax assets of RMB6,530,421.32, increase in deferred income tax of RMB6,530,421.32, increase in net profit of RMB35,576,775.03 and increase in undistributed profit at the end of the period of RMB32,019,097.52.

VI. ORDINARY OPERATIONS OF THE BOARD

1. Board meeting and resolution

Session	Board meeting date	Resolution	Publishing newspaper	Publishing date
15th meeting of the 6th session of the Board	24th March 2010	Approved the "Annual Report and Summary for 2009"	China Securities Daily, Shanghai Securities News and Securities Times	25th March 2010
16th meeting of the 6th session of the Board	23rd April 2010	Approved the written resolution on the "First Quarterly Report for 2010"	China Securities Daily, Shanghai Securities News and Securities Times	26th April 2010
17th meeting of the 6th session of the Board	29th April 2010	Approved the written resolution on the vehicle purchase plan		
18th meeting of the 6th session of the Board	19th May 2010	Approved the written resolution on revisions to the "Financial Budget Report for 2010"		
19th meeting of the 6th session of the Board	16th August 2010	Approved the "Interim Report and Summary for 2010"	China Securities Daily, Shanghai Securities News and Securities Times	17th August 2010
20th meeting of the 6th session of the Board	7th September 2010	Approved the written resolution on the "Supplementary Plan of Regular Technical Renovation for 2010"	China Securities Daily, Shanghai Securities News and Securities Times	8th September 2010
21st meeting of the 6th session of the Board	27th October 2010	Approved the written resolution on the "Third Quarterly Report for 2010"	China Securities Daily, Shanghai Securities News and Securities Times	28th October 2010
22nd meeting of the 6th session of the Board	27th November 2010	Approved the written resolution on the "Proposal for the Disposal of Fujian Kunjii Conventional Machine Tool Co., Ltd."		

2. Implementation of resolutions at the shareholders' meeting by the Board

During the reporting period, the Board exercised the rights granted to them at the shareholders' meeting in a sound manner and all resolutions at the shareholders' meeting were duly executed.

3. Overall reporting on the performance of duties of Audit Committee of the Board

(For details, please refer to the Work Summary of the Audit Committee for 2010 of the Company dated 23rd March 2011 on the website of the Company (www.kmtcl.com.cn) and the website of Shanghai Stock Exchange (www.sse.com.cn)).

4. Overall reporting on the performance of duties of Remuneration and Assessment Committee of the Board

On 20th March 2011, the Remuneration and Assessment Committee under the Board held a meeting. Having diligently reviewed the remuneration of directors, supervisors, and senior management officers, the Remuneration and Assessment Committee of the Board considered that the remuneration of the senior management officers as disclosed in the annual report for 2010 was determined according to the implementation of the growth strategies and investment decisions as formulated by the Board and the completion of the operating objectives as framed by the Board.

5. Establishment and improvement of the System for the Administration of External Information Users

The System of Shenji Group Kunming Machine Tool Company Limited for the Administration of External Information Users has been formulated and approved at the 15th meeting of the 6th session of the Board held on 24th March 2010. The system clearly regulates the approval, reporting and confidentiality in relation to the use of external information and has been effectively implemented by the Company.

6. Statement of Directors' Responsibilities on Internal Control

(See the self-assessment report on the internal control for 2010 of the Company published on the website of the Company (www.kmtcl.com.cn) and the website of Shanghai Stock Exchange (www.sse.com.cn) on 23rd March 2011 for details)

VII. IMPLEMENTATION OF PROFIT DISTRIBUTION PLAN OF THE COMPANY DURING THE REPORTING PERIOD

1. Proposal on profit distribution of the Company for the year of 2009

As proposed by the sixth session of the board of directors at its 15th meeting, the proposal on profit distribution of the Company for the year of 2009 was approved at the 2009 annual general meeting of the Company held on 23rd June 2010. In accordance with the PRC GAAP, in 2009, the Company recorded a net profit of RMB215,848,000 and, after deducting the amount of RMB21,652,000 transferred to the surplus reserves, a distributable profit and an accumulated distributable profit of the Company for the year amounted to RMB194,196,000 and RMB568,379,000 respectively. In particular, the parent company recorded a net profit of RMB216,519,000 and, after deducting the amount of RMB21,652,000 transferred to surplus reserves, a distributable profit and an accumulated distributable profit of the parent company for the year amounted to RMB194,867,000 and RMB506,167,000 respectively. In accordance with the Hong Kong Accounting Standards, the Company recorded a net profit of RMB215,710,000, and after deducting the amount of RMB21,652,000 transferred to the surplus reserves, a distributable profit and an accumulated distributable profit recorded of the Company in 2009 amounted to RMB194,058,000 and RMB566,593,000 respectively.

Proposal on the distribution of profit for the year of 2009: a cash bonus dividend of RMB0.5 (tax inclusive) is proposed for every 10 shares held by Shareholders of the Company based on the existing total share capital of 424,864,883 shares, totaling RMB21,243,244.15 in cash. The actual cash dividend after tax to be distributed to the individual shareholders, investment fund and qualified overseas institutional investors for A Shares would be RMB0.45 for every 10 shares held. For other holders of A Shares who are non-resident enterprises, no withholding tax is deducted by the Company and such tax shall be paid by the shareholders of the relevant jurisdictions.

On 22nd July 2010, the Company paid cash bonus dividend to holders of A Shares whose names appeared on the register of members of the Company on the record date (i.e. 15th July 2010). The Shanghai Branch of China Securities Depository and Clearing Corp. Ltd. was entrusted by the Company to pay the cash dividend on its behalf to the holders of the A Shares without selling restrictions. With respect to the A Shares subject to selling restrictions, the cash dividend was directly paid to the holders of such shares.

On 28th July 2010, the Company paid final cash dividends to the holders of H Shares whose names appeared on the register of holders of H Shares of the Company on the record date (i.e. 24th May 2010). The final dividends payable to the holders of H Shares were denominated and declared in Renminbi and were paid in Hong Kong dollars. The exchange rate was HK$100 to RMB87.655, which was based on the average value of the benchmark exchange rates for Hong Kong dollar to Renminbi as announced by the People's Bank of China for one calendar week prior to the date of approval for the payment of such dividends (i.e. 23rd June 2010). The final dividend per H Share was HK$0.057042 (including tax). ICBC (Asia) Trustee Company Limited was appointed by the Company as the receiving agent (the "Receiving Agent") in Hong Kong to receive the dividends on behalf of the holders of H Shares. The Company would pay the final dividends declared in respect of H Shares of the Company to the Receiving Agent, who would hold such dividends in trust on behalf of the relevant holders of H Shares until the payment is received.

2. Resolution on the capitalization of capital reserve to increase share capital

As at 31st December 2009, the share premium under capital reserve of the Company amounted to RMB125,422,997.12 under the PRC GAAP and RMB113,886,855 under the Hong Kong Accounting Standards. According to the Hong Kong Accounting Standards, based on the share premium under capital reserve of RMB113,886,855, the Board proposed to capitalize the capital reserve to share capital on the basis of 2.5 New Shares for every 10 shares held based on the existing total issued share capital of 424,864,883 Shares (comprising 312,149,033 A Shares and 112,715,850 H Shares). After the implementation of the proposal, the total share capital of the Company would be 531,081,103 Shares (comprising 390,186,291 A Shares and 140,894,812 H Shares).

In July 2010, the Company received the Letter of Approval from the Department of Commerce of Yunnan Province Concerning its Consent on the Proposal for Bonus Issue by Capitalization of Capital Reserve of Shenji Group Kunming Machine Tool Company Limited (Yun Nan Sheng Shang Wu Ting Shang Zi [2010] No. 130), under which the total share capital of the Company was approved to be increased from 424,864,883 shares to 531,081,103 shares and the registered capital would be increased from RMB424,864,883 to RMB531,081,103. The increased capital would be financed by the capitalization of the capital reserve.

The new A Shares without selling restrictions have been listed for trading on 19th July 2010 and the trading of new H Shares commenced on 18th August 2010.

Proposal on profit distribution of the Company for the year of 2010

Proposal on profit distribution of the Company for the year of 2010: In accordance with the PRC GAAP, in 2010, the Company recorded a net profit of RMB178,325,000 and, after deducting the amount of RMB18,774,000 transferred to the surplus reserves, a distributable profit and an accumulated distributable profit of the Company for the year amounted to RMB159,551,000 and RMB706,716,000 respectively. In particular, the parent company recorded a net profit of RMB187,738,000 and, after deducting the amount of RMB18,774,000 transferred to surplus reserves, a distributable profit and an accumulated distributable profit of the parent company for the year amounted to RMB168,964,000 and RMB653,918,000 respectively. In accordance with the Hong Kong Accounting Standards, the Company recorded a net profit of RMB178,370,000, and after deducting the amount of RMB18,774,000 transferred to the surplus reserves, a distributable profit and an accumulated distributable profit recorded of the Company in 2010 amounted to RMB159,596,000 and RMB704,975,000 respectively. In particular, the parent company recorded a net profit of RMB183,218,000 and, after deducting the amount of RMB18,774,000 transferred to surplus reserves, the profit available for distribution in accordance with the PRC accounting standards amounted to RMB159,551,000.

Proposal on the distribution of cash dividends for the year of 2010: a cash bonus dividend of RMB0.5 (tax inclusive) is proposed for every 10 shares held by Shareholders of the Company based on the existing total share capital of 531,081,103 shares (including 390,186,291 A shares and 140,894,812 H shares), totaling RMB26,554,055.15 in cash. The actual cash dividend after tax to be distributed to the individual shareholders, investment fund and qualified overseas institutional investors for A Shares would be RMB0.45 for every 10 shares held. For other holders of A Shares who are non-resident enterprises, no withholding tax is deducted by the Company and such tax shall be paid by the shareholders of the relevant jurisdictions.

IX. DISTRIBUTION OF CASH DIVIDENDS OF THE COMPANY FOR THE PRECEDING THREE YEARS *(Unit: RMB'000)*

Year	Distributable profits	Cash dividend amount	Cash dividend/ distributable profit
2008	228,074	40,065	17.57%
2009	191,995	21,243	11%
2010	159,551	26,554	16.64%

X. CERTIFIED ACCOUNTANTS' SPECIAL STATEMENT OF THE CAPITAL APPROPRIATION BY THE CONTROLLING SHAREHOLDER AND OTHER RELATED PARTIES OF THE COMPANY

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

Special Statement on the Capital Transfer with Related Parties and External Guarantee of Shenji Group Kunming Machine Tool Co., Ltd.
Zonzunzhuanzi [2011] No.2028

To all shareholders of Shenji Group Kunming Machine Tool Co., Ltd.,

We have been engaged to audit the financial statements of Shenji Group Kunming Machine Tool Co., Ltd ("the Company") for 2010 and have issued the unqualified opinions in the audit report (Zonzunshenzi [2011] No.2028). In accordance with the requirements as stated in the "Notice of Standard Current Funds between Listed Companies and Related Parties and External Guarantees of Listed Companies" (Zheng Jian Fa [2003] No.56) as promulgated by the CSRC, we have performed a special audit on the Summary of Capital Appropriation by the Controlling Shareholder and Other Related Parties of the Company ("Summary of Capital Appropriation") as attached below. It is the responsibility of the Company's management to provide authentic, legitimate and complete accounting and relevant information while our responsibility is to express an opinion on the Summary of Capital Appropriation based on our audit of the financial statements for 2010. During the review, we have performed audit tests, confirmations and other procedures we deem necessary according to the specific circumstances of the Company. Based on a reconciliation between the Summary of Capital Appropriation and the audited financial statements for 2010, we found no discrepancies in any material aspect.

The Statement is intended to facilitate understanding of the capital appropriation by the largest shareholder and other related parties of the Company only and may not be used for any other purposes. To gain a better understanding of the capital appropriation by the controlling shareholder and other related parties of the Company, the Summary of Capital Appropriation should be read in conjunction with the audited financial statements.

Based on our review,

1. as of 31st December 2010, we are not aware of any capital appropriation incurred by the controlling shareholder or any other related parties of the Company.

2. as of 31st December 2010, we are not aware of any external guarantee provided by the Company to the controlling shareholder of the Company and its affiliates.

Appendix 1: Summary of Capital Appropriation by the Controlling Shareholder and Other Related Parties of the Company

ZONZUN Accounting Office Ltd.

Chinese Certified Public Accountant: Han Feng

Beijing, the PRC

Chinese Certified Public Accountant: Cheng Weiguo

22nd March 2011

Summary of Capital Appropriation by the Controlling Shareholder and Other Related Parties of the Company for 2010

Item	Name of shareholders/ controlling parties	Relationship with the Company	Accounting items of the Company subject to audit	Opening balance of capital appropriation for 2010	Accumulated capital appropriation incurred (exclusive of interests) for 2010	Interests of capital appropriation for 2010 (if any)	Accumulated repayment incurred for 2010	Closing balance of capital appropriation for 2010	Purpose of capital appropriation	Nature of capital appropriation
Controlling shareholder and its affiliates	–	–	–	–	–	–	–	–	–	–
	Sub-total	–	–	–	–	–	–	–	–	–

Transactions with other related parties	Name of shareholders/ controlling parties	Relationship with the Company	Accounting items of the Company subject to audit	Opening balance of capital appropriation for 2010	Accumulated capital appropriation incurred (exclusive of interests) for 2010	Interests of capital appropriation for 2010 (if any)	Accumulated repayment incurred for 2010	Closing balance of capital appropriation for 2010	Purpose of capital appropriation	Nature of capital appropriation
Controlling shareholder and its affiliates	Yunnan CY (Group) Company Products Trading Centre	Affiliate of the controlling shareholder	Accounts receivable	7,116.00	554,884.00	–	553,000.00	9,000.00	Purchase of goods	Operation
	Shenji Group Import and Export Co., Ltd.	Affiliate of the controlling shareholder	Advance from customers	(1,260,000.00)	1,256,000.00	–	–	(4,000.00)	Purchase of goods	Operation
	Yunnan CY (Group) Company Jinhui Spraying Factory	Affiliate of the controlling shareholder	Accounts payable	(327,061.16)	192,985.09	–	–	(134,076.07)	Purchase of goods	Operation
	Sub-total			(1,579,945.16)	2,003,869.09	–	553,000.00	(129,076.07)		
Company's subsidiaries and their respective affiliates	Winko Machines Co., Ltd.	Controlling subsidiary	Other receivables	14,155,881.50	–	–	1,462,466.55	12,693,414.95	Temporary payment	Non-operations
	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Subsidiary	Dividends receivable	11,800,925.00	–	–	584,100.00	12,385,025.00	Dividend and interest	Non-operations
	Sub-total			25,956,806.50	–	584,100.00	1,462,466.55	25,078,439.95		
Related natural persons and its controlled legal persons										
	Sub-total									
Other related persons and their subsidiaries										
	Sub-total									
	Total	–	–	27,536,751.66	(2,003,869.09)	584,100.00	909,466.55	25,207,516.02		

XI. DETAILS OF AND INDEPENDENT OPINIONS ON THE EXTERNAL GUARANTEE EXPRESSED BY THE INDEPENDENT DIRECTORS

For the details of and independent opinions on the external guarantee of the Company for 2010 expressed by the independent directors, we conducted a due diligence investigation on the external guarantee of the Company and its subsidiaries in accordance with the requirements of the "Notice of Standard Current Funds between Listed Companies and Related Parties and External Guarantees of Listed Companies" (Zheng Jian Fa [2003] No.56) as promulgated by the CSRC. The results of the due diligence were as follows:

There was no external guarantee, nor any other guarantee incurred prior to and subsisting during the reporting period.

Independent non-executive directors: Wayne Yu
Liu Minghui
Chen Ying
Li Dongru

22nd March 2011

SUPERVISORY COMMITTEE'S REPORT

I. Work review of the Supervisory Committee

Number of meetings held	2
Description of meetings of the Supervisory Committee	**Resolutions proposed at the meetings of the Supervisory Committee**
The 6th meeting of the 6th session of the Board	Reviewed and approved the annual report and summary for 2009
The 7th meeting of the 6th session of the Board	Reviewed and approved the interim report and summary for 2010

II. Independent opinions of the Supervisory Committee on the Company's compliance in operations

The Supervisory Committee attended all general shareholders' meetings and board meetings, and supervised the procedures of such meetings held, resolutions to be reviewed and approved, procedures of decision-making, implementation of resolutions, occurrence of connected transactions, undertaking of duties by the senior management officers and functioning of internal management systems. The Supervisory Committee considered that, the Board, all Directors and senior management officers had duly exercised all resolutions passed at the general shareholders' meetings and the board meetings; all decisions-making procedures were in compliance with the laws and Articles of Associations; and all management systems were effectively in force. The Company's internal control systems were continuously improving. During the supervision and inspection process, none of the Board, Directors or any senior management officers were found to have breached any laws or regulations, or infringed upon the interests of the Company and its shareholders.

III. Independent opinions of the Supervisory Committee on the review of the Company's financial conditions

During the reporting period, the Supervisory Committee of the Company diligently examined the Company's 2010 Annual Report and auditors' reports prepared by the domestic and foreign accounting firms. The Supervisory Committee considered that the Company's 2010 Annual Financial Report had truly and fairly reflected the financial conditions and operating results of the Company. The Supervisory Committee consented to the auditors' reports prepared by the auditors.

IV. Independent Opinions of the Supervisory Committee on the use of proceeds from the latest fundraising

During the reporting period, no changes were made to the proposed use of proceeds raised

V. Independent Opinions of the Supervisory Committee on the Company's Acquisition and sale of assets

During the reporting period, there was no major acquisition or sale of assets

VI. Independent Opinions of the Supervisory Committee on the Company's connected transactions

The Supervisory Committee diligently examined the connected transactions that arose during the reporting period and considered that such connected transactions were all conducted on an arm's length basis and on reasonable commercial terms, and were in the interests of the Company and its shareholders.

VII. Independent Opinions of the Supervisory Committee on material differences between realized profit of the Company and estimate

There was no material difference between the realized profit of the Company for 2010 and the estimate.

VIII. Review of the internal control self-assessment by the Supervisory Committee

The Supervisory Committee has considered and passed the internal control self-assessment report.

SIGNIFICANT EVENTS

I. PRE-EMPTIVE RIGHTS

Since there is no provision for pre-emptive rights under the Company's Articles of Association, the Company did not have any arrangement for the pre-emptive rights scheme during the reporting period.

II. WARRANTS AND OTHERS

Neither the Company nor its subsidiaries issued any warrants, convertible securities, options or other securities with similar rights, nor did any person exercise any rights as stated above.

III. PURCHASE, SALE AND REDEMPTION OF SECURITIES OF THE COMPANY

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any securities issued by the Company during reporting period.

IV. BANK LOANS, OVERDRAFT AND OTHER BORROWINGS

Details of bank loans, overdrafts and other borrowings as at 31st December 2010 are set out in the Notes to the financial statements.

V. FINANCIAL RESOURCES AND CAPITAL STRUCTURE OF THE GROUP (IN ACCORDANCE WITH THE IFRS)

For the year ended 31st December 2010, the Group had no long-term borrowings and the Group had borrowing due within one year of RMB46,000,000. The Group maintains a sound credit condition with a high margin product mix and has sufficient cash flow for future repayment of liabilities due.

As at the end of 2010, the shareholders' equity of the Group was RMB1,421,056,000, compared to RMB1,268,761,000 as at the end of 2009.

VI. GEARING RATIO

In accordance with the Hong Kong GAAP, the shareholders' equity to debt ratio of the Group for 2010 was 1.73, compared to 1.71 in 2009.

VII. CONTINGENT LIABILITIES

The Company signed a sales contract with Yancheng Xinde Oil Machine Company ("Xinde Machine") in June 2002 for sales of four machine tools with contract amount of RMB11.9 million. Related four machine tools have been delivered to Xinde Machine before October 2003. In June 2009, Xinde Machine filed a lawsuit against the Company alleging that the goods delivered by the Company were unqualified and sought for return of goods, refund of advances paid of RMB10.7 million and payment of penalty and compensation of RMB0.3 million and RMB3.7 million respectively. In consultation with legal counsels, the Company has denied the claim and filed a counter claim against Xinde Machine alleging that it was unreasonable for Xinde Machine to claim for return of goods after use of the Company's products for more than 6 years and requesting Xinde Machine to repay the unpaid amount of RMB1.3 million for the goods. In February 2010, the Company and Xinde Machine agreed to mediate the disputes through the court.

Up to the date of the financial statements, the above case is still under the mediation stage. Management considered it is too preliminary to reasonably estimate the outcome of the mediation at this stage. Therefore no provision has been made in respect of the above pending case in the financial statements.

VIII. MAJOR LITIGATIONS AND ARBITRATIONS

There was no major litigation or arbitration in the reporting period.

IX. THE COMPANY'S EQUITY INTEREST HELD IN OTHER LISTED COMPANIES AND INVESTMENT IN FINANCIAL ENTERPRISES

There was no equity interest held by the Company in other listed companies, nor any investment in financial enterprises during the reporting period.

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

There was no purchase or sale of assets, nor any merger and acquisition activity during the reporting period.

XI. CONNECTED TRANSACTIONS DURING THE REPORTING PERIOD

1. The Company entered into distribution agreements with Shenyang Machine Tool Import & Export Co., Ltd. ("Shenji EXIM") and Yunnan Yunji Group Import & Export Co., Ltd. ("Yunji EXIM") respectively in respect of certain machine tool products. Pursuant to the agreements, the Company agreed to authorize Shenji EXIM and Yunji EXIM to distribute and export certain machine tool products from 1st April 2008 to 31st December 2010, effective from the date of the passing of the resolution by the independent shareholders at the EGM held on 12th June 2008. The annual caps were RMB40,000,000, RMB50,000,000, and RMB60,000,000 for Shenji EXIM respectively and RMB10,000,000, RMB15,000,000, and RMB20,000,000 for Yunji EXIM respectively. Such transactions were conducted on a regular and continuing basis in the ordinary and usual course of business of the Company as an effort to expand overseas market leveraging on the existing overseas distribution network of the export and import companies. The Directors of the Company (including four independent non-executive directors) reviewed such transactions and considered that: i) the distribution agreements were entered into on normal commercial terms and conditions in the ordinary and usual course of business of the Company, negotiated on an arm's length basis and at prices and terms no less favorable than those charged and offered to other distributors of the Company (independent third parties); ii) the terms of the distribution agreements were fair, reasonable and in the interests of the Company and its shareholders as a whole.

2. On 31st January 2011, the Company entered into the agreement on the lease of land use rights and the agreement on the lease of buildings with Kunming Kunji General Machine Co., Ltd. ("Kunji Group"), a subsidiary of Yunnan Industrial Investment Holding Group Co., Ltd., the second largest shareholder of the Company. Pursuant to the agreement on the lease of land use rights, the annual fee on the lease of land use rights paid by the Company to Kunji Group is RMB4,457,340.30 with a term of three years from 12th November 2010 to 11th November 2013. Pursuant to the agreement on the lease of buildings, the annual fee on the lease of buildings paid by the Company to Kunji Group is RMB792,659.70 with a term of three years from 12th November 2010 to 11th November 2013.

XII. BANKRUPTCY RESTRUCTURING

There was no bankruptcy restructuring of the Company.

XIII. ANALYSIS OF OTHER MAJOR MATTERS AND ITS IMPACTS AND SOLUTIONS

During the year, no other major matters relating to the Company arose.

SIGNIFICANT EVENTS

XIV. MATERIAL CONTRACTS AND THEIR PERFORMANCE

1. Escrow agency, contracting and lease matters

(1) Escrow agency

There was no escrow agency of the Company during the year.

(2) Contracting

There was no contracting of the Company during the year.

(3) Lease

There was no lease of the Company during the year.

2. Guarantee

The Company did not provide any guarantee during the year.

3. Entrusted investment

There was no entrusted investment of the Company during the year.

4. Other material contracts

There was no other material contract of the Company during the year.

XV. PERFORMANCE OF COMMITMENTS

1. Shenyang Machine Tool (Group) Co., Ltd. and Yunnan Industrial Investment Holding Group Co., Ltd. undertook that the shares held by them would not be sold through the stock exchange for trading from listing to 31st December 2010. As at 31 December 2010, the shares held by the above two shareholders were not tradable. From 1 January 2011, the selling restricted period for the selling restricted shares held by the above shareholders is expired.

2. Shenyang Machine Tool (Group) Co., Ltd. and Yunnan Industrial Investment Holding Co. Ltd. undertook that the resolution on the transfer of capital reserves to issue new shares be proposed and approved at the general meeting within one year after the completion of share reform on the basis of no less than five new shares for every 10 shares held. Such resolution was approved at the general meeting and relevant class meetings for 2006 held on 29th June 2007 and the transfer was completed.

3. Shenyang Machine Tool (Group) Co., Ltd. and Yunnan Industrial Investment Holding Co. Ltd. undertook that the resolution on the distribution of profits of no less than 50% of profits in the form of cash bonus dividend be proposed and approved at the general meeting if the performance of the Company in 2006 or 2007 fulfils the conditions for distribution of profits to shareholders. Such distribution of profits was completed in July 2008.

4. Shenyang Machine Tool (Group) Co., Ltd. undertook that it would provide full support to the business development of the Company in terms of technology, corporate management and resources and would consolidate the relevant resources and markets leverage on its own unique strengths based on the principles and models favorable to accelerating the growth of the Company within two years after the share transfer and share reform with a view to developing Kunming Machine Tool as an important platform for technological upgrade, business expansion and sector growth to provide comprehensive support and facilitate the sustainable and healthy development of the Company. Currently, Shenyang Machine Tool (Group) Co., Ltd. has introduced production management officers to the Company in order to facilitate the increase in the production management capabilities and provide convenience for the exports of the Company in terms of market expansion.

SIGNIFICANT EVENTS

XVI. APPOINTMENT AND REMOVAL OF AUDITORS

Appointment of new auditors:	No Current auditors engaged
Domestic auditor	ZONZUN Accounting Office Ltd.
Term of domestic auditor	4 years
Foreign auditor	KPMG (Hong Kong CPA)
Term of foreign auditor	4 years

XVII. PENALTIES ON THE COMPANY, ITS DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS, SHAREHOLDERS AND BENEFICIAL CONTROLLER OF THE COMPANY, AND RECTIFICATION ISSUES

During the reporting period, there were no penalties on the Company, its Directors, supervisors and senior management officers

XVIII. DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS, AND SHAREHOLDERS HOLDING OVER 5% SHARES OF THE COMPANY INVOLVED IN IRREGULAR TRADING OF SHARES OF THE COMPANY AND DISCLOSURE OF THE RECOVERY OF SUCH GAIN ARISING FROM SUCH IRREGULAR TRADING

During the reporting period, no Directors, supervisors, senior management and shareholders holding over 5% shares of the Company were involved in the irregular trading of the shares of the Company

XIX. PUBLIC FLOAT

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

XX. OTHER SIGNIFICANT EVENTS

1. Explanation on matters of Winko Machines

Pursuant to the resolution passed at the 32nd meeting of the 5th session of the Board, the Company's subsidiary Winko Machines Co., Ltd. convened an extraordinary general meeting on 30th June 2008, at which it was resolved to establish a liquidation team for liquidation of Winko Machines. According to the auditors' report (Yun Hui Shen Bao Zi (2011) No.038) issued by Yunnan Huitong Accounting Firm Co., Ltd.: As at 28th February 2011, all assets and liabilities of the company were liquidated, the remaining property was nil and the shareholders' equity was nil. Also the liquidation team completed the cancellation procedures with business registration, taxation and other authorities and banks. As at the date hereof, all liquidation and cancellation work for the company was completed.

2. Kunming Kunji General Machine Co., Ltd., a wholly-owned subsidiary of the Company, was established on 16th October 2007 as a business arm of its parent. Since its establishment, all activities of the company including raw material purchase, production of machine tools, sales and after-sale services were undertaken by the parent on its behalf. With dull business performance afterwards, the company was dormant as of September 2010. Given the failure of its objective, the company was resolved to be cancelled.

3. Approval of selected research areas under the major projects on technology of the State and the funding

According to the approval by the panel for major projects on technology of "high-end CNC machine tool and fundamental manufacturing machinery" under the Ministry of Industry and Information Technology, details of approval and funding of selected research areas are as follows:

SIGNIFICANT EVENTS

According to the Approval on Selected Research Areas for 2009 (MIIT Machinery Circular [2009] No.619), the funding budget for the Company's research area of THM65160 series precision horizontal processing center is RMB78.96 million, among which: the funding from central government is RMB9.06 million and the funding from local government is RMB2.00 million (or not less than 20% of the investment amount from central government) while the remaining amount is financed by the enterprise itself. Since 26th February 2010, the funding from central government for the research area amounting to RMB9.06 million has been granted in four installments and transferred to the designated account of the Company. The first installment of funding from the local government amounting to RMB1.55 million has also been granted and deposited to the bank account of the Company.

According to the Approval on Selected Research Areas for 2010 (MIIT Machinery Circular [2010] No.537), the funding budget for the Company's research area of TGK46100 high precision CNC horizontal jig boring machines was RMB43.33 million, among which: the funding from central government is RMB7.78 million and the funding from local government is RMB2 million (or not less than 20% of the investment amount from central government) while the remaining amount is financed by the enterprise itself. The first installment of funding from central government for the research area amounting to RMB5.41 million and the funding from local government amounting to RMB2 million was granted and transferred to the designated account of the Company.

4. Certification of high and new technology enterprise

Shenji Group Kunming Machine Tool Company Limited, among seven enterprises, was certified as the 7th batch of high and new technology enterprises for 2009 in Yunnan province by the Provincial Science and Technology Bureau, Provincial Finance Bureau, Provincial Office of State Administration of Taxation and Provincial Local Taxation Bureau. The certification was granted after following the procedures including formal examination, expert review, public notice and authorisation by the National Panel Office for Administration on Certification of High and New Technology Enterprises based on the application submitted by enterprises, as required by the Administration Methods on Certification of High and New Technology Enterprise (Guo Ke Fa Huo [2008] No.172) and the Administration Guides on Certification of High and New Technology Enterprise (Guo Ke Fa Huo [2008] No.362) jointly published by the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation. The Certificate of High and New Technology Enterprise was issued on 30th December 2009 with a term of three years (certificate number: GR200953000132).

XXI. INFORMATION DISCLOSURE

Event	Publishing newspaper	Publishing date	Wesite
Indicative announcement on the disposal of shares by holders of selling restricted shares	China Securities Daily, Shanghai Securities News and Security Times	11th February 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Regular report	China Securities Daily, Shanghai Securities News and Security Times	25th March 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the results of the 15th meeting of the 6th session of the Board	China Securities Daily, Shanghai Securities News and Security Times	25th March 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn

SIGNIFICANT EVENTS

Event	Publishing newspaper	Publishing date	Wesite
Announcement on the results of the 6th meeting of the 6th session of the Supervisory Committee	China Securities Daily, Shanghai Securities News and Security Times	25th March 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the certification of the Company as a high and new tech enterprise	China Securities Daily, Shanghai Securities News and Security Times	25th March 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement of the first quarterly results for 2010	China Securities Daily, Shanghai Securities News and Security Times	13th April 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Regular report	China Securities Daily, Shanghai Securities News and Security Times	26th April 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Notice of 2009 AGM	China Securities Daily, Shanghai Securities News and Security Times	7th May 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement from the Board of Kunming Machine Tool	China Securities Daily, Shanghai Securities News and Security Times	12th May 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Supplemental notice of 2009 AGM	China Securities Daily, Shanghai Securities News and Security Times	7th June 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the results of 2009 AGM	China Securities Daily, Shanghai Securities News and Security Times	24th June 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the payment of dividend for A shares and the implementation of bonus issue by capitalization of capital reserve for 2009	China Securities Daily, Shanghai Securities News and Security Times	12th July 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Regular report	China Securities Daily, Shanghai Securities News and Security Times	17th August 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn

SIGNIFICANT EVENTS

Event	Publishing newspaper	Publishing date	Wesite
Announcement on the results of the 19th meeting of the 6th session of the Board	China Securities Daily, Shanghai Securities News and Security Times	17th August 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the change in accounting estimates	China Securities Daily, Shanghai Securities News and Security Times	17th August 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on supplementary explanation of the interim results for 2010	China Securities Daily, Shanghai Securities News and Security Times	26th August 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the results of the 20th meeting of the 6th session of the Board	China Securities Daily, Shanghai Securities News and Security Times	8th September 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Regular report	China Securities Daily, Shanghai Securities News and Security Times	28th October 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement of the Supervisory Committee	China Securities Daily, Shanghai Securities News and Security Times	29th October 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn
Announcement on the approval of major projects on selected research areas under the major projects on technology of the State and the funding	China Securities Daily, Shanghai Securities News and Security Times	14th December 2010	http://www.sse.com.cn, http://www.hkex.com.hk, http://www.kmtcl.com.cn

AUDITOR'S REPORT

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

Auditor's Report
Zonzunshenzi (2011) No. 2117

To all shareholders of Shenji Group Kunming Machine Tool Co., Ltd.,

We have audited the accompanying financial statements of Shenji Group Kunming Machine Tool Co., Ltd. (the "Company or Kunming Machine Tool"), which comprise the consolidated balance sheet and balance sheet as at 31st December 2010, the consolidated income and profit appropriation statement, income and profit appropriation statement, the consolidated statement of changes in equity, the statement of changes in equity, and consolidated cash flow statement and cash flow statement for the year then ended, and notes to the financial statements.

1. MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

2. AUDITOR'S RESPONSIBILITY

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

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

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

3. OPINION

In our opinion, the financial statements comply with the requirements of the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises and present fairly, in all material respects, the financial position of the Company as at 31st December 2010, the results of operations and cash flows of the Company for the year then ended.

ZONZUN Accounting Office Ltd.
Chinese Certified Public Accountant: Han Feng
Chinese Certified Public Accountant: Cheng Weiguo

Beijing, PRC
22nd March 2011

CONSOLIDATED BALANCE SHEET

As at 31st December 2010

By: Shenji Group Kunming Machine Tool Company Limited *Unit: RMB*

Item	Note	Closing balance	Opening balance
Current Assets:			
Cash and cash equivalents		296,294,409.56	280,102,559.13
Settlement reserve		–	–
Loans to other banks		–	–
Trading financial assets		–	–
Bills receivable		115,906,620.42	186,485,466.36
Accounts receivable		249,828,811.68	177,604,480.70
Prepayments		53,337,722.23	39,877,114.75
Premiums receivable		–	–
Reinsurance accounts receivable		–	–
Reinsurance contract reserve receivable		–	–
Interests receivable		–	–
Dividends receivable		–	–
Other receivables		16,619,229.09	19,826,304.26
Purchase and sell-back of financial assets		–	–
Inventories		752,776,010.82	610,288,482.06
Non-current assets due within one year		–	–
Other current assets		–	–
TOTAL CURRENT ASSETS		**1,484,762,803.80**	**1,314,184,407.26**
NON-CURRENT ASSETS:			
Entrusted loans and advances granted		–	–
Available-for-sale financial assets		–	–
Held-to-maturity investment		–	–
Long-term receivables		–	–
Long-term equity investment		60,589,759.15	56,019,887.06
Real estate held for investment		–	–
Fixed assets		486,847,924.98	464,015,461.93
Construction-in-progress		122,304,905.59	99,821,730.63
Project materials		–	–
Disposal of fixed assets		–	–
Productive biological assets		–	–
Oil assets		–	–
Intangible assets		35,195,153.39	35,886,800.80
Development cost		–	–
Goodwill		7,296,277.00	7,296,277.00
Long-term deferred expenditures		678,209.81	433,422.50
Deferred income tax assets		50,055,327.91	46,775,638.38
Other non-current assets		–	–
TOTAL NON-CURRENT ASSETS		**762,967,557.83**	**710,249,218.30**
TOTAL ASSETS		**2,247,730,361.63**	**2,024,433,625.56**

CONSOLIDATED BALANCE SHEET

As at 31st December 2010

By: Shenji Group Kunming Machine Tool Company Limited | *Unit: RMB*

Item	Note	Closing balance	Opening balance
CURRENT LIABILITIES:			
Short-term loans		46,000,000.00	70,000,000.00
Borrowings from central bank		–	–
Deposits from customers and deposits from banks received		–	–
Loans from other banks		–	–
Trading financial liabilities		–	–
Bills payable		20,426,973.00	8,370,000.00
Accounts payable		230,256,410.68	183,186,540.07
Advances from customers		414,725,123.22	374,213,169.95
Gain on disposal of re-purchased financial assets		–	–
Fees and commissions payable		–	–
Accrued salary		34,656,409.79	39,863,443.01
Taxes payable		4,870,643.57	26,349,931.91
Interests payable		–	–
Dividends payable		135,898.49	344,092.75
Other payables		20,662,047.15	16,925,660.07
Reinsurance accounts payables		–	–
Insurance contract reserve payable		–	–
Agency securities trading		–	–
Agency securities underwriting		–	–
Non-current liabilities due within one year		–	–
Other current liabilities		79,817.18	–
TOTAL CURRENT LIABILITIES		**771,813,323.08**	**719,252,837.76**
NON-CURRENT LIABILITIES:			
Long-term borrowings		–	–
Bonds payable		–	–
Long-term payables		2,345,300.00	2,558,508.20
Specific payables		100,000.00	100,000.00
Contingent liabilities		16,301,190.59	11,885,194.70
Deferred income tax liabilities		–	–
Other non-current liabilities		26,147,303.11	11,863,603.31
TOTAL NON-CURRENT LIABILITIES		**44,893,793.70**	**26,407,306.21**
TOTAL LIABILITIES		**816,707,116.78**	**745,660,143.97**
Owners' equity (shareholders' interests):			
Paid-in capital (of share capital)		531,081,103.00	424,864,883.00
Capital reserve		27,303,321.72	133,519,541.72
Less: Treasury shares		–	–
Special reserve		–	–
Surplus reserve		109,024,823.62	90,250,998.55
Common risk provision		–	–
Undistributed profits		706,716,031.08	568,378,612.85
Foreign currency translation difference		–	–
Total equity attributable to the holders of the parent company		**1,374,125,279.42**	**1,217,014,036.12**
Minority interests		56,897,965.43	61,759,445.47
Total owners' equity		**1,431,023,244.85**	**1,278,773,481.59**
Total liabilities and owners' equity		**2,247,730,361.63**	**2,024,433,625.56**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms Zhao Qiongfen

BALANCE SHEET OF THE PARENT COMPANY

As at 31st December 2010

By: Shenji Group Kunming Machine Tool Company Limited *Unit: RMB*

Item	Note	Closing balance	Opening balance
Current Assets:			
Cash and cash equivalents		248,304,966.05	237,844,655.24
Trading financial assets		–	–
Bills receivable		85,692,620.42	154,667,406.36
Accounts receivable		193,467,126.14	138,513,373.63
Prepayments		9,145,017.82	10,094,839.52
Interests receivable		–	–
Dividends receivable		11,000,000.00	11,000,000.00
Other receivables		22,497,529.81	14,153,705.06
Inventories		585,789,448.80	430,395,804.09
Non-current assets due within one year		–	–
Other current assets		–	–
TOTAL CURRENT ASSETS		**1,155,896,709.04**	**996,669,783.90**
NON-CURRENT ASSETS:			
Available-for-sale financial assets		–	–
Held-to-maturity investment		–	–
Long-term receivables		–	–
Long-term equity investment		88,283,025.01	83,713,152.92
Real estate held for investment		–	–
Fixed Assets		433,479,837.52	405,827,528.95
Construction-in-progress		122,304,905.59	99,821,730.63
Project materials		–	–
Disposal of fixed assets		–	–
Productive biological assets		–	–
Oil assets		–	–
Intangible Assets		22,725,913.32	23,109,339.68
Development cost		–	–
Goodwill		–	–
Long-term deferred expenditures		640,217.11	354,579.80
Deferred income tax assets		47,637,778.82	46,988,759.14
Other non-current assets		–	–
TOTAL NON-CURRENT ASSETS		**715,071,677.37**	**659,815,091.12**
TOTAL ASSETS		**1,870,968,386.41**	**1,656,484,875.02**
CURRENT LIABILITIES:			
Short-term borrowings		21,000,000.00	50,000,000.00
Trading financial liabilities		–	–
Bills payable		–	–
Accounts payable		167,607,105.93	122,361,074.78
Advances from customers		264,996,242.49	230,330,889.56
Accrued salary		32,938,912.49	38,331,377.43
Taxes payable		4,497,424.19	24,614,699.42
Interests payable		–	–
Dividends payable		–	–
Other payables		13,807,715.82	9,747,695.01
Non-current liabilities due within one year		–	–
Other current liabilities		–	–
TOTAL CURRENT LIABILITIES		**504,847,400.92**	**475,385,736.20**

BALANCE SHEET OF THE PARENT COMPANY

As at 31st December 2010

By: Shenji Group Kunming Machine Tool Company Limited *Unit: RMB*

Item	Note	Closing balance	Opening balance
NON-CURRENT LIABILITIES:			
Long-term borrowings		–	–
Bonds payable		–	–
Long-term payables		2,345,300.00	2,558,508.20
Specific payables		–	–
Contingent liabilities		16,301,190.59	11,874,528.03
Deferred income tax liabilities		–	–
Other non-current liabilities		26,147,303.11	11,863,603.31
TOTAL NON-CURRENT LIABILITIES		**44,793,793.70**	**26,296,639.54**
TOTAL LIABILITIES		**549,641,194.62**	**501,682,375.74**
Owners' equity (or shareholders' interests):			
Paid-in capital (or share capital)		531,081,103.00	424,864,883.00
Capital reserve		27,303,321.72	133,519,541.72
Less: Treasury shares		–	–
Special reserve		–	–
Surplus reserve		109,004,823.62	90,250,998.55
Common risk provision		–	–
Undistributed profits		653,917,943.45	506,167,076.01
Total owners' equity (or shareholders' interests)		**1,321,327,191.79**	**1,154,802,499.28**
Total liabilities and owners' equity (or shareholders' interests)		**1,870,968,386.41**	**1,656,484,875.02**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

CONSOLIDATED INCOME STATEMENT

For the year ended 31st December 2010

Unit: RMB

Item		Note	Current period	Prior period
1.	**Total operating income**		**1,597,705,267.19**	**1,372,196,639.36**
	Including: Operating income		1,597,705,267.19	1,372,196,639.36
	Interest income		–	–
	Premium earned		–	–
	Fee and commission income		–	–
2.	**Total operating costs**			
	Including: Operating costs		**1,162,557,001.55**	**903,615,496.71**
	Interest expense		–	–
	Fee and commission expenses		–	–
	Premium refunded		–	–
	Net compensation expenses		–	–
	Net insurance contract reserve withdrawn		–	–
	Premium bonus expenses		–	–
	Reinsurance expenses		–	–
	Business tax and additions		1,558,286.19	972,098.94
	Selling expenses		108,183,773.43	70,358,799.54
	Administrative expenses		140,968,801.22	155,238,095.75
	Finance expenses		3,992,791.80	5,447,280.07
	Losses on impairment of assets		1,356,465.78	28,459,221.26
	Add: Gain on fair value change ("–" for loss)		–	–
	Investment income ("–" for loss)		9,859,063.47	12,314,282.02
	Including: Investment income from associates and joint ventures		9,859,063.47	12,314,282.02
	Exchange gain ("–" for loss)		–	–
3.	**Operating profits ("–" for loss)**		**188,947,210.69**	**220,419,929.11**
	Add: Non-operating income		14,068,307.88	29,559,518.15
	Less: Non-operating expenses		2,155,073.16	2,005,927.38
	Including: Net loss on disposal of non-current assets		625,490.12	445,182.42
4.	**Total profits ("–" for loss)**		**200,860,445.41**	247,973,519.88
	Less: Income tax expenses		27,397,123.94	34,846,368.54
5.	**Net profits ("–" for loss)**		**173,463,321.48**	**213,127,151.34**
	Net profit attributable to the owners of the parent company		– 178,324,801.52	– 215,847,994.25
	Minority interests		(4,861,480.04)	(2,720,842.91)
6.	**Earnings per share**			
	(1) Basic EPS		0.34	0.41
	(2) Diluted EPS		0.34	0.41
7.	**Other comprehensive income**		–	–
8.	**Total comprehensive income**		**173,463,321.48**	**213,127,151.34**
	Total comprehensive income attributable to owners of the parent company		178,324,801.52	215,847,994.25
	Total comprehensive income attributable to minority shareholders		(4,861,480.04)	(2,720,842.91)

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

PROFIT APPROPRIATION STATEMENT OF THE COMPANY

For the year ended 31st December 2010

Unit: RMB

Item		*Note*	Current period	Prior period
1.	**Operating income**		**1,394,948,280.91**	**1,168,781,890.12**
	Less: Operating costs		975,122,087.66	730,793,386.49
	Business tax and additions		81,212.46	–
	Selling expenses		100,412,256.15	61,226,774.76
	Administrative expenses		117,446,027.64	125,703,283.47
	Finance expenses		3,070,139.06	3,482,397.25
	Losses on impairment of assets		394,749.38	28,281,260.44
	Add: Gain on fair value change ("–" for loss)		–	–
	Investment income ("–" for loss)		9,859,063.47	12,314,282.02
	Including: Investment income from associates and joint ventures		9,859,063.47	12,314,282.02
2.	**Operating profits ("–" for loss)**		**208,280,872.03**	**231,609,069.73**
	Add: Non-operating income		10,711,329.75	20,432,925.60
	Less: Non-operating expenses		1,807,557.04	1,300,562.36
	Including: Net loss on disposal of non-current assets		–624,889.14	209,589.48
3.	**Total profits ("–" for loss)**		**217,184,644.74**	**250,741,432.97**
	Less: Income tax expenses		29,446,394.02	34,222,848.24
4.	**Net profits ("–" for loss)**		**187,738,250.72**	**216,518,584.73**
5.	**Earnings per share:**			
	(1) Basic earnings per share		0.35	0.41
	(2) Diluted earnings per share		0.35	0.41
6.	**Other comprehensive income**		**–**	**–**
7.	**Total comprehensive income**		**187,738,250.72**	**216,518,584.73**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31st December 2010

Unit: Shenji Group Kunming Machine Tool Company Limited *Unit: RMB*

Item		Note	Current period	Prior period
1.	**Cash flows from operating activities:**			
	Cash received from sale of goods or rendering of services		2,017,681,599.79	1,480,668,793.76
	Net increase in deposits from customers and deposits from other banks		–	–
	Net increase in borrowings from central bank		–	–
	Net increase in loans from other financial institutions		–	–
	Cash premiums received from existing insurance contracts		–	–
	Net cash received from reinsurance business		–	–
	Net increase in deposit and investment from the insured		–	–
	Net increase in the disposal of trading financial assets		–	–
	Cash from interest, fee and commission received		–	–
	Net increase in loans from other banks		–	–
	Net increase in loans of repurchased business		–	–
	Refund of tax received		1,240,180.70	17,737,912.22
	Other cash received relating to operating activities		24,122,610.13	6,927,717.54
	Sub-total of cash inflows from operating activities		2,043,044,390.62	1,505,334,423.52
	Cash paid for purchase of goods and services		1,450,105,945.55	967,179,421.78
	Net increase in customer loans and advances		–	–
	Net increase in deposits with central bank and other banks		–	–
	Cash compensations paid for existing insurance contracts		–	–
	Cash paid for interest, fee and commission		–	–
	Cash paid for premium bonus		–	–
	Cash paid to and on behalf of employees		235,138,343.49	201,320,847.64
	Taxes paid		127,771,856.59	147,909,058.08
	Other cash paid relating to operating activities		100,755,461.65	83,175,629.84
	Sub-total of cash outflows from operating activities		1,913,771,607.28	1,399,584,957.34
	Net cash flows from operating activities		129,272,783.34	105,749,466.18
2.	**Cash flows from investing activities:**			
	Cash received from recovery of investment		–	–
	Cash received from return on investment		5,289,191.40	9,500,000.00
	Net cash received from disposal of fixed assets, intangible assets and other long-term assets		365,498.47	405,282.00
	Net cash received from disposal of subsidiaries and other business units		–	–
	Other cash received relating to investing activities		–	–
	Sub-total of cash inflows from investing activities		5,654,689.87	9,905,282.00
	Cash paid to acquire fixed assets, intangible assets and long-term assets		69,989,452.71	119,053,580.29
	Cash paid for investment		–	–
	Net increase in pledged loans		–	–
	Net cash paid to acquire subsidiaries and other business units		–	–
	Other cash paid relating to investing activities		–	–
	Sub-total of cash outflows from investing activities		69,989,452.71	119,053,580.29
	Net cash flows from investing activities		(64,334,762.84)	(109,148,298.29)

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31st December 2010

Unit: Shenji Group Kunming Machine Tool Company Limited *Unit: RMB*

Item		*Note*	Current period	Prior period
3.	**Cash flows from financing activities:**			
	Cash received from capital contribution		–	–
	Including: Cash received from investment of minority shareholders of subsidiaries		–	–
	Cash from borrowings		46,000,000.00	20,000,000.00
	Cash received from bond issuance		–	–
	Other cash received relating to financing activities		–	–
	Sub-total of cash inflows from financing activities		46,000,000.00	20,000,000.00
	Cash repayments for amounts borrowed		70,000,000.00	20,000,000.00
	Cash paid for distribution of dividends, profits or repayment of interest expenses		24,136,523.76	43,586,037.40
	Including: Dividends and profits paid by subsidiaries to minority shareholders		–	–
	Other cash paid relating to financing activities		–	–
	Sub-total of cash outflows from financing activities		94,136,523.76	63,586,037.40
	Net cash flows from financing activities		(48,136,523.76)	(43,586,037.40)
4.	**Effect of foreign exchange rate changes on cash and cash equivalents**		**(609,646.31)**	**(853,973.24)**
5.	**Net increase in cash and cash equivalents**		**16,191,850.43**	**(47,838,842.75)**
	Add: Cash and cash equivalents at the beginning of the period		280,102,559.13	327,941,401.88
6.	**Cash and cash equivalents at the end of the period**		**296,294,409.56**	**280,102,559.13**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

CASH FLOW STATEMENT OF THE PARENT COMPANY

For the year ended 31st December 2010

Unit: RMB

Item		Note	Current period	Prior period
1.	**Cash flows from operating activities:**			
	Cash received from sale of goods or rendering of services		1,648,030,993.03	1,162,620,515.87
	Tax refund received		1,089,237.53	17,172,846.19
	Other cash received relating to operating activities		23,121,367.95	5,161,689.91
	Sub-total of cash inflows from operating activities		1,672,241,598.51	1,184,955,051.97
	Cash paid for purchase of goods and services		1,129,373,117.76	712,071,831.51
	Cash paid to and on behalf of employees		213,289,347.27	170,357,308.86
	Taxes paid		113,415,766.36	132,053,066.70
	Other cash paid relating to operating activities		90,991,755.10	64,378,055.02
	Sub-total of cash outflows from operating activities		1,547,069,986.49	1,078,860,262.09
	Net cash flows from operating activities		125,171,612.02	106,094,789.88
2.	**Cash flows from investing activities:**			
	Cash received from recovery of investment		–	–
	Cash received from return on investment		5,289,191.40	9,500,000.00
	Net cash received from disposal of fixed assets, intangible assets and other long-term assets		335,667.00	221,782.00
	Net cash received from disposal of subsidiaries and other business units		–	–
	Other cash received relating to investing activities		–	–
	Sub-total of cash inflows from investing activities		5,624,858.40	9,721,782.00
	Cash paid to acquire fixed assets, intangible assets and long-term assets		67,775,153.71	113,754,891.67
	Cash paid for investment		–	–
	Cash paid to acquire subsidiaries and other business units		–	–
	Other cash paid relating to investing activities		–	–
	Sub-total of cash outflows from investing activities		67,775,153.71	113,754,891.67
	Net cash flows from investing activities		(62,150,295.31)	(104,033,109.67)
3.	**Cash flows from financing activities:**			
	Cash received from capital contribution		–	–
	Cash from borrowings		21,000,000.00	–
	Cash received from bond issuance		–	–
	Other cash received relating to financing activities		–	–
	Sub-total of cash inflows from financing activities		21,000,000.00	–
	Cash repayment paid for amount borrowed		50,000,000.00	–
	Cash paid for distribution of dividends, profits or repayment of interest expenses		22,951,359.59	42,447,130.40
	Other cash paid relating to financing activities		–	–
	Sub-total of cash outflows from financing activities		72,951,359.59	42,447,130.40
	Net cash flows from financing activities		(51,951,359.59)	(42,447,130.40)
4.	**Effect of foreign exchange rate changes on cash and cash equivalents**		**(609,646.31)**	**(853,973.24)**
5.	**Net increase in cash and cash equivalents**		**10,460,310.81**	**(41,239,423.43)**
	Add: Cash and cash equivalents at the beginning of the period		237,844,655.24	279,084,078.67
6.	**Cash and cash equivalents at the end of the period**		**248,304,966.05**	**237,844,655.24**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2010

Unit: RMB

	Current period									
	Attributable to the owners of the parent company									
Item	**Paid-in capital (or share capital)**	**Capital reserve**	**Less: Treasury shares**	**Special reserve**	**Surplus reserve**	**Common risk reserve**	**Undistributed profit**	**Others**	**Minority interest**	**Total shareholders' interests**
1. Closing balance of prior year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**90,250,998.55**	**–**	**568,378,612.85**	**–**	**61,759,445.47**	**1,278,773,481.59**
Add: Changes in accounting policies	–	–	–	–	–	–	–	–	–	–
Prior period adjustment	–	–	–	–	–	–	–	–	–	–
Others	–	–	–	–	–	–	–	–	–	–
2. Opening balance of current year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**90,250,998.55**	**–**	**568,378,612.85**	**–**	**61,759,445.47**	**1,278,773,481.59**
3. Changes during the year ("–" for decrease)	**106,216,220.00**	**(106,216,220.00)**	**–**	**–**	**18,773,825.07**	**–**	**138,337,418.23**	**–**	**(4,861,480.04)**	**152,249,763.26**
(1) Net profits	–	–	–	–	–	–	178,324,801.52	–	(4,861,480.04)	173,463,321.48
(2) Other comprehensive income	–	–	–	–	–	–	–	–	–	–
Sub-total of (1) and (2) above	–	–	–	–	–	–	178,324,801.52	–	(4,861,480.04)	173,463,321.48
(3) Capital contribution and reduction by owners	–	–	–	–	–	–	–	–	–	–
(4) Profit distribution	–	–	–	–	18,773,825.07	–	(39,987,383.29)	–	–	(21,213,558.22)
(i) Transfer to surplus reserve	–	–	–	–	18,773,825.07	–	(18,773,825.07)	–	–	–
(ii) Transfer to common risk reserve	–	–	–	–	–	–	–	–	–	–
(iii) Transfer to owners (or shareholders)	–	–	–	–	–	–	(21,213,558.22)	–	–	(21,213,558.22)
(iv) Others	–	–	–	–	–	–	–	–	–	–
(5) Shareholders' interests internally carried forward	106,216,220.00	(106,216,220.00)	–	–	–	–	–	–	–	–
(i) Transfer from capital reserve to increase share capital	106,216,220.00	(106,216,220.00)	–	–	–	–	–	–	–	–
(ii) Transfer from surplus reserve to increase share capital	–	–	–	–	–	–	–	–	–	–
(iii) Losses offset by surplus reserve	–	–	–	–	–	–	–	–	–	–
(iv) Others	–	–	–	–	–	–	–	–	–	–
(6) Special reserve										
1. Withdrawn in the period	–	–	–	–	–	–	–	–	–	–
2. Utilized in the period	–	–	–	–	–	–	–	–	–	–
(7) Others	–	–	–	–	–	–	–	–	–	–
4. Closing balance of current period	**531,081,103.00**	**27,303,321.72**	**–**	**–**	**109,024,823.62**	**–**	**706,716,031.08**	**–**	**56,897,965.43**	**1,431,023,244.85**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2010

Unit: RMB

Item	Paid-in capital (or share capital)	Capital reserve	Less: Treasury shares	Special reserve	Surplus reserve	Common risk reserve	Undistributed profit	Others	Minority interest	Total shareholders' interests
	Prior period									
	Attributable to the owners of the parent company									
1. Closing balance of prior year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**68,599,140.08**	**–**	**414,246,947.45**	**–**	**64,480,288.39**	**1,105,710,800.64**
Add: Changes in accounting policies	–	–	–	–	–	–	–	–	–	–
Prior period adjustment	–	–	–	–	–	–	–	–	–	–
Others	–	–	–	–	–	–	–	–	–	–
2. Opening balance of current year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**68,599,140.08**	**–**	**414,246,947.45**	**–**	**64,480,288.39**	**1,105,710,800.64**
3. Changes during the year ("–" for decrease)	**–**	**–**	**–**	**–**	**21,651,858.47**	**–**	**154,131,665.40**	**–**	**(2,720,842.91)**	**173,062,680.95**
(1) Net profits	–	–	–	–	–	–	215,847,994.25	–	(2,720,842.91)	213,127,151.34
(2) Other comprehensive income	–	–	–	–	–	–	–	–	–	–
Sub-total of (1) and (2) above	–	–	–	–	–	–	215,847,994.25	–	(2,720,842.91)	213,127,151.34
(3) Capital contribution and reduction by owners	–	–	–	–	–	–	–	–	–	–
(i) Capital contribution by owners	–	–	–	–	–	–	–	–	–	–
(ii) Share-based payments recognized in shareholders' interests	–	–	–	–	–	–	–	–	–	–
(iii) Others	–	–	–	–	–	–	–	–	–	–
(4) Profit distribution	–	–	–	–	**21,651,858.47**	–	(61,716,328.87)	–	–	(40,064,470.40)
(i) Transfer to surplus reserve	–	–	–	–	**21,651,858.47**	–	(21,651,858.47)	–	–	–
(ii) Transfer to common risk reserve	–	–	–	–	–	–	–	–	–	–
(iii) Transfer to owners (or shareholders)	–	–	–	–	–	–	(40,064,470.40)	–	–	(40,064,470.40)
(iv) Others	–	–	–	–	–	–	–	–	–	–
(5) Shareholders' interests internally carried forward										
(i) Transfer from capital reserve to increase share capital	–	–	–	–	–	–	–	–	–	–
(ii) Transfer from surplus reserve to increase share capital	–	–	–	–	–	–	–	–	–	–
(iii) Losses offset by surplus reserve	–	–	–	–	–	–	–	–	–	–
(iv) Others	–	–	–	–	–	–	–	–	–	–
(6) Special reserve										
1. Withdrawn in the period	–	–	–	–	–	–	–	–	–	–
2. Utilized in the period	–	–	–	–	–	–	–	–	–	–
(7) Others										
4. Closing balance of current period	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**90,250,998.55**	**–**	**568,378,612.85**	**–**	**61,759,445.47**	**1,278,773,481.59**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

STATEMENT OF CHANGES IN EQUITY OF THE PARENT COMPANY

For the year ended 31st December 2010

Unit: RMB

	Current period							
Item	**Paid-in capital (or share capital)**	**Capital reserve**	**Less: Treasury shares**	**Special reserve**	**Surplus reserve**	**Common risk reserve**	**Undistributed profit**	**Total shareholders' interests**
1. Closing balance of prior year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**90,250,998.55**	**–**	**506,167,076.01**	**1,154,802,499.28**
Add: Changes in accounting policies	–	–	–	–	–	–	–	–
Prior period adjustment	–	–	–	–	–	–	–	–
Others	–	–	–	–	–	–	–	–
2. Opening balance of current year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**90,250,998.55**	**–**	**506,167,076.01**	**1,154,802,499.28**
3. Changes during the year ("–" for decrease)	**106,216,220.00**	**(106,216,220.00)**	**–**	**–**	**18,773,825.07**	**–**	**147,750,867.44**	**166,524,692.51**
(1) Net profits	–	–	–	–	–	–	187,738,250.72	187,738,250.72
(2) Other comprehensive income								
Sub-total of (1) and (2) above	–	–	–	–	–	–	187,738,250.72	187,738,250.72
(3) Capital contribution and reduction by owners								
(i) Capital contribution by owners	–	–	–	–	–	–	–	–
(ii) Share-based payments recognized in shareholders' interests	–	–	–	–	–	–	–	–
(iii) Others	–	–	–	–	–	–	–	–
(4) Profit distribution	–	–	–	–	18,773,825.07	–	(39,987,383.29)	(21,213,558.22)
(i) Transfer to surplus reserve	–	–	–	–	18,773,825.07	–	(18,773,825.07)	–
(ii) Transfer to common risk reserve	–	–	–	–	–	–	–	–
(iii) Transfer to owners (or shareholders)	–	–	–	–	–	–	(21,213,558.22)	(21,213,558.22)
(iv) Others	–	–	–	–	–	–	–	–
(5) Shareholders' interests internally carried forward	106,216,220.00	(106,216,220.00)	–	–	–	–	–	–
(i) Transfer from capital reserve to increase share capital	106,216,220.00	(106,216,220.00)	–	–	–	–	–	–
(ii) Transfer from surplus reserve to increase share capital	–	–	–	–	–	–	–	–
(iii) Losses offset by surplus reserve	–	–	–	–	–	–	–	–
(iv) Others	–	–	–	–	–	–	–	–
(6) Special reserve								
1. Withdrawn in the period	–	–	–	–	–	–	–	–
2. Utilized in the period	–	–	–	–	–	–	–	–
(7) Others	–	–	–	–	–	–	–	–
4. Closing balance of current period	**531,081,103.00**	**27,303,321.72**	**–**	**–**	**109,024,823.62**	**–**	**653,917,943.45**	**1,321,327,191.79**

STATEMENT OF CHANGES IN EQUITY OF THE PARENT COMPANY

For the year ended 31st December 2010

Unit: RMB

Item	Prior period							
	Paid-in capital (or share capital)	Capital reserve	Less: Treasury shares	Special reserve	Surplus reserve	Common risk reserve	Undistributed profit	Total shareholders' interests
1. Closing balance of prior year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**68,599,140.08**	**–**	**351,364,820.13**	**978,348,384.93**
Add: Changes in accounting policies	–	–	–	–	–	–	–	–
Prior period adjustment	–	–	–	–	–	–	–	–
Others	–	–	–	–	–	–	–	–
2. Opening balance of current year	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**68,599,140.08**	**–**	**351,364,820.13**	**978,348,384.93**
3. Changes during the year ("–" for decrease)	**–**	**–**	**–**	**–**	**21,651,858.47**	**–**	**154,802,255.88**	**176,454,114.35**
(1) Net profits	–	–	–	–	–	–	216,518,584.73	216,518,584.73
(2) Other comprehensive income	–	–	–	–	–	–	–	–
Sub-total of (1) and (2) above	–	–	–	–	–	–	216,518,584.73	216,518,584.73
(3) Capital contribution and reduction by owners	–	–	–	–	–	–	–	–
(i) Capital contribution by owners	–	–	–	–	–	–	–	–
(ii) Share-based payments recognized in shareholders' interests	–	–	–	–	–	–	–	–
(iii) Others	–	–	–	–	–	–	–	–
(4) Profit distribution	–	–	–	–	21,651,858.47	–	(61,716,328.87)	(40,064,470.40)
(i) Transfer to surplus reserve	–	–	–	–	21,651,858.47	–	(21,651,858.47)	–
(ii) Transfer to common risk reserve								
(iii) Transfer to owners (or shareholders)	–	–	–	–	–	–	(40,064,470.40)	(40,064,470.40)
(iv) Others	–	–	–	–	–	–	–	–
(5) Shareholders' interests internally carried forward								
(i) Transfer from capital reserve to increase share capital	–	–	–	–	–	–	–	–
(ii) Transfer from surplus reserve to increase share capital	–	–	–	–	–	–	–	–
(iii) Losses offset by surplus reserve	–	–	–	–	–	–	–	–
(iv) Others	–	–	–	–	–	–	–	–
(6) Special reserve								
1. Withdrawn in the period	–	–	–	–	–	–	–	–
2. Utilized in the period	–	–	–	–	–	–	–	–
(7) Others	–	–	–	–	–	–	–	–
4. Closing balance of current period	**424,864,883.00**	**133,519,541.72**	**–**	**–**	**90,250,998.55**	**–**	**506,167,076.01**	**1,154,802,499.28**

Legal representative of the Company: Mr. Gao Minghui, Chief Financial Officer: Mr. Pi Jianguo, Prepared by: Ms. Zhao Qiongfen

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

I. CORPORATE INFORMATION

The name of the Company has been changed from Jiaoda Kunji High-Tech Co. Ltd ("JKHT") to Shenyang Group Kunming Machine Tool Co,. Ltd. Jiaoda Kunji High-Tech Co., Ltd. (formerly known as Kunming Machine Tool Co., Ltd.) was established in the People's Republic of China as a sino-foreign joint stock limited company as part of the reorganization of a state-owned enterprise known as Kunming Machine Tool Plant ("KMTP"). Pursuant to the reorganization, the operations, assets and liabilities of KMTP were divided between the Company and Kunming Kunji Group Company ("Kunji Group Company"). The Company was established on 19th October 1993. The Company's A Shares and H Shares have been listed in Shanghai and Hong Kong respectively. The Company is engaged principally in the development, design, production and sale of machine tool products and parts, IT products, high power products, integrated optical, mechanical and electrical products; development of high-tech products; transfer of proprietary technical know-how; provision of technical services and technical advisory services.

On 15th September 2005, Jiaoda Industrial and Shenyang Machine Tool (Group) Co., Ltd. entered into an agreement regarding transfer of shares. Shenyang Machine Tool (Group) Co., Ltd. agreed to purchase 71,052,146 shares of Jiaoda Kunji High-tech Co., Ltd. held by Jiaoda Industrial, representing 29% of the total shares of the Company. The share transfer was approved pursuant to the "Written Reply regarding the Transfer of State-owned Shares of Jiaoda Kunji High-tech Co., Ltd." (Guo Zi Chan Quan [2006] No.628) issued by State-owned Assets Supervision and Administration Committee of the State Council and the Opinion on Information Disclosure of the Acquisition of Jiaoda Kunji High-tech Co., Ltd. by Shenyang Machine Tool (Group) Co., Ltd. (Zheng Jian Gong Si [2006] No.255) by China Securities Regulation Committee. On 1st December 2006, the register of equity transfer was completed and Shenyang Machine Tool (Group) Co., Ltd. became the largest shareholder of the Company instead of Jiaoda Industrial.

On 4th April 2006, pursuant to the "Written Reply of the People's Government of Yunnan Province regarding the Transfer of Title of Jiaoda Kunji High-tech Co., Ltd." issued by the People's Government of Yunnan Province and the "Written Reply of Yunnan State-owned Assets Supervision and Administration Committee regarding the Grant of Authorization to Yunnan State-owned Assets Operation Co., Ltd. to Exercise the Shareholders' Right of Jiaoda Kunji High-tech Co., Ltd." issued by Yunnan State-owned Assets Supervision and Administration Committee, 31,345,600 state-owned shares held by the People's Government of Yunnan (representing 12.79% total issued shares) were transferred to Yunnan State-owned Assets Operation Co., Ltd. at nil consideration on 31st December 2005. The share transfer was approved by the State-owned Assets Supervision and Administration Committee of the State Council pursuant to the "Written Reply regarding the Transfer of Part of the State-owned Shares of Jiaoda Kunji High-tech Co., Ltd." (Guo Zi Chan Quan [2006] No.1412). The transfer was completed on 19th January 2007.

On 25th January 2007, the "Written Reply regarding the Transfer of Shares and Increase in Share of Jiaoda Kunji High-Tech Co., Ltd." (Shuang Zi Pi [2007] No.133) was issued by the Ministry of Commerce to approve the share reform proposal of the Company, pursuant to which a total of 38,235,855 shares (as to 28,091,955 A Shares and 10,143,900 H Shares respectively) were transferred from the capital reserve to all the shareholders whose names appeared on the Company's register of members on the 26th February 2007 on the basis of 1.5606 shares for every 10 shares held. On 5th March 2007, the holders of non-circulating shares of the Company made the payment with a total of 18,728,355 shares held as consideration to the holders of circulating A Shares on the basis of 2.7 shares for every 10 shares held. The new A Shares were listed on 7th March 2007. Of 18,728,355 shares, Shenyang Machine Tool (Group) Co., Ltd., Yunnan State-owned Assets Operation Co., Ltd. and Jinghua Company contributed as to 11,088,398 shares, 4,891,787 shares and 2,748,170 shares respectively. After implementation of the consideration arrangement, non-circulating shares held by the holders of non-circulating shares of the Company became tradable and listed.

In April 2007, two shareholders of the Company, Shenyang Machine Tool (Group) Co., Ltd. and Yunnan State-owned Assets Operation Co., Ltd. jointly proposed the share increase proposal by capitalization of capital reserve on the basis of 5 shares for every 10 shares held to all the shareholders assuming that the then total share capital of the Company was 283,243,255 shares. The proposal was approved at the 21st meeting of the 5th session of the Board held on 18th April 2007 and the resolution was submitted to 2006 annual general meeting and the relevant class general meetings held on 29th June 2007 respectively.

I. CORPORATE INFORMATION *(Continued)*

On 15th August 2007, pursuant to the "Written Reply regarding the Change of Name and Increase in Share Capital of Jiaoda Kunji High-Tech Co., Ltd." (Shuang Zi Pi [2007] No.1390) issued by the Ministry of Commerce, the capitalization of capital reserve to increase the share capital of the Company was approved where the total number of shares of the Company was increased from 283,243,255 shares to 424,864,883 shares and the registered capital was increased to RMB424,864,883 from RMB283,243,255.

Pursuant to the "Written Reply on the Change in Shareholders of the Six Listed Companies including Yunnan Salt & Chemical Industry Co., Ltd." (Guo Zi Chan Quan [2009] No.1182) issued by the State-owned Assets Supervision and Administration Commission of the State Council on 22nd October 2009, 47,018,331 shares of the Company held by Yunnan tateowned Assets Operation Co. Ltd. (accounting for 11.07% of the total issued share capital of the Company) were transferred to Yunnan Industrial Investment Holding Group Co., Ltd. to perform the obligations as the contributor of state-owned assets.

On 2nd July 2010, the Company received the "Letter of Approval from the Department of Commerce of Yunnan Province Concerning its Consent to the Bonus Issue by Capitalization of the Capital Reserve by Shenji Group Kunming Machine Tool Company Limited" (Yun Nan Sheng Shang Wu Ting Yun Shang Zi [2010] No. 130, under which it is consented that the total share capital of the Company increases from 424,864,883 shares to 531,081,103 shares and the registered capital increased from RMB424,864,883 to RMB531,081,103 where the increased capital was capitalized from the capital reserve.

The place of registration of the Company is 23 Ciba Road, Kunming City, Yunnan Province. The registered capital is RMB531,018,103. The business registration number is 530000400000458.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT

1. Basis of preparation of financial statements

The financial statements of the Company have been prepared on an ongoing concern basis and based on the actual transactions and matters occurred and are recognized and measured in accordance with the Accounting Standards for Enterprises-Basic Standards and other requirements of various accounting standards.

The financial statements were approved for publication at the 26th meeting of the 6th session of the Board of the Company.

2. Statement of compliance with the accounting standards of the Company

The financial statements have been prepared by the Company in conformity with the requirements of the accounting standards of the Company and truly and completely reflect the Company's financial condition, operating results, cash flows and other financial information.

3. Accounting period

The accounting period follows the Gregorian calendar and commences on 1st January and ends on 31st December each year.

4. Reporting currency

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

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

5. Accounting treatment for business combination under common control and not under common control

(1) For business combination under common control during the reporting period, the Company shall adopt the pooling of interests method for accounting. The assets and liabilities acquired by the acquirer in business combination shall be measured at the carrying value of the acquiree on the date of combination. The difference between the carrying value of the net assets acquired by the acquirer and the carrying value of the consideration paid for combination (or total nominal value of the issued shares) shall be adjusted in the capital reserve. If such difference cannot be offset against the capital reserve, it shall be adjusted in the retained earnings. The direct expenses incurred in business combination, including the audit fee, appraisal fee and legal service fee paid by the acquirer in connection with business combination shall be included in the profit or loss when incurred. Other liabilities including the processing fee and commission paid for bond issuance or other obligations in connection with business combination are included as the initial measurement amount of bonds issued and other obligations. The administrative charges and commission incurred upon issuance of equity securities in business combination shall be offset against the premium income from equity securities. If such amount cannot be offset by premium income, it shall be adjusted in retained earnings. If the company becomes a subsidiary of the Company after business combination, the parent company shall prepare the consolidated financial statements, including the consolidated balance sheet, consolidated income statement and consolidated cash flow statement in accordance with the accounting policies for "consolidated financial statements" prepared by the Company.

(2) For business combination not under common control during the reporting period, the Company shall adopt the purchase method for accounting.

1) The cost of combination is determined by the acquirer based on the following: i) for business combination by one-off exchange transaction, the cost of consolidation shall be measured at the fair value of the assets transferred, liabilities incurred or committed and equity securities issued on the date of acquisition for the acquirer to obtain the controlling interests of the acquiree; ii) for business combination by several exchange transactions, the cost of consolidation shall be measured at the sum of the cost of each single transaction; iii) the direct expenses incurred by the acquirer in connection with business combination shall also be included in the cost of combination of enterprises; iv) for any future events stated in the contract or agreement of combination that are likely to affect the cost of combination, the acquirer shall include the same in the cost of combination if it is likely that the future events will occur and the impact on the cost of combination can be measured reliably on the date of acquisition.

2) The assets paid and liabilities incurred or committed as a consideration of business combination by the acquirer was measured at fair value on the date of acquisition and the difference between the fair value and its carrying value shall be included in the profit or loss for the period.

3) The acquirer shall allocate the cost of combination on the date of acquisition and recognize the identifiable assets, liabilities and contingent liabilities acquired from the acquiree in accordance with the requirements: i) where the cost of combination is higher than the fair value of the identifiable net assets aquired from the acquiree in business combination, the acquirer shall recognize such difference as goodwill; ii) where the cost of combination is less than the fair value of the identifiable net assets acquired from the acquiree in business combination, the acquirer shall review the measurement of the fair value of the identifiable net assets aquired from the acquiree and the cost of combination; if the reviewed cost of combination remains lower than the fair value of the identifiable net assets acquired from the acquiree in business combination, the acquirer shall recognize such difference in the profit or loss for the period.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

5. Accounting treatment for business combination under common control and not under common control *(Continued)*

(2) For business combination not under common control during the reporting period, the Company shall adopt the purchase method for accounting. *(Continued)*

4) If the company becomes a subsidiary of the Company after business combination, the parent company shall establish a record book that states the fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiaries acquired in business combination on the date of acquisition. In preparing the consolidated financial statements, the financial statements of the subsidiaries shall be restated based on the fair value of the identifiable assets, liabilities and contingent liabilities recognized on the date of acquisition in accordance with the accounting polices of the "consolidated financial statements" prepared by the Company.

6. Preparation of consolidated financial statements

(1) Determination of scope of consolidation

The scope of consolidation of the consolidated financial statements of the Company is based on controlling interests.

The parent company directly owns or, through its subsidiaries, indirectly owns the majority of the voting rights of the investees and if the parent company has control over the investees, such investees are classified as subsidiaries and included in the scope of consolidation in the consolidated financial statements. If the parent company has 50% or below voting rights of the investees and fulfils one of the following conditions, it is deemed that the parent company has control over the investees. Accordingly, such investees will be classified as subsidiaries and included in the scope of consolidation in the consolidated financial statements:

1) owns the majority of the voting rights in the investees through the agreement between the investees and other investors;

2) has the right to decide on the financial and operating policies of the investees in accordance with the articles or other requirements;

3) has the power to appoint or remove the majority of the members of the board or similar committees of the investees;

4) has the majority of voting rights in the board or similar committees of the investees.

If there is any evidence that the parent company does not have control over the investees, such investees shall not be included in the scope of consolidation in the financial statements of the Company.

(2) Preparation of consolidated financial statements

1) The consolidated financial statements of the Company are based on the individual financial statements of the subsidiaries that are within the scope of consolidation. Based on other relevant information, the long-term equity investments in the subsidiaries are adjusted in accordance with the equity method to offset the impact of the internal transactions entered into between the parent company and the subsidiaries and among the subsidiaries on the consolidated financial statements. If the accounting policies and accounting period of the subsidiaries are different from those of the parent company, the financial statements of the subsidiaries will be adjusted according to the accounting policies and accounting period of the parent company prior to consolidation.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

6. Preparation of consolidated financial statements *(Continued)*

(2) Preparation of consolidated financial statements (Continued)

2) For subsidiaries acquired upon business combination under common control, in preparing the consolidated financial statements, its assets, liabilities, operating results and cash flows at the beginning of the year from the earliest period of the reporting period are included in the consolidated financial statements and the net profit realized prior to consolidation will be reflected in the "net profit of acquiree realized prior to consolidation" separately under "net profits" in the consolidated income statement. For subsidiaries acquired upon business combination not under common control, in preparing the consolidated financial statements, its individual financial statements will be adjusted at the fair value of the identifiable net assets on the date of acquisition.

3) For subsidiaries acquired upon business combination under common control, in preparing the consolidated balance sheet, the opening balance of the consolidated balance sheet will be adjusted; for subsidiaries acquired upon business combination not under common control, the opening balance of the consolidated balance sheet will not be adjusted. For disposal of subsidiaries during the reporting period, in preparing the consolidated balance sheet, the opening balance of the consolidated balance sheet will not be adjusted.

4) For subsidiaries acquired upon business combination under common control, in preparing the consolidated income statement, the income, expenses and profits of such subsidiary from the beginning of the consolidation period to the end of the reporting period will be included in the consolidated income statement; for subsidiaries acquired upon business combination not under common control, in preparing the consolidated income statement, the income, expenses and profits of such subsidiary from the date of acquisition to the end of the reporting period will be included in the consolidated income statement. For disposal of subsidiaries during the reporting period, the income, expenses and profits of such subsidiary from the beginning of the period to the date of disposal will be included in the consolidated income statement.

5) For subsidiaries acquired upon business combination under common control, in preparing the consolidated cash flow statement, the cash flow of such subsidiary from the beginning of the consolidation period to the end of the reporting period will be included in the consolidated cash flow statement; for subsidiaries acquired upon business combination not under common control, in preparing the consolidated cash flow statement, the cash flow of such subsidiary from the date of acquisition to the end of the reporting period will be included in the consolidated cash flow statement. For disposal of subsidiaries during the reporting period, the cash flow of such subsidiary from the beginning of the period to the date of disposal will be included in the consolidated cash flow statement.

6) Minority interests and presentation of profit or loss

The shareholders' equity of the subsidiaries is not accounted for as equity of the parent company but as minority interests. In the consolidated balance sheet, the shareholders' equity is presented under "minority interests". The profit or loss of the subsidiaries for the period is accounted for as minority interests and presented under "minority interests" in "net profits" in the consolidated income statement.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

6. Preparation of consolidated financial statements *(Continued)*

(2) Preparation of consolidated financial statements (Continued)

7) Treatment of excess loss

If the loss for the period attributable to minority shareholders of a subsidiary exceeds the shareholders' equity attributable to minority shareholders in such subsidiary at the beginning of the period, the excess loss shall be offset against the minority interests if the articles or agreements provided that the minority shareholders are obliged to and the minority shareholders are able to make remedies. Otherwise, such excess loss shall be offset against the shareholders' equity of the parent company. The profit of such subsidiary realized in the subsequent periods will be included in the shareholders' equity of the parent company prior to offsetting the loss attributable to minority shareholders associated with the shareholders' equity of the parent company.

7. Determination of cash and cash equivalents

Short-term, highly liquid investments that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in value are recognized as cash and cash equivalents.

8. Foreign currency transactions and foreign currency translation

(1) Determination of foreign exchange rate and its accounting treatment

Upon initial recognition, the foreign currency transactions are translated into RMB using the exchange rate ruling on the transaction date; capital denominated in foreign currency received from investors is translated using the exchange rate ruling on the transaction date. On the balance sheet date, the following items will be treated:

1) Foreign currency monetary items will be translated using the exchange rate ruling on the balance sheet date. The exchange difference arising from the exchange rate ruling on the balance sheet date and the exchange rate upon initial recognition or ruling on the date prior to the balance sheet date will be included in finance cost.

2) Foreign currency non-monetary items measured at historical cost will be translated using the exchange rate ruling on the transaction date. The reporting currency shall not be changed on the balance sheet date.

3) Foreign currency non-monetary items measured at fair value are translated using the exchange rates at the date when the fair value is determined. After translation, the difference between the translated amount and the original amount in the reporting currency is recognized as change in fair value and included in profit or loss, or recognized in capital reserve if they are classified as foreign currency non-monetary items available-for-sale.

(2) Translation of off-balance sheet items and accounting of translation of financial statements of foreign operations

The assets and liabilities in the balance sheet are translated at the exchange rate prevailing at the balance sheet date; apart from "retained profits", the items in shareholders' equity are translated at exchange rates at the dates of the relevant transactions. The revenue and expenses items in the income statement are translated at the exchange rates at the dates of the relevant transactions. In preparing the consolidated financial statements, the exchange differences arising from above translation of financial statements of foreign operations are recognized in shareholders' equity in the consolidated balance sheet and are presented as a separate component as "exchange difference from translation of financial statements of foreign operations".

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

9. Financial instruments

(1) *Classification of financial assets:*

Upon initial recognition, financial assets are classified based on the purpose of assets held, business nature and risk management requirements of the Company as follows:

1) Financial assets measured at fair value through profit or loss include financial assets held for trading and financial assets designated as fair value through profit or loss.

2) Held-to-maturity investments are non-derivative financial assets with fixed maturity and fixed or determinable payments that an entity has intention and ability to hold to maturity.

3) Accounts receivable are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

4) Financial assets available-for-sale

(2) *Classification of financial liabilities:*

Upon initial recognition, financial liabilities are classified based on the business nature and risk management requirements of the Company as follows:

1) Financial liabilities measured at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated as fair value through profit or loss.

2) Other financial liabilities

(3) *Recognition of financial instruments:*

When the Company becomes a party to a contract of financial instrument, items within the definition of the financial assets or financial liabilities as recognized as financial assets or a financial liabilities.

(4) *Measurement of financial instruments:*

1) Initial measurement:

Financial assets or financial liabilities are initially measured at fair value. For financial assets or financial liabilities, measured at fair value through profit or loss, its transaction costs are directly charged to profit or loss, and for others are recognized as initial cost of financial assets or financial liabilities.

2) Subsequent measurement of financial assets:

i) Financial assets measured at fair value through profit or loss and financial assets available-for-sale are measured at fair value without deducting the transaction costs that are likely to arise upon the disposal of such financial asset in the future.

ii) Held-to-maturity investments and accounts receivable are measured at amortized costs using effective interest rate method.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

9. Financial instruments *(Continued)*

(4) Measurement of financial instruments: (Continued)

3) Treatment of gain or loss associated with financial assets:

i) The gain or loss arising from the change in fair value of financial assets at fair value through profit or loss, other than those related to hedging, is included in profit or loss for the period.

ii) The gain or loss arising from the fair value change of financial assets available-forsale, other than those related to hedging, is directly included in shareholders' equity and transferred to profit or loss for the period upon derecognition of such financial assets.

iii) For held-to-maturity investments and accounts receivable, the gain or loss arising from impairment, amortization or derecognition is included in profit or loss for the period, other than those designated as financial assets for hedging.

4) Subsequent measurement of financial liabilities:

i) Financial liabilities at fair value through profit or loss are measured at fair value without deducting the transaction costs that are likely to arise upon settlement of such financial liabilities in the future.

ii) Derivative financial liabilities assets that are linked with equity instruments that are not quoted in an active market, whose fair value cannot be reliably measured and that are settled through the delivery of such equity instrument, are measured at cost.

iii) Financial liabilities not measured at fair value with the change in their fair value not through profit or loss and not a part of the financial guarantee contract thereof are subsequently measured at the higher of the following two amounts upon initial recognition:

A. Amount recognized in accordance with "PRC GAAP 13 – Contingencies";

B. Initial amount recognized net of accumulated amortization recognized in accordance with "PRC GAAP 14 – Revenue".

iv) Save as the above, financial liabilities are subsequently measured at amortized cost using effective interest rate method.

(5) Treatment of gain or loss associated with financial liabilities:

1) The gain or loss arising from the change in fair value of financial liabilities subsequently measured at fair value is included in profit or loss for the period.

2) For financial liabilities measured at amortized cost or at cost, the gain or loss arising from impairment, amortization or derecognition is included in profit or loss for the period.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

9. Financial instruments *(Continued)*

(6) Recognition of the transfer of financial assets:

1) If the Company transfers substantially all the risks and rewards of ownership of the financial assets, such financial assets shall be derecognized.

2) If the Company retains substantially all the risks and rewards of ownership of the financial assets, such financial assets shall not be derecognized.

3) If the Company has not transferred nor retained substantially all the risks of ownership of the financial assets:

   i) such financial assets are derecognized as it has lost its control over such financial assets.

   ii) such financial assets are recognized to the extent of the financial assets transferred as it has not lost its control over such financial assets and relevant liabilities are recognized accordingly.

(7) Measurement of transfer of financial assets:

1) If the transfer of all financial assets satisfies the conditions for derecognition, the difference between the following two amounts shall be dealt with in the profit or loss for the period:

   i) Carrying value of the financial assets transferred.

   ii) Sum of the consideration received from the transfer and the accumulated fair value change that would have been included in the shareholders' equity (where the financial assets transferred are financial assets available-for-sale).

2) If the transfer of part of the financial assets satisfies the conditions for derecognition, the total carrying value of the financial assets transferred shall be amortized at their respective fair values between the portion derecognized and the portion not derecognized (in that case, the service assets retained shall be deemed a part of the financial assets not derecognized) and the difference between the following two amounts shall be dealt with in profit or loss for the period:

   i) Carrying value of the portion derecognized.

   i) Sum of the consideration of the portion derecognized and the corresponding amount of the portion derecognized in the accumulated fair value change that would have been directly included in the shareholders' equity (where the financial assets transferred are financial assets available-for-sale).

   The corresponding amount of the portion derecognized in the accumulated fair value change that would have been directly included in the shareholders' equity shall be amortized according to the corresponding fair value of the portion of financial assets derecognized and that of the portion not derecognized.

3) If the Company retains substantially all the risks and rewards of ownership of the financial assets transferred, all such financial assets transferred shall be continued to be recognized and the consideration received shall be recognized as a financial liability.

4) If the Company has not transferred nor retained substantially all the risks of ownership of the financial assets, such financial assets are recognized to the extent of the financial assets transferred as it has not lost control over such financial assets and relevant liabilities are recognized accordingly.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

9. Financial instruments *(Continued)*

(8) Determination of fair value of major financial assets or financial liabilities:

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist on the balance sheet date, to measure the financial asset or financial liability. If market prices do not exist on the balance sheet date and there is no material change in future economic environment in which the transaction has taken place recently, fair value should be determined using the market price of the recent transaction. If market prices do not exist on the balance sheet date but there are material changes in future economic environment in which the transaction has taken place recently, fair value should be determined using the adjusted recent market price. If there is sufficient evidence that the recent market price cannot truly reflect the fair value fair value should be determined by adjusting the market price of the recent transaction.

If a market for a financial asset or financial liability is not active, fair value is determined by using a reliable valuation technique that is common among market participants based on actual historical transaction prices. The outcome of the valuation technique should reflect the market price adopted in a transaction entered into after arm's length negotiation and at normal commercial terms on the date of valuation. In determining fair value using the valuation technique, the use of market parameters of the market participants should be maximized in pricing and regular assessment should be made to ensure the effectiveness of the valuation technique.

(9) Assessment for impairment of major financial assets:

The Company will test the carrying value of the financial assets other than the financial assets measured at fair value through profit or loss on the balance sheet date and make impairment provision if there are the following objective evidences to ascertain the impairment of such financial assets:

1) issuer or debtor experiences material financial difficulty.

2) debtor is in breach of the terms of agreement such as default or overdue interest or principal repayment.

3) creditor compromises with the debtor that is in financial difficulty based on economic or legal considerations.

4) debtor is likely to go bankrupt or engage in other financial restructuring.

5) such financial asset is unable to trade on an active market due to the material financial difficulty faced by the issuer.

6) cash flow of an asset in a group of financial assets, whether decreases or increases, cannot be identified but the estimated future cash flow of such group of financial assets has decreased and can be reliably measured since initial recognition based on the overall assessment on the publicly disclosed information; debtor of such group of financial assets becomes insolvent, or unemployment rate increases in the country or place where the debtor is located, or the price of collateral in the place where the debtor is located experience a significant fall, or the industry where the debtor is engaged in is under poor market sentiment.

7) there is material adverse changes in the technology, market, economy or legal environments where the debtor operates, such that the investors of equity instruments are unable to recover their investment costs.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

9. Financial instruments *(Continued)*

(9) Assessment for impairment of major financial assets: (Continued)

8) fair value of equity instrument investments experiences a significant or non-temporary reduction.

9) there are other objective evidences that ascertain the impairment of financial assets.

(10) Provision for impairment of major financial assets:

1) Upon the occurrence of impairment of financial assets measured at amortized cost, the carrying value of such financial asset shall be discounted to the present value of the estimated future cash flow (excluding the future credit loss that has not occurred). The discounted value is recognized as asset impairment loss and dealt with in profit or loss for the period.

2) Upon recognition of impairment of financial assets measured at amortized cost, if there is objective evidence that the value of such financial assets is recovered and it is related to the matters that occur after the recognition of such loss objectively (such as upgrade of credit rating of debtor), the impairment loss recognized shall be reversed and dealt with in profit or loss for the period. However, the carrying value after reversal should be no more than the amortized cost of such financial assets on the date of reversal had the provision for impairment not been made.

3) For equity instrument investments that are not quoted in an active market and the fair value of which cannot be reliably measured, or upon occurrence of impairment of the derivative financial assets that are linked with such equity instrument and settled through the delivery of such equity instrument, the difference between the carrying value of such equity instrument investments or derivative financial assets and the present value of future cash flow discounted using the then market rate of return of similar financial assets is recognized as impairment loss and dealt with in profit or loss for the period.

10. Recognition of bad debt provision for accounts receivable and its provision

(1) Recognition of bad debt impairment:

1) The accounts receivable that are uncollectible even after the liquidation of the debtor's bankrupt estate or legacy after the bankruptcy or death of the debtor.

2) The accounts receivable cannot be collected or are unlikely to be collected because of the debtor's default in making repayment and the existence of relevant conclusive evidence.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

10. Recognition of bad debt provision for accounts receivable and its provision *(Continued)*

(2) Provision:

1) Recognition of bad debt provision for significant single accounts receivable and its provision:

Recognition of bad debt provision for significant single accounts receivable	i) Category of trade receivables (accounts receivable): standard amount is RMB7,000,000 per transaction; ii) Category of cash flows receivables (other receivables): standard amount is RMB3,500,000 per transaction; iii) Individual receivables (other receivables): standard amount is RMB100,000 per transaction
Bad debt provision for significant single accounts receivable	The Company will carry out impairment tests separately on significant single accounts receivable. If there is objective evidence to ascertain the occurrence of impairment, impairment loss will be recognized and bad debt provision will be made; if there is no objective evidence to ascertain the occurrence of impairment, bad debt provision will be made according to the aging analysis of the significant single accounts receivable.

2) Aging analysis

Age	Percentage of provision for accounts receivable (%)	Percentage of provision for other receivables (%)
Within one year (including one year)	5	5
1-2 years	30	50
2-3 years	60	100
3 years above	95	100

Explanation of provision for bad debt	For not significant single accounts receivable of unrelated party that are not impaired after separate testing at the end of the period, bad debt provision will be made according to the percentage of the age balance of the accounts receivable and the difference between the bad debt provision at the end and at the beginning of the period will be carried at asset impairment loss.
Explanation of other provision	An impairment test will be separately carried out at the end of the period on the accounts receivable of the Company and related parties within the scope of consolidation. If there is objective evidence to ascertain the occurrence of impairment, the shortfall between the present value of its future cash flow and its carrying value will be recognized as impairment loss and a bad debt provision will be made. If there is no objective evidence to ascertain the occurrence of impairment, bad debt provision will be made according to the aging analysis of the accounts receivable of related parties and no bad debt provision will be made for the companies not within the scope of consolidation.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

11. Inventories

(1) Classification of inventory: The inventory of the Company comprises raw material, finished goods, work in progress, packaging materials and low-value consumables and is stated at cost incurred upon acquisition. The costs incurred in the delivery of inventory (apart from packaging materials and low-value consumables) are measured using the weighted average method. The amortization of packaging materials and low-value consumables are measured using the equal split amortization method.

(2) The Group maintains a perpetual inventory system. Inventory surplus, inventory loss and inventory damage are dealt with in the profit or loss for the period after deducting the compensation of the responsible party.

(3) Recognition of provision for loss of inventory and its provision:

Inventories are recorded at the actual costs or net realizable value, whichever is lower. Net realizable value is the amount of estimated selling price of inventory less the costs to be incurred upon completion, estimated selling expenses and relevant taxes in the course of daily activities. In particular, net realizable value of commodity inventories is the amount of estimated selling price less selling expenses and relevant taxes. Net realizable value of material inventories is the estimated selling price of products less the costs to be incurred upon completion, estimated selling expenses and relevant taxes.

At the end of the period, based on the comprehensive stock-taking, provision for loss of inventory will be made and dealt with in profit or loss for the period for inventory cost higher than its net realizable value. The excess of the cost of individual inventory items over its net realizable value is considered as a provision.

12. Long-term equity investments

(1) Initial measurement of long-term equity investments:

1) For long-term equity investments arising from business combination under the same control, the Company will recognize the share of carrying value of the shareholders' equity of the acquiree as the initial investment cost of long-term equity investment. The difference between the initial investment cost of long-term equity investment and the cash paid, non-monetary assets transferred, carrying value of the liabilities undertaken and the total nominal value of the issued shares of the Company will be adjusted in the capital reserve. If such difference cannot be offset against the capital reserve, it shall be adjusted in the retained earnings. For long-term equity investment arising from business combination not under the same control, the Company will recognize the initial investment cost of long-term equity investment at the sum of the fair value of the assets paid, liabilities undertaken and equity securities issued to gain control on the date of acquisition and the relevant expenses directly incurred in connection with business combination. Where the cost of longterm equity investment is higher than the fair value of the identifiable net assets of the subsidiaries, the difference shall be recognized as goodwill. Where the cost of long-term equity investment is less than the fair value of the identifiable net assets of the subsidiaries, the cost of long-term equity investment and the fair value of the identifiable net assets of the subsidiaries shall be reviewed. If the reviewed cost of long-term equity investment remains lower than the fair value of the identifiable net assets of the subsidiaries, the difference shall be dealt with in the profit or loss for the period.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

12. Long-term equity investments *(Continued)*

(1) Initial measurement of long-term equity investments: (Continued)

2) For long-term equity investments acquired through payment of cash, the initial investment cost shall be based on the actual consideration paid for acquisition. The initial investment costs include expenses directly related to long-term equity investment, taxes and other necessary charges. However, the actual consideration paid, including cash dividends declared but not collected, is recorded separately as accounts receivable.

3) For long-term equity investments acquired through the issue of equity securities, the initial investment cost shall be recorded at the fair value of the issued equity securities.

4) For long-term equity investments contributed by investors, the initial investment cost shall be the value, if not being unfair, as agreed by the contract or agreement governing the investment.

5) For long-term equity investments acquired by non-monetary asset exchange, should the non-monetary asset exchange has commercial substance or the fair value of the assets received or surrendered can be measured reliably, the initial investment cost shall be the fair value and related taxes of the assets surrendered and the difference between the fair value and the carrying value of the asset surrendered shall be recorded into the profit or loss of for the period; Should the non-monetary asset exchange do not have the above two conditions at the same time, the initial investment cost shall be carrying value and related taxes of the assets surrendered.

6) For long-term equity investments acquired by debt rearrangement, the initial investment cost shall be the fair value of long-term equity investment acquired and the difference between initial investment cost and carrying value of debt rearrangement is recognized in profit or loss for the period.

(2) Basis of recognition of investees subject to joint control and significant influence:

1) Basis of recognition of investees subject to joint control: A. no any party could solely control operating activity of the joint venture; B. the operating decisions of joint venture need consensus of each party; C. each party to the joint venture may engage one of parties to the joint venture to manage the daily activities of the joint venture by means of contract or agreement but the management rights within the scope of financial and operating policies should be exercised after obtaining the consensus of each party.

2) Basis of recognition of investees subject significant influence: A. the Company directly owns or through its subsidiaries indirectly owns more than 20% but less than 50% voting rights of the investees; B. the Company has representatives in board of directors of the investees or similar authorities; C. the Company is involved in the investees' policy making; D. there are significant transactions with the investees; E. the Company has designated management staff to the investees; F. the Company provides key technology to the investees.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

12. Long-term equity investments *(Continued)*

(3) Subsequent measurement of long-term equity investments:

The Company uses the cost method to recognize the longterm equity investments and other equity investments of the subsidiaries, whereas the long-term equity investments of joint ventures and associated companies are measured using equity method.

The Company adopts the cost method to adjust the cost of long-term equity investments upon the addition or recovery of long-term equity investments. The cash dividend or profit declared by the investees is recognized as investment income for the period.

Upon the acquisition of long-term equity investments using equity method, the investment gain or loss will be recognized according to the net realized gain or loss attributable to the investees and the carrying value of the long-term equity investments will be adjusted accordingly. For the changes in shareholders' equity of the investees resulted from factors other than net profit or loss, whilst percentage of shareholding remains constant, the carrying value of the long-term equity investments will be adjusted according to their respective percentage of shareholding and recognized in capital reserve (other capital reserve) accordingly. The net loss from the investment in investee is recognized to the extent that the carrying value of the long-term equity investments and other long-term interest in substance in the investees are written down till nil, unless an obligation to bear additional loss is stated in the contract or agreement.

(4) Impairment test and impairment provision

On the balance sheet date, if there is an indication of impairment of long-term equity investments of the subsidiaries, joint ventures and associated companies, an impairment loss will be recognized for its estimated recoverable amount is lower than its carrying value and dealt with in the profit or loss for the period, meanwhile a provision for the impairment of the long-term equity investments will be made. Upon the impairment of other equity investments, the difference between the present value of the future cash flow discounted using the market rate of return of similar financial assets and the carrying value of the investment will be recognized as an impairment loss and dealt with in the profit or loss for the period. At the same time, a provision will be made for the long-term equity investments. The impairment provision for the long-term equity investments above shall not be reversed in the subsequent periods.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

13. Investment properties

(1) *Type of investment properties*

Investment properties are classified as leased land use rights, land use rights held for transfer upon appreciation and leased structures.

(2) *Measurement of investment properties*

The investment properties of the Company are measured initially at cost. The costs of investment properties purchased from third parties include purchase consideration, related taxes and other expenses directly attributable to such assets. The costs of self-constructed investment properties include the expenses necessary to bring such asset to a condition for its intended use.

The investment properties are measured subsequently by using the cost method on the balance sheet date and the investment properties will be measured, depreciated or amortized over the terms of the fixed assets and intangible assets. If an indication of impairment exists, its recoverable amount will be estimated. If the recoverable amount of the investment properties is lower than is carrying value, the carrying value of the investment properties will be reduced to its recoverable amount. Such difference will be recorded as asset impairment loss and dealt with in the profit or loss for the period, and a provision for the impairment of the investment properties will be made accordingly. Upon the recognition of impairment loss on investment properties, the depreciation or amortization expenses of the impaired investment properties will be adjusted in the subsequent periods so that the carrying value of the adjusted investment properties can be amortized systematically over the remaining useful life of such investment properties (net of estimated net residual value).

Once recognized, the impairment loss on investment properties cannot be reversed in the future accounting periods.

14. Fixed assets

(1) *Recognition of fixed assets:*

Tangible assets with a useful life of 1 year (less than 1 year) held for the provision of labor services, leasing or operation and management of the Company will be recorded in fixed assets. They include buildings and structures, machinery and equipment and transportation facilities. Software attached to the computer hardware purchased is not valued separately and shall be combined with computer hardware as fixed assets management. Software that is valued separately shall be recorded in intangible assets.

(2) *Depreciation of various fixed assets:*

Fixed assets are depreciated over their useful life at straight-line method. Depreciation rates of fixed assets are determined based on the category, estimated useful life and estimated rate of net residual value of fixed assets (5%). Fixed assets are depreciated on a monthly basis in the month following the acquisition (other than fixed assets depreciated which are currently in use and land valued separately). The useful life and depreciation rates of various fixed assets are as follows:

Category	**Useful life** (year)	**Depreciation rate** (%)	**Depreciation method**
Buildings and structures	40	2.38	Straight-line method
Machinery and equipment	5-20	4.78-19.00	Straight-line method
Transportation equipment	5-14	6.78-19.00	Straight-line method
Others	5-14	6.78-19.00	Straight-line method

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

14. Fixed assets *(Continued)*

(3) *Impairment test of and impairment provision for fixed assets:*

The Company will carry out an impairment test on fixed assets that have signs of impairment on the balance sheet date and estimate its recoverable amount. If the recoverable amount is less than its carrying value, the carrying value of the assets will be reduced to its recoverable amount. Such difference will be dealt with in the profit or loss for the period and a provision will be made for the impairment of assets accordingly. The recoverable amount is the higher of the net fair value of the assets less disposal expenses and the present value of the future cash flow of the assets. The Company estimates the recoverable amount based on a single asset in principle. If it is difficult to estimate the recoverable amount of a single asset, the recoverable amount of the asset group will be determined based on the asset group under such asset. Once an impairment provision is made, it shall not be reversed in future accounting periods.

(4) *Recognition and valuation of fixed assets under finance lease:*

Basis of valuation: a finance lease is identified if any one or several of the following conditions is/are fulfilled:

1) upon the expiry of lease, the ownership of the leased asset is transferred to the lessee.

2) the lessee has the option to purchase the leased asset, the purchase consideration entered into is expected to be far less than the fair value of the leased asset upon the exercise of the option. Accordingly, it can be reasonably determined that the lessee will exercise such option upon the commencement of the lease.

3) the lease term accounts for the majority of the useful life of the leased asset even if the ownership of the asset is not transferred.

4) the present value of the minimum lease payment of the lessee upon the commencement of the lease is substantially the same as the fair value of the leased asset upon the commencement of the lease; the present value of the minimum rental receipt of the lessor upon the commencement of the lease is substantially the same as the fair value of the leased asset upon the commencement of the lease.

5) only the lessee may use such leased asset due to its specific nature if no material change is made.

Valuation method: for fixed assets leased under finance lease, if it can be reasonably determined that the ownership of the leased asset can be acquired upon the expiry of the lease term, depreciation policies in line with the fixed assets will be adopted for depreciation during the remaining useful life of the leased asset. If it cannot be reasonably determined that the ownership of the leased asset can be acquired upon the expiry of the lease term, depreciation polices in line with the fixed assets will be adopted for depreciation during the shorter of the lease term and the remaining useful life of the leased asset.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

15. Construction-in-progress

(1) Construction-in-progress refers to the expenses incurred in the construction and installation of infrastructure and renovation.

(2) Construction costs are determined based on the actual expenses incurred in construction-in-progress. For fixed assets constructed or fixed assets improvement under operating lease that have reached the condition for intended use but have not been completed, the estimated construction budget, consideration or actual construction costs will be transferred to fixed assets or long-term deferred expenditures for depreciation or amortization. Upon completion, the original temporary value will be adjusted based on actual costs, but the depreciation or amortization made is not subject to adjustment.

(3) Borrowing costs incurred for acquisition or construction of a fixed asset are capitalized when the following three conditions are fully satisfied: expenditures for the asset are being incurred; borrowing costs are being incurred; and acquisition and construction that are necessary to enable the asset to reach the condition for its intended use have commenced. The capitalization of borrowing costs ceases when the construction-in-progress is ready for intended use. Borrowing costs incurred thereafter are recognized in the profit or loss for the period.

(4) Provision for impairment of construction-in-progress

On the balance sheet date, an impairment test will be carried out on individual construction projects if there is an indication that the construction-in-progress is impaired. The Company will then estimate its recoverable amount. If the recoverable amount is lower than the carrying value, the carrying value of the asset will be reduced to the recoverable amount. Such difference will be dealt with in the profit or loss for the period and a provision for the asset impairment will be made accordingly. The recoverable amount is the higher of the net fair value of the assets less disposal expenses and the present value of the future cash flow of the assets. Once an impairment provision is made, it shall not be reversed in future accounting periods.

16. Borrowing costs

(1) Recognition of capitalization of borrowing costs

Qualifying assets shall refer to the fixed assets, investment properties, inventories and other assets, of which the acquisition and construction or production may take a substantially long period of time to get ready for its intended use or for sale.

Borrowing costs include borrowing interests, amortization at discount or premium, ancillary expenses and foreign exchange difference arising from borrowings denominated in foreign currency. Where the borrowing costs incurred to an enterprise can be directly attributable to the acquisition and construction or production of qualifying assets, it shall be capitalized and recorded in the costs of relevant assets. Other borrowing costs shall be recognized as expenses on the basis of the actual amount incurred, and shall be dealt with in the profit or loss for the period.

(2) Borrowing costs are capitalized when the following three conditions are fully satisfied:

1) Expenditures for the asset are being incurred where expenditures for the asset include cash paid for acquisition, construction or production of qualifying assets and expenditures incurred due to transfer of non-cash assets or interest-bearing loans;

2) Borrowing costs are being incurred;

3) Acquisition and construction or production that is necessary to enable the asset to reach the condition for its intended use or for sale have commenced.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

16. Borrowing costs *(Continued)*

(3) *Capitalization period of borrowing costs:*

The borrowing cost incurred for a fixed asset acquired or constructed in fulfillment with the above conditions is capitalized before the asset has reached the condition for its intended use or for sale. The capitalization of borrowing costs is suspended during the period in which the acquisition or construction of a fixed asset or an investment property is abnormally interrupted, and the interruption period is more than 3 months. Borrowing costs during the period are then treated as an expense for the period until the acquisition or construction is resumed. The capitalization of borrowing costs ceases when the fixed asset is ready for its intended use or for sale and borrowing costs incurred thereafter are directly included in finance cost for the period in which they are incurred.

(4) *Computation of capitalized amount of borrowing costs:*

1) Specific borrowings for acquisition or construction or production or development of qualifying assets will be recorded based on the actual interest expense incurred in the period of special borrowings less the interest income from unutilized borrowings placed at banks or investment gain from temporary investment.

2) Capitalization of interest expenses of general borrowings

During the capitalization period of borrowing costs, the interest expenses of general borrowings subject to capitalization used for acquisition, construction or production of qualifying assets shall be calculated at the following formula:

Capitalized interest expenses of general borrowings = aggregate amount of asset expenses

less weighted average of asset expenses in respect of the balance of specific borrowings x rate of capitalization of general borrowings

Rate of capitalization of general borrowings = weighted average rate of general borrowings

= sum of actual interests incurred for the period of general borrowings/weighted average of principal of general borrowings

Weighted average of principal of general borrowings = ∑ [principal per each batch of general borrowings x number of days attributable to each batch of general borrowings]/number of days in the period

3) Capitalization of ancillary costs

Ancillary costs are capitalized based on the actual amount incurred before the qualifying asset acquired or constructed or produced is ready for its intended use or for sale and accounted for as cost of qualifying assets. After the qualifying asset acquired or construction or produced is ready for its intended use or for sale, the ancillary costs will be recognized as an expense based on the actual amount incurred and dealt with in the profit or loss for the period.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

17. Intangible assets

(1) Intangible assets are defined as identifiable non-monetary assets owned or controlled by the Company that cannot be physically measured. Intangible assets are initially measured at cost.

(2) Intangible assets are initially measured based on the costs of acquisition or expenses that are attributable to the development stage of intangible assets and can be reliably measured.

(3) Subsequent measurement of intangible assets:

1) Useful life of intangible assets:

In estimating the useful life of intangible assets, for those with a definite useful life, if the intangible assets are derived from contractual rights or other legal rights, its useful life should not exceed the period stated under the contractual rights or other legal rights; if the contractual rights or other legal rights allow an extension upon expiry and renewal, and there is evidence that no substantial costs are involved in renewal, the period of renewal will be included as part of the useful life. If no useful life is stated in the contracts or the law, the Company will determine the term that the intangible assets can bring future economic benefits to the Company after its judgment on various aspects.

If the term of future economic benefits that the intangible assets can bring to the Company cannot be determined based on the above methods, the intangible assets are classified as intangible assets with an indefinite useful life.

The consideration factors for an enterprise to identify the useful life of intangible assets are:

1 General useful life of products of such asset and information on the useful life of similar assets can be acquired;

2 Current technology and procedural conditions and estimates on future growth trends;

3 Market demand for the products (or services) produced by the assets;

4 Action expected to be taken by existing or potential competitors;

5 Estimated maintenance expenses required to maintain the ability to generate future economic benefits of such asset and the Company's estimated ability to settle such expenses;

6 Term and laws or similar restrictions governing such asset such as licensing period and lease term;

7 Relationship with the useful life of other assets held by the Company.

2) Amortization of intangible assets:

Intangible assets with a definite useful life are amortized using the straight-line method over the estimated useful life since the month of acquisition. Intangible assets with an indefinite useful life are not amortized and are subject to an impairment test at the end of the period.

The Company reviews the useful life and amortization method of the intangible assets at least once at every year end and makes adjustment if necessary.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

17. Intangible assets *(Continued)*

3) Impairment of intangible assets:

If there is conclusive evidence that there is an indication of impairment of intangible assets, the Company will carry out an impairment test on the balance sheet date and estimate its recoverable amount. If the recoverable amount is lower than its carrying value, the carrying value of the intangible assets will be reduced to its recoverable amount. Such difference will be dealt with in the profit or loss for the period and a provision will be made for impairment of intangible assets accordingly. For intangible assets with an indefinite useful life, whether there is an indication of impairment, an impairment test will be carried out each year.

(4) R&D expenses:

The expenses incurred in the internal R&D projects of the Company are classified as research expenses and development expenses.

Criteria for classification of research expenses and development expenses under the internal R&D projects of the Company are as follows:

Research expenses refer to scheduled innovative investigations to obtain and understand scientific or technological knowledge in preparing the information or other aspects for further development activities. Whether research activities commenced will turn into development and whether any intangible assets will be formed after development are highly uncertain. Accordingly, all research expenses will be recorded as an expense and dealt with in the profit or loss for the period.

Development expenses mean to apply the research outcomes or other knowledge to a plan or design prior to a commercial production or use in order to produce new or essentially-improved materials, devises, products, etc. The expenses in the development phase are recognized as intangible assets if the following conditions are fulfilled:

1) it is technically feasible to complete such intangible asset so that it will be available for use or for sale;

2) management intends to complete such intangible asset and use or sell it;

3) it can be demonstrated how such intangible asset will generate future economic benefits, including the existence of a market for the products produced using such intangible assets or the existence of a market for such intangible assets; it can also be demonstrated how such intangible assets are used internally;

4) adequate technical, financial and other resources to complete the development and to use or sell such intangible assets are available;

5) the expenditure attributable to such intangible assets during its development can be reliably measured.

For R&D projects that are in progress and recognized as intangible assets, the expenses incurred after acquisition shall be accounted for based on the above.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

18. Long-term deferred expenditures

Long-term deferred expenditures refer to the incurred expenses that are amortized in current period and the periods following where the amortized period is longer than one year. Long-term deferred expenditures are measured according to the actual amount incurred and amortized using straight-line method during the period that it enjoys benefits from the project. In particular:

Expenditures of fixed asset improvements under operating lease are amortized at the shorter of the remaining lease term and the useful life of the lease asset; whereas for fixed assets under finance lease, the qualifying renovation expenses are amortized at the shorter of the interval between two renovations, remaining lease term and the useful life of the fixed asset.

Other long-term deferred expenditures are amortized over the period that it enjoys benefits.

If the long-term deferred expenditures cannot generate future accounting periods, the remaining amortized amount of the project is fully transferred to profit or loss for the period.

19. Contingent liabilities

(1) Recognition of contingent liabilities:

Contingent liabilities shall be recognized when the obligations pertinent to the contingencies satisfy the following conditions: Such obligations are present obligations undertaken by the Company; the performance of which may result in outflow of economic benefits; the amount of such obligations may be reliably measured.

1) Such obligations are present obligations undertaken by the Company;

It refers to the obligations pertinent to the contingencies and are obligations undertaken by the Company under the prevailing conditions. The Company can only perform such present obligations without other options.

2) It may result in outflow of economic benefits as a result of performance of the obligations;

It refers to the performance of present obligations pertinent to the contingencies may result in outflow of economic benefits with a probability of over 50% but less than 95%.

3) The amount of such obligations can be reliably measured;

It refers to the amount of the present obligations pertinent to the contingencies that can be reasonably measured.

(2) Measurement of contingent liabilities:

1) Determination of best estimates:

Contingent liabilities are initially measured based on the best estimates of the expenditures required to be paid for performance of the present obligations. Determination of the best estimates shall be treated in the following two scenarios:

A. If there is a sequent range for the necessary expenditures and if all the outcomes within this range are equally likely to occur, the best estimates shall be determined in accordance with the middle estimate within the range, i.e. the average of the highest and the lowest amounts.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

19. Contingent liabilities *(Continued)*

(2) Measurement of contingent liabilities: (Continued)

B. If there is no sequent range for the necessary expenditures, or all the outcomes within this range are not equally likely to occur despite that there is a sequent range; in that case, the best estimates shall be determined according to the following methods:

a. If the contingencies concern a single item, it shall be determined in light of the most likely outcome.

b. If the contingencies concern two or more items, the best estimate shall be calculated and determined in accordance with all possible outcomes and the relevant probabilities.

2) Treatment of estimated compensation:

When all or some of the expenditures necessary for the liquidation of contingent liabilities of the Company is expected to be compensated by a third party, the compensation should be separately recognized as an asset only when it is virtually certain that the compensation will be obtained. The amount recognized for the compensation should not exceed the carrying value of the contingent liabilities.

The Company reviews the carrying value of contingent liabilities on the balance sheet date. If there is conclusive evidence that such carrying value cannot truly reflect the prevailing best estimates, such carrying value shall be adjusted according to the prevailing best estimates.

20. Share-based payments and equity instruments

Recognition and measurement of share-based payments are based on accurate, complete and effective share-based payment agreements. It can be classified as equity-settled share-based payment and cash-settled share-based payment.

(1) Equity-settled share-based payment:

The equity-settled share-based payment made in return for the rendering of employee services shall be measured at the fair value of the equity instruments granted to the employees. For equity instruments that may be exercised immediately after the grant, the fair value of such instrument shall, on the date of the grant, be recognized in relevant costs or expenses with the increase in the capital reserve accordingly. For equity-settled share-based payment made in return for the rendering of employee services that cannot be exercised until the services are fully rendered during vesting period or specified performance targets are met, on each balance sheet date within the vesting period, the services acquired in the current period shall, based on the best estimate of the number of exercisable instruments, be recognized in relevant costs or expenses and the capital reserves at the fair value of such instruments on the date of the grant.

Determination of fair value of equity instruments:

1 For the shares granted to the employees, its fair value is measured at the market price of the share of the company and adjusted according to the terms and conditions of the shares (excluding the vesting conditions other than market conditions). If the transaction is not disclosed by the company, it shall be measured at the estimated market price and adjusted according to the terms and conditions of the shares granted.

2 For the share options granted to the employees, if there are no trading options with similar terms and conditions, the fair value of the option granted shall be estimated using the option pricing model.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

20. Share-based payments and equity instruments *(Continued)*

(1) Equity-settled share-based payment: (Continued)

In determining the fair value at the date of grant of the equity instruments, the company shall consider the impact of market conditions in the vesting conditions and non-vesting conditions stated in the share-based payment agreement. If there are no vesting conditions in the share-based payments, as long as the employees or other aspects satisfy the non-market conditions in all the vesting conditions (such as term of service), the company shall recognize the services rendered as an expense accordingly.

(2) Cash-settled share-based payment:

The cash-settled share-based payment shall be measured at the fair value of liability incurred, which is calculated and determined based on the shares or other equity instruments. For the cash-settled share-based payment that may be exercised immediately after the grant, the fair value of the liability incurred by the Company shall, on the date of the grant, be recognized in relevant costs or expenses and the liabilities shall be increased accordingly. For cash-settled share-based payment made in return for the rendering of employee services that cannot be exercised until the services are fully provided during vesting period or specified performance targets are met, on each balance sheet date within the vesting period, the services acquired in the current period shall, based on the best estimate of the number of exercisable instruments, be recognized in relevant costs or expenses and the corresponding liabilities at the fair value of the liability incurred by the Company.

(3) *Basis for determining the best estimates of exercisable equity instruments:*

On each balance sheet date within the vesting period, the Company shall determine the best estimates based on the latest number of employees able to exercise their options and revise the estimated number of exercisable equity instruments to make the best estimates of the exercisable equity instruments.

(4) *Accounting treatment for revision and termination of share-based payment plans:*

If the revision results in an increase in the fair value of the equity instruments granted, the Company shall recognize the increase in the services rendered accordingly at the increased fair value of the equity instruments. If the revision results in an increase in the number of equity instruments granted, the Company will recognize the increase in the services rendered accordingly at the fair value of the increased number of equity instruments. If the Company revises the vesting conditions on terms favorable to the employees, the Company will take into consideration of the revised vesting conditions when dealing with the vesting conditions.

If the revision results in a decrease in the fair value of the equity instruments granted, the Company shall continue recognize the amount of services rendered accordingly at the fair value of the equity instruments on the date of grant without considering the decrease in the fair value of the equity instruments. If the revision results in a decrease in the number of equity instruments granted, the Company will account for such decrease by reducing part of the cancellation of equity instruments granted. If the Company revises the vesting conditions on terms not favorable to the employees, the Company will not take into consideration of the revised vesting conditions when dealing with the vesting conditions.

If the Company cancels the equity instruments granted or settles the equity instruments granted during the vesting period (other than cancellation as a result of failure to satisfy the vesting conditions), such cancellation or settlement will be treated as accelerated exercisable rights and the original amount in the remaining vesting period will be recognized immediately.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

21. Repurchase of shares of the Company

For capital reduction by means of acquisition of the shares of the Company approved in accordance with the legal procedures, the capital will be reduced by the total nominal value of the shares cancelled. The difference between the consideration paid for the repurchase of shares (including the transaction costs) and the nominal value of the shares shall be adjusted in the shareholders' equity. The excess over the total nominal value shall be offset against the capital reserve (share premium), surplus reserve and unallocated profits in sequence. The shortfall from the total nominal value will be included in capital reserve (share premium).

Prior to cancellation or transfer of shares repurchased, the Company will recognize all expenditures arising from share repurchase as cost of treasury shares as part of the treasury share management.

Upon the transfer of treasury shares, the excess of revenue from transfer over the cost of treasury shares will be included in capital reserve (share premium); whereas the shortfall from the cost of treasury shares will be offset against the capital reserve (share premium), surplus reserve and unallocated profits in sequence. For repurchase of the shares of the Company as a result of implementation of share incentive scheme, upon repurchase, all the expenditures arising from share repurchase are treated as treasury shares and are registered and available for inspection.

22. Revenue

(1) Revenue from sale of commodities:

Revenue is recognized if the following conditions are satisfied:

1) The Company has transferred the major risks and returns in the ownership of commodities to the purchaser;

2) The Company no longer exercises continuing management generally related to the ownership and no longer has actual control over the commodities sold;

3) Amount of revenue can be reliably measured.

4) It is very likely that an inflow of economic benefits to the Company will occur.

5) Costs related, incurred or to be incurred can be reliably measured.

(2) Revenue from provision of labor services:

1) For labor services which are commenced and completed in the same accounting year, revenue is recognized upon completion of the labor services and the amount recognized is the total amount stated in the contract or agreement.

2) If the commencement and completion of labor services falls in different accounting years, relevant revenue from the labor services will be recognized on the balance sheet date on percentage of completion method, provided that the results of the labor service provision transaction can be reliably estimated.

3) If the results of the labor service provision transaction cannot be reliably estimated, revenue will be recognized on the balance sheet date based on the cost of labor services incurred and estimates of the ability to compensate such cost and carried forward as costs. If it is estimated that the cost of labor services incurred can be partially compensated, revenue will be recognized to the extent that the cost of labor services can be compensated and the cost of labor services incurred will be carried forward as costs. If it is estimated that the cost of labor services incurred cannot be compensated, no revenue will be recognized and the cost of labor services incurred will be recognized as an expense for the period.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

22. Revenue *(Continued)*

(3) Assignment of asset use rights:

The licensing revenue arising from assignment of asset use rights will be recognized according to the period and method stated under relevant contract or agreement, provided that the following conditions shall be satisfied:

1) Inflow of economic benefits in connection with the transaction to the Company

2) Amount of revenue can be reliably estimated.

23. Government grants

(1) Recognition of government grants:

Government grants are recognized if the Company receives the monetary assets or non-monetary assets from the government at nil consideration and the following conditions are satisfied:

1) The Company can satisfy the conditions attached to the government grants;

2) The Company can receive the government grants.

(2) Measurement of government grants:

1) For government grants in the form of monetary assets, the amount received or receivable is measured. For government grants in the form of non-monetary assets, it is measured at fair value or nominal amount if the fair value cannot be reliably estimated.

2) For asset-related government grants, the Company will recognize as deferred income upon the grant. Such amount will be amortized over the useful life of such asset from the time when such asset reach the condition for its intended use and will be dealt with in the profit or loss in the subsequent periods. For those assets that are sold, transferred, retired or damaged prior to the expiry of the useful life, the balance of the unallocated deferred income will be transferred as one-time gain or loss arising from disposal of assets for the period.

For revenue-related government grants used for compensating the relevant expenses or losses of the Company in subsequent periods, deferred income will be recognized upon the grant and dealt with in the profit or loss during the period when the relevant expenses are recognized. For those used for compensating the relevant expenses or losses incurred, it will be directly dealt with in the profit or loss for the period upon the grant.

3) Reversal of the government grants recognized shall be treated as follows:

i) If the relevant deferred income exists, such deferred income is offset against the balance of the carrying value with the excess dealt with in the profit or loss for the period.

ii) If the relevant deferred income does not exist, it will be directly dealt with in the profit or loss for the period.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

24. Deferred income tax assets/deferred income tax liabilities

(1) Recognition of deferred income tax assets:

1) Deferred income tax assets arising from deductible temporary difference are recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. However, deferred income tax assets arising from the initial recognition of assets or liabilities are not recognized in the transactions with the following characteristics:

1 Such transaction or event is not a part of the business combination;

2 Accounting profit nor taxable profit (or deductible loss) is affected when the transaction takes place.

2) Deferred income tax assets are recognized for the deductible temporary difference associated with the subsidiaries, associated companies and joint ventures of the Company and if the following conditions are satisfied:

1 Reversal of temporary difference is expected in the foreseeable future;

2 It is very likely that future taxable profit is available against which the temporary difference can be utilized.

3) Deferred income tax assets are recognized for the deductible losses and tax deductions that can be carried forward to subsequent years to the extent that future taxable profits are available against which deductible losses and tax deductions can be utilized.

(2) Recognition of deferred income tax liabilities:

Deferred income tax liabilities arising from all taxable temporary difference are recognized apart from the deferred income tax liabilities arising from the following conditions:

1) Initial recognition of goodwill;

2) Assets or liabilities arising from the transactions with the following characteristics are initially recognized:

1 Such transaction is not a part of the business combination;

2 Accounting profit nor taxable profit (or deductible loss) is affected when the transaction or event takes place.

3) Deferred income tax liabilities are recognized for the taxable temporary difference associated with the subsidiaries, associated companies and joint ventures of the Company and if the following conditions are satisfied:

1 Timing of reversal of temporary difference can be controlled by the Company;

2 It is very likely that the temporary difference will not be reversed in the foreseeable future.

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

24. Deferred income tax assets/deferred income tax liabilities *(Continued)*

(3) Measurement of income tax expense:

1) On the balance sheet date, estimated amount of income tax payable (or refundable) calculated in accordance with the tax laws is measured for the income tax liabilities (or assets) formed in the current period or prior periods. According to the tax laws, deferred income tax assets and deferred income tax liabilities are measured at applicable tax rates during the period when such assets are expected to be recovered or such liabilities are expected to be settled. If there is a change in the tax rate, the deferred income tax assets and deferred income tax liabilities recognized will be re-measured and recorded as income tax expense for the period, save for the deferred income tax assets and deferred income tax liabilities arising from the transaction or event recognized in the shareholders' equity.

2) On the balance sheet date, the Company reviews the carrying value of the deferred income tax assets. If it is very likely that no future taxable profits will be available to deduct the gain from deferred income tax assets, the carrying value of the deferred income tax assets will be reduced. If it is very likely that sufficient taxable profits will be available, the amount reduced will be reversed.

25. Employee benefits

Employee benefits include salaries, bonus, allowance and subsidy; staff benefits; medical insurance; pension insurance; unemployment insurance; work injury insurance; maternity insurance and other social insurances; housing fund; union fund and staff education fund, non-monetary benefits and resignation and retirement benefits in connection with the rendering of employee services. The Company shall recognize the remuneration payable to employees as liabilities during the period of service and record the relevant costs and expenses based on the revenue items arising from the rendering of employee services apart from the compensation given as a result of termination of employment relationship with the employees. Employee benefits are measured based on the following principles:

(1) Monetary remuneration with defined standards is recognized as employee benefits payables according to the stated standards;

(2) Monetary remuneration with undefined standards is recognized as employee benefits payables according to the historical experience and its own actual conditions;

(3) Non-monetary employee benefits are recognized as employee benefits payable upon actual disbursement at the fair value of the non-monetary assets;

(4) For resignation and retirement benefits under the scheme of termination of employment relationship that is duly formulated by the Company and cannot be revoked unilaterally, it will be dealt with in the profit or loss for the period and recognized as employee benefits payable.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

26. Change in major accounting policies and accounting estimates

(1) Change in major accounting estimates

Based on the changes in the Company's operating conditions, the empirical figures on the collection of accounts receivable and the estimates of the bad debt rate, the Company has made the following changes in the accounting estimates of the applicable rate of bad debt provision for accounts receivable:

Item/Year	Applicable rate before the change	Applicable rate after the change
Within one year	5%	5%
1-2 years	50%	30%
2-3 years	100%	60%
Over 3 years	100%	95%

(2) Reason for the change in accounting estimates

The Company's sales revenue increased rapidly for the recent years, along with the significant change in product structure. The original applicable rate of bad debt provision for accounts receivable cannot reflect such changes. According to the practical accounts receivable collection for these years, the applicable rate of bad debt provision for accounts receivable has changed since 30th June 2010 for the following reasons:

A. The sales proportion of digital machine tool products increased from 20% in 2002 to 70% in 2009; whereas digital floor-type boring and milling machine replaced the conventional boring and milling machine to become the leading products. However, with the extension of after-sales installation and commissioning period and service period of the floor-type boring and milling machine for around three months in average than those of conventional boring and milling machine, the collection period is extended.

B. Historical figures for the aging analysis of the accounts receivable of the Company for the last four years:

Age	2006	2007	2008	2009
Within one year	82,007,539.24	110,201,209.19	145,465,388.98	114,077,418.48
1-2 years	12,854,514.11	20,659,851.95	35,395,967.04	56,243,055.13
2-3 years	7,232,469.05	7,171,514.21	12,004,296.22	25,588,781.11
Over 3 years	17,002,579.40	19,709,632.61	24,172,509.56	31,533,873.78
Total	119,097,101.79	157,742,207.96	217,038,161.80	227,443,128.50

Based on the above table, the Company estimates that:

a. 89% of the accounts receivable due 1-2 years can be collected with a bad debt possibility of not more than 11%;

b. 47% of the accounts receivable due 2-3 years can be collected with a bad debt possibility of not more than 53%;

c. 14% of the accounts receivable due over 3 years can be collected with a bad debt possibility of not more than 86%.

According to the historical figures over the past four years, the original applicable rate of bad debt provision for the accounts receivable is obviously higher than that of the practical bad debt that is likely to be incurred.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

II. SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY, ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT *(Continued)*

26. Change in major accounting policies and accounting estimates *(Continued)*

(2) Reason for the change in accounting estimates (Continued)

C. The Company's original applicable rate of bad debt provision for the accounts receivable is much higher than the average applicable rate of the similar listed companies in the same industry.

Based on the changes in the Company's operating conditions, the empirical figures on the collection of accounts receivable and the estimates of the bad debt rate, the Company has made the following changes in the accounting estimates of the applicable rate of bad debt provision for accounts receivable:

Item/Year	Applicable rate before the change	Applicable rate after the change
Within one year	5%	5%
1-2 years	50%	30%
2-3 years	100%	60%
Over 3 years	100%	95%

The adjusted bad debt provision applicable rate is still higher than the possibility of the practical bad debt that is likely to be incurred, and is higher than that of the similar listed companies in the same industry.

(3) Impact of the change in accounting estimates on the Company

The change in accounting estimates only relates to the applicable rate of the bad debt provision for accounts receivable and shall be treated with the prospective application method under the PRC GAAP. The change in accounting estimates has resulted in the decrease in bad debt provision for the period of RMB42,107,196.35, increase in net accounts receivable of RMB42,107,196.35, decrease in impairment on assets of RMB42,107,196.35, increase in operating profit of RMB42,107,196.35, increase in total profit of RMB42,107,196.35, decrease in deferred income tax assets of RMB6,530,421.32, increase in deferred income tax of RMB6,530,421.32, increase in net profit of RMB35,576,775.03 and increase in undistributed profit at the end of the period of RMB32,019,097.52.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

III. TAXATION

1. Major types of tax and tax rates

Types	Basis of tax computation	Tax rate
VAT	Tax on sales for the period after deducting the tax on purchase in accordance with the policies	Uniform tax rate of 17%
Business tax	Assessable income	3%, 5%
City construction tax	VAT or business tax paid	See III.3
Enterprise income tax	Income tax payable	See III.2

2. Preferential tax policies and approvals

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

Pursuant to the written reply issued by the taxation authority, the applicable rate of income tax of the Company is 15% due to the preferential tax policy for Western Region Development for 2010.

The subsidiaries of the Company including Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. and Changsha Ser Turbo Equipment Co., Ltd. are high tech companies. The applicable rate of income tax is 15%. The applicable rate of income tax of the other subsidiaries including Kunming Kunji General Machine Co., Ltd., Winko Machines Co., Ltd., Kunji Transportation Co., Ltd. and Fujian Kunji Conventional Machine Tool Co., Ltd. is 25%.

3. Changes in tax policies

Pursuant to the Decision Regarding the Application of Provisional Regulations on Taxes Including Value added Tax, Consumption Tax and Business Tax to Foreign-Invested Enterprises and Foreign Enterprises adopted at the Fifth Meeting of the Standing Committee of the Eighth National People's Congress and the Circular of the State Council on Unification of the Systems of Urban Maintenance and Construction Tax and Education Surtax for Domestic Enterprises and Individuals and for Foreign-Invested Enterprises and Foreigners (Guo Fa [2010] No. 35), the Company has started to pay the urban maintenance and construction tax and education surtax from 1st December 2010.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

IV. ENTITIES CONSOLIDATION AND CONSOLIDATED FINANCIAL STATEMENTS

1. Major domestic and overseas subsidiaries controlled by the Company

(1) Subsidiaries and joint ventures acquired through establishment or investment

Name	Type	Place of registration	Business nature and scope of business	Registered capital (RMB10,000)	Actual contribution at the end of the period (RMB10,000)	Balance of other projects which constitutes actual net investments in subsidiaries	Shareholding percentage (%)	Voting percentage (%)	Consolidation	Minority interests (RMB10,000)	Amount used to offset the minority loss out of minority interests
Xi'an Ser Turbo Machinery Co., Ltd. (Xi'an Ser")	Fellow subsidiary	Xi'an city	Design, development and sales of turbo machines, energy saving sintering fans, compressor equipment, research and re-modification of imported equipment and its parts, automated control system engineering, CNC engineering, mechanical and chemical equipment, meter technology development, whole machine production and sales	5,000	2169.33		45.00	45.00	Yes	75.97	
Fujian Kunji Conventional Machine Tool Co., Ltd. ("Fujian Kunji")	Fellow subsidiary	Nanan city	Development, design, production and sales of self-produced machine tool series products and accessories	500	250		50.00	50.00	Yes		
Kunming Kunji General Machine Co., Ltd.	Wholly-owned subsidiary	Kunming city	Development, design and sales of machine tool products and accessories	300	300		100.00	100.00	Yes		
Winko Machines Co., Ltd. ("Winko Machines")	Fellow subsidiary	Kunming city	Development, application and system integration of hardware and software; retail, wholesale and distribution of general machinery and electronic machines	2023	1934.15		96.74	96.74	Yes		
TOS Kunming Machine Tool Manufacturing Co., Ltd. ("TOS Kunming")	Joint venture	Kunming city	Development, design, production and sales of self-produced machine tool series products and accessories; development of high-tech products, transfer of self-developed technology, provision of technical services and technical advisory; provision of repairs and processing of machine tool products for third parties	5,000,000 Euros	2473.95		50.00	50.00	No		
Changsha Ser Turbo Equipment Co., Ltd. ("Changsha Ser")	Subsidiary of Xi'an Ser	Changsha city	Production and sales of centrifugal compressors, centrifugal blowers, sintering fans and its accessories	1,000			100.00	100.00	Yes		

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

IV. ENTITIES CONSOLIDATION AND CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

1. Major domestic and overseas subsidiaries controlled by the Company *(Continued)*

(1) Subsidiaries and joint ventures acquired through establishment or investment (Continued)

Name	Type	Place of registration	Business nature and scope of business	Registered capital (RMB10,000)	Actual contribution at the end of the period (RMB10,000)	Balance of other projects which constitutes actual net investments in subsidiaries	Shareholding percentage (%)	Voting percentage (%)	Consolidation	Minority interests (RMB10,000)	Amount used to offset the minority loss out of minority interests
Hangzhou Ser Gas Engineering Co., Ltd. ("Hangzhou Ser")	Subsidiary of Xi'an Ser	Hanzhou city	Contracting: design, development, sales and technology support of gas equipment engineering, compressors, sintering fans, whole sintering fan equipment, low-temperature machines, automated control system equipment and its parts; wholesale and retail: mechanical and electrical products, building materials, hardware tools, metal materials; operation of import/export businesses; all legally valid projects not subject to review and approval	120			51.00	51.00	Yes		
Kunji Transportation Co., Ltd. ("Kunji Transportation")	Wholly-owned subsidiary	Kunming city	General cargo transportation	50	50		100	100	Yes		
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite")	Associated company	Xi'an city	Laser prototyping machine	6,000	1400		23.34	23.34	No	598.41	

(2) Subsidiaries acquired from entities consolidation under same control

No

(3) Subsidiaries acquired from entities consolidation under different control

No

IV. ENTITIES CONSOLIDATION AND CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

2. Explanation of scope of consolidation of the Company

(1) During the Reporting Period, the Company did not have any material changes in the consolidated financial statements.

1) Kunming Kunji General Machine Co., Ltd., a wholly-owned subsidiary of the Company, was established on 16th October 2007. Given the failure of its objective, the company was resolved to be cancelled. Pursuant to the No. 5 Memorandum on the Implementation of New Accounting Standards by Listed Companies, the company was cancelled by the sole decision of the Company and therefore was still included in the consolidated financial statements for the year.

2) As the main businesses of Kunji Transportation Co., Ltd., a wholly-owned subsidiary of the Company, have been transferred to the Company, the company was resolved to be cancelled. Pursuant to the No. 5 Memorandum on the Implementation of New Accounting Standards by Listed Companies, the company was cancelled by the sole decision of the Company and therefore was still included in the consolidated financial statements for the year.

(2) The Company holds 45% of the total share capital of Xi'an Ser. Among the members of the board of Xi'an Ser, as the majority of the directors were appointed by the Company, the financial statements of Xi'an Ser and its subsidiaries Changsha Ser and Hangzhou Ser were consolidated in the financial statements of the Company.

On 7th April 2005, the joint venture TOS Kunming was established by the Company and Czech Tos Vansdorf Co.,Ltd. with a registered capital of 5 million Euros. The Company holds 50% of the registered capital of TOS Kunming. Among the 6 members of the Board, 3 of them were appointed by the Company and the chairman was appointed by Czech Tos Vansdorf Co.,Ltd. The Company does not have the controlling power. Thus, the financial statements of TOS Kunming were not consolidated in the financial statements of the Company.

The Company holds 50% equity interests in Fujian Kunji. However, as the majority of the members of the board of Fujian Kunji were appointed by the directors of the Company, it was consolidated in the financial statements for the year.

(3) The Company does not own investees that own the majority voting rights but the financial statements of which are not consolidated in the Company's financial statements.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unless otherwise stated, the opening balance refers to the balance as at 31st December 2009 and the closing balance refers to the balance as at 31st December 2010; whereas the current period refers to the year ended 31st December 2010 and the prior period refers to the year ended 31st December 2009. The currency unit is RMB.

1. Cash and cash equivalents

	Closing balance			Opening balance		
Item	**Foreign currency**	**Exchange rate**	**RMB amounts**	**Foreign currency**	**Exchange rate**	**RMB amounts**
Cash:			1,107,200.04			423,310.35
RMB			1,062,540.52			375,512.90
HKD	5,132.64	0.8509	4,367.36	5,132.64	0.8805	4,519.19
USD	2,866.15	6.6227	18,981.66	2,866.15	6.8282	19,570.65
EUR	2,419.86	8.8065	21,310.50	2,419.86	9.7971	23,707.61
Bank deposit:			295,187,209.52			279,679,248.78
RMB			273,554,720.93			248,922,033.19
HKD	8,908,215.67	0.8509	7,580,000.71	8,963,958.74	0.8805	7,892,586.39
USD	2,118,260.00	6.6227	14,028,600.51	3,347,016.42	6.8282	22,854,097.52
EUR	2,712.47	8.8065	23,887.37	1,074.98	9.7971	10,531.68
Other currencies:						–
RMB						–
Total			296,294,409.56			280,102,559.13

Bank deposit include RMB1,500,000.00 time deposit.

2. Bills receivable

(1) Types of bills receivable

Type	**Closing balance**	**Opening balance**
Bank acceptance notes	115,906,620.42	186,485,466.36
Commercial acceptance notes	–	–
Total	115,906,620.42	186,485,466.36

Bills receivable for the period decreased by 37.85% as compared to that in the prior period, which was primarily as a result of the payment by endorsed bills for the amounts due to suppliers during the period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

3. Accounts receivable

(1) Accounts receivable by customer type

	Closing balance			Opening balance		
	Book balance			Book balance		
Item	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Significant single accounts receivable	24,260,424.16	6.43	3,587,513.37	14,314,718.31	4.72	715,735.92
Insignificant single accounts receivable with similar credit risk characteristic	–	–	–	–	–	–
Other insignificant accounts receivable	352,941,354.30	93.57	123,785,453.41	288,844,599.45	95.28	124,839,101.14
Total	377,201,778.46	100.00	127,372,966.78	303,159,317.76	100	125,554,837.06

Please refer to 2.10(2) for the recognition criteria on significant single accounts receivable.

1) Significant single accounts receivable

The Company carries out impairment tests separately on significant single accounts receivable. Since there was no objective evidence to ascertain the occurrence of impairment as at 31st December 2010, bad debt provision was made according to the aging analysis of the significant single accounts receivable for the period. For any amount collected as of the date of audit, no bad debt provision will be made.

	Closing balance			Opening balance		
	Book balance			Book balance		
Age	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within one year	14,762,455.53	60.85	738,122.78	14,314,718.31	100.00	715,735.92
1-2 years	9,497,968.63	39.15	2,849,390.59	–	–	–
2-3 years	–	–	–	–	–	–
Over 3 years	–	–	–	–	–	–
Total	24,260,424.16	100.00	3,587,513.37	14,314,718.31	100.00	715,735.92

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

3. Accounts receivable *(Continued)*

(1) Accounts receivable by customer type (Continued)

2) Other insignificant accounts receivable

For not significant single accounts receivable at the end of the period, bad debt provision will be made according to the percentage of the age balance of the accounts receivable and the difference between the bad debt provision at the end and at the beginning of the period will be carried at asset impairment loss. For any amount collected as of the date of audit, no bad debt provision will be made.

	Closing balance			Opening balance		
	Book balance			Book balance		
Age	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within one year	143,157,187.99	40.56	6,634,274.66	129,277,839.95	44.76	6,495,454.51
1-2 years	84,564,761.73	23.96	25,280,595.90	72,691,175.70	25.17	31,468,062.83
2-3 years	58,560,347.76	16.59	30,146,178.87	38,790,466.14	13.43	38,790,466.14
Over 3 years	66,659,056.82	18.89	61,724,403.98	48,085,117.66	16.65	48,085,117.66
Total	352,941,354.30	100	123,785,453.41	288,844,599.45	100.00	124,839,101.14

(2) Total amount of top five accounts receivable is RMB37,196,115.24, representing 9.86% of the total amount of accounts receivable at the end of the year.

Ranking	Relationship with the Company	Amount	Term	Percentage to total accounts receivable (%)
1st	Customer	9,497,968.63	Within one year	2.52
2nd	Customer	7,521,367.52	Within one year	1.99
3rd	Customer	7,241,088.01	Within one year	1.92
4th	Customer	6,632,213.78	Over one year	1.76
5th	Customer	6,303,477.30	Within one year	1.67
Total		37,196,115.24		9.86

(3) There were no accounts receivable due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

4. Other receivables

(1) Other receivables by customer type

	Closing balance			Opening balance		
	Book balance			Book balance		
Item	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Significant single other receivables	29,513,906.14	88.45	15,494,868.20	14,172,048.05	33.81	420,349.40
Insignificant single other receivables with similar credit risk characteristic	–	–	–	–	–	–
Other insignificant receivables	3,854,817.79	11.55	1,254,626.64	27,742,246.13	66.19	21,667,640.52
Total	33,368,723.93	100	16,749,494.84	41,914,294.18	100	22,087,989.92

Please refer to 2.10(2) for the recognition criteria on significant single other receivables.

1) Significant single other receivables

The Company carries out impairment tests separately on significant single other receivables. Since there was no objective evidence to ascertain the occurrence of impairment as at 31st December 2010, bad debt provision was made according to the aging analysis of the significant single other receivables for the period. For any amount collected as at the date of audit, no bad debt provision will be made.

	Closing balance			Opening balance		
	Book balance			Book balance		
Age	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within one year	11,788,199.28	39.94	597,344.44	14,172,048.05	100	420,349.40
1-2 years	2,831,840.85	9.59	337,712.26	–	–	–
2-3 years	584,234.51	1.98	250,180.00	–	–	–
Over 3 years	14,309,631.50	48.48	14,309,631.50	–	–	–
Total	29,513,906.14	100	15,494,868.20	14,172,048.05	100	420,349.40

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

4. Other receivables *(Continued)*

(1) Other receivables by customer type (Continued)

2) Other insignificant receivables

For not significant single other receivables at the end of the period, bad debt provision will be made according to the percentage of the age balance of other receivables and the difference between the bad debt provision at the end and at the beginning of the period will be carried at asset impairment loss. For any amount collected as at the date of audit, no bad debt provision will be made.

	Closing balance			Opening balance		
	Book balance			Book balance		
Age	**Amount**	**Proportion (%)**	**Bad debt provision**	**Amount**	**Proportion (%)**	**Bad debt provision**
Within one year	2,732,355.77	70.88	235,284.19	557,086.98	2.01	203,665.38
1-2 years	206,239.15	5.35	103,119.58	6,225,666.03	22.44	504,482.02
2-3 years	44,808.79	1.16	44,808.79	1,109,000.00	4	1,109,000.00
Over 3 years	871,414.08	22.61	871,414.08	19,850,493.12	71.55	19,850,493.12
Total	3,854,817.79	100.00	1,254,626.64	27,742,246.13	100	21,667,640.52

(2) Total amount of top five other receivables is RMB8,821,745.63, representing 26.44% of the total amount of other receivables at the end of the year.

Ranking	**Relationship with the Company**	**Amount**	**Term**	**Percentage to total total accounts receivable (%)**
1st	Staff	4,566,500.00	1 year	13.68
2nd	Staff	2,090,000.00	1 year	6.26
3rd	Staff	1,257,180.00	1 year	3.77
4th	Staff	674,390.01	1 year	2.02
5th	Related party	233,675.62	1 year	0.70
Total		8,821,745.63		26.44

(3) There were no other receivables due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

5. Prepayments

(1) The aging analysis of prepayments is as follows:

	Closing balance		Opening balance	
Age	**Amount**	**Proportion (%)**	**Amount**	**Proportion (%)**
Within one year	23,767,550.55	44.56	21,257,024.34	53.31
1-2 years	14,229,912.34	26.68	14,569,626.72	36.54
2-3 years	12,464,467.74	23.37	2,298,097.70	5.76
Over 3 years	2,875,791.60	5.39	1,752,365.99	4.39
Total	53,337,722.23	100.00	39,877,114.75	100.00

(2) Details of top five prepayments:

Ranking	Relationship with the Company	Amount	Term	Reason for unsettlement
1st	Unrelated party	8,664,123.00	Within one year	Unexpired contract
2nd	Unrelated party	3,400,000.00	Within one year	Unexpired contract
3rd	Unrelated party	1,702,380.00	Within one year	Unexpired contract
4th	Unrelated party	1,650,000.00	Within one year	Unexpired contract
5th	Unrelated party	1,540,405.87	Within one year	Unexpired contract
Total		16,956,908.87		

(3) There were no prepayments due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

6. Inventories

The category of inventories is as follows:

	Closing balance			Opening balance		
Item	**Book balance**	**Impairment provision**	**Book value**	**Book balance**	**Impairment provision**	**Book value**
Raw materials	117,321,473.22	3,065,619.64	114,255,853.58	88,651,716.47	3,058,111.54	85,593,604.93
Turnover materials	5,358,146.97	82,781.00	5,275,365.97	5,903,710.92	82,781.00	5,820,929.92
Work in progress	435,732,995.40	5,898,283.82	429,834,711.58	343,012,799.82	6,467,085.00	336,545,714.82
Finished goods	200,248,281.45	2,684,150.37	197,564,131.08	180,655,458.38	6,449,308.24	174,206,150.14
Goods sold	0.00	0.00	0.00	4,934,486.09	3,765,157.87	1,169,328.22
Consigned processing materials	5,845,948.61	0.00	5,845,948.61	6,952,754.03	–	6,952,754.03
Total	764,506,845.65	11,730,834.83	752,776,010.82	630,110,925.71	19,822,443.65	610,288,482.06

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

7. Investment in joint ventures and associated companies

Name of investee	Type	Place of registration	Legal representative	Business nature	Registered capital	Shareholding percentage (%)	Percentage of voting rights in investee (%)	Total assets at the end of the period	Total liabilities at the end of the period	Total net assets at the end of the period	Total operating income for the period	Net profits for the period
I. Joint venture												
TOS Kunming Machine Tool Manufacturing Co,. Ltd.	Limited liability	Yunnan, Kunming		Production and sales of machine tool products	5,000,000 Euros	50	50	181,383,426.76	89,474,622.62	91,908.804.14	126,934,465.29	18,550,414.91
II. Associated company												
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Limited liability	Xi'an city		Laser prototyping machine	RMB60,000,000	23.34	23.34	122,066,141.82	53,489,768.67	68,576,373.15	23,285,836.30	2,502,240.05

8. Long-term equity investment

(1) Long-term equity investment

Name of investee	Methodology	Initial investment cost	Opening balance	Increase/ decrease	Closing balance	Percentage of shareholding in the investee (%)	Percentage of voting rights in investee (%)	Explanation of inconsistence	Impairment provision	Impairment provision made for the period	Cash dividend for the period
TOS Kunming Machine Tool Manufacturing Co., Ltd.	Equity method	24,739,533.99	41,979,409.03	3,986,016.06	45,965,425.09	50	50	–	–	–	5,289,191.40
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Equity method	14,000,000.00	14,040,478.03	583,856.03	14,624,334.06	23.34	23.34	–	–	–	–
Yunnan Cheng Jiang Copper Products Plant	Cost method	2,000,000.00	2,000,000.00	0.00	2,000,000.00	–	–	–	2,000,000	–	–
Total		40,739,533.99	58,019,887.06	4,569,872.09	62,589,759.15	–	–	–	2,000,000	–	5,289,191.40

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

8. Long-term equity investment *(Continued)*

(2) Full provision for impairment loss on long-term investment of Yunnan Cheng Jiang Copper Products Plant was made in 1999 because the plant has lost of the ability of sustainable operation. In 2009, as approved at the 7th meeting of the 6th session of the Board of the Company, the Company was in the process of disposing such investment during the year.

(3) There is no significant difference between the accounting policies used by the investees and those used by the Company. There is no significant restriction to realization of investment and investment income outflow as foreign currency.

9. Fixed assets

Item	Opening balance	Increase during the period	Decrease during the period	Closing balance
1. Total fixed assets at cost:	737,382,650.53	60,094,283.31	4,930,385.04	792,546,548.80
Including: Buildings and structures	316,139,138.11	1,648,731.00	40,532.00	317,747,337.11
Machinery equipment	344,498,189.31	53,977,564.52	2,697,277.94	395,778,475.89
Transportation equipment	38,481,331.35	2,709,194.41	1,872,125.90	39,318,399.86
Electronic equipment	38,263,991.76	1,758,793.38	320,449.20	39,702,335.94
2. Total accumulated depreciation:	269,589,714.36	36,405,474.26	4,005,608.84	301,989,579.78
Including: Buildings and structures	61,196,884.67	9,119,637.68	–	70,316,522.35
Machinery equipment	172,063,216.31	22,616,358.53	2,029,502.58	192,650,072.26
Transportation equipment	14,784,216.68	2,964,072.95	1,690,773.43	16,057,516.20
Electronic equipment	21,545,396.70	1,705,405.10	285,332.83	22,965,468.97
3. Total net fixed assets	467,792,936.17	60,094,283.31	37,330,250.46	490,556,969.02
Including: Buildings and structures	254,942,253.44	1,648,731.00	9,160,169.68	247,430,814.76
Machinery equipment	172,434,973.00	53,977,564.52	23,284,133.89	203,128,403.63
Transportation equipment	23,697,114.67	2,709,194.41	3,145,425.42	23,260,883.66
Electronic equipment	16,718,595.06	1,758,793.38	1,740,521.47	16,736,866.97
4. Total provision for impairment	3,777,474.24	–	68,430.20	3,709,044.04
Including: Buildings and structures	–	–	–	–
Machinery equipment	3,650,136.96	–	68,430.20	3,581,706.76
Transportation equipment	–	–	–	–
Electronic equipment	127,337.28	–	–	127,337.28
5. Total net fixed assets	464,015,461.93	60,094,283.31	37,261,820.26	486,847,924.98
Including: Buildings and structures	254,942,253.44	1,648,731.00	9,160,169.68	247,430,814.76
Machinery equipment	168,784,836.04	53,977,564.52	23,215,703.69	199,546,696.87
Transportation equipment	23,697,114.67	2,709,194.41	3,145,425.42	23,260,883.66
Electronic equipment	16,591,257.78	1,758,793.38	1,740,521.47	16,609,529.69

(1) At the end of the period, the pledged fixed assets (buildings and structures) at cost amounted to RMB19,603,454.38 and the net amount was RMB15,839,591.02.

(2) The transfer from Construction-in-progress to fixed assets at cost during the period amounted to RMB48,528,007.30.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

10. Construction-in-progress

Item	Opening balance	Impairment provision at the beginning of the period	Increase during the period	Transfer to fixed assets	Other decrease	Closing balance	Impairment provision at the end of the period
Reconstruction of new and old constant temperature workshop	3,994,532.98	–	349,500.00	4,110,000.00	–	234,032.98	–
Implementation and service of Kingdee software of the informationalization project Phase II	2,096,216.00	–	658,581.21	–	–	2,754,797.21	–
Re-engineering of resin sand casting recycling system	2,664,159.13	–	–	114,414.84	–	2,549,744.29	–
Italian CNC guideway grinder at big parts workshop	31,454,479.57	–	–	31,454,479.57	–	–	–
Okamoto gantry precision CNC surface guideway grinder	3,507,882.56	–	16,372,402.49	–	–	19,880,285.05	–
Duyun Guihang 14m gantry planer	4,700,061.28	–	509,943.23	509,943.23	–	4,700,061.28	–
High precision universal CNC grinder	2,348,720.72	–	–	2,348,720.72	–	–	–
Power distribution reconstruction of 27m-span casting workshop	975,000.00	–	–	975,000.00	–	–	–
Yanglin casting base	25,597,300.00	–	41,099,241.29	–	–	66,696,541.29	–
Reconstruction of 24m-span big parts workshop	790,282.05	–	2,490,000.00	790,282.05	–	2,490,000.00	–
11-head fixed Beam (JD236) gantry milling machine	–	–	1,230,000.00	–	–	1,230,000.00	–
CNC vertical lathe	–	–	4,100,000.00	–	–	4,100,000.00	–
Imported precision CNC cylindrical/ internal grinder from Switzerland	–	–	3,755,700.00	–	–	3,755,700.00	–
Others	23,750,027.71	2,056,931.37	445,814.04	8,225,166.89	–	15,970,674.86	2,056,931.37
Total	101,878,662.00	2,056,931.37	71,011,182.26	48,528,007.30	–	124,361,836.96	2,056,931.37

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

11. Intangible assets

Item	Opening balance	Increase during the period	Decrease during the period	Closing balance
1. Total book value at cost	46,364,341.26	2,051,650.70	2,323,453.26	46,092,538.70
Land use rights	25,925,562.02	–	–	25,925,562.02
Various softwares	14,379,236.05	2,051,650.70	–	16,430,886.75
Patent technology	239,000.00	–	–	239,000.00
Trademark right	39,140.00	–	–	39,140.00
Exclusive technology used in embroidery machines	2,323,453.26	–	2,323,453.26	–
Others	3,457,949.93	–	–	3,457,949.93
2. Total accumulated amortization	8,154,087.20	2,743,298.11	–	10,897,385.31
Land use rights	2,447,087.40	605,486.05	–	3,052,573.45
Various softwares	5,413,032.15	2,008,540.02	–	7,421,572.17
Patent technology	6,658.33	31,900.00	–	38,558.33
Trademark right	6,935.20	3,914.00	–	10,849.20
Exclusive technology used in embroidery machines	–	–	–	–
Others	280,374.12	93,458.04	–	373,832.16
3. Total net book value of intangible assets	38,210,254.06	2,051,650.70	5,066,751.37	35,195,153.39
Land use rights	23,478,474.62		605,486.05	22,872,988.57
Various softwares	8,966,203.90	2,051,650.70	2,008,540.02	9,009,314.58
Patent technology	232,341.67	–	31,900.00	200,441.67
Trademark right	32,204.80	–	3,914.00	28,290.80
Exclusive technology used in embroidery machines	2,323,453.26	–	2,323,453.26	–
Others	3,177,575.81	–	93,458.04	3,084,117.77
4. Total impairment provision	2,323,453.26	–	2,323,453.26	–
Land use rights	–	–	–	–
Various softwares	–	–	–	–
Patent technology	–	–	–	–
Trademark right	–	–	–	–
Exclusive technology used in embroidery machines	2,323,453.26	–	2,323,453.26	–
Others	–	–	–	–
5. Total book value of intangible assets	35,886,800.80	2,051,650.70	2,743,298.11	35,195,153.39
Land use rights	23,478,474.62	–	605,486.05	22,872,988.57
Various softwares	8,966,203.90	2,051,650.70	2,008,540.02	9,009,314.58
Patent technology	232,341.67	–	31,900.00	200,441.67
Trademark right	32,204.80	–	3,914.00	28,290.80
Exclusive technology used in embroidery machines	–	–	–	–
Others	3,177,575.81	–	93,458.04	3,084,117.77

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

12. Deferred income tax assets

(1) Deferred income tax assets recognized

Causes for deferred income tax assets	Closing balance	Opening balance
Bad debt provision	25,341,705.62	22,784,274.03
Impairment of available-for-sale financial assets	–	–
Provision for impairment of inventories	2,719,396.12	3,665,744.70
Provision for impairment of fixed assets	927,261.01	929,973.45
Provision for impairment of construction-in-progress	514,232.84	514,232.85
Provision for impairment of long-term equity investment	5,335,386.21	5,335,386.21
Contingent liabilities	3,370,408.59	1,783,845.87
Depreciation of fixed assets	934,530.38	934,530.38
Long-term deferred expenses	–	–
Unrealized internal profits	651,871.71	414,855.66
Discounted value of retirement benefits of internal staff under early retirement	2,369,107.93	3,054,385.66
Issuance of VAT invoice in advance (revenue not yet recognized)	2,914,461.05	4,919,257.42
Government grants *(Note1)*	3,583,350.00	1,410,000.00
Withholding expenses	–	837,615.00
Accounts payable overdue for two years	191,537.15	191,537.15
Losse coverage	1,202,079.29	–
Total	50,055,327.91	46,775,638.38

Note: 1. Such amounts refer to government grants related to the assets. Deferred income tax assets were recognized as these amounts did not meet the requirements to carry forward to the non-operating income.

2. Deferred income tax assets and deferred income tax liabilities are not recognized at net value after offsetting.

(2) Temporary differences arising from the assets that result in temporary differences

Item	Temporary differences Closing balance	Temporary differences Opening balance
Bad debt provision	144,122,461.62	147,642,826.97
Provision for impairment of inventories	11,730,834.83	19,822,443.65
Provision for impairment of fixed assets	3,709,044.04	3,777,474.24
Provision for impairment of construction-in-progress	2,056,931.37	2,056,931.37
Provision for impairment of long-term equity investment	2,000,000.00	2,000,000.00
Deferred gain (government grants)	23,889,000.00	9,400,000.00
Provision for warranty expense	22,469,390.59	11,885,194.70
Discounted value of retirement benefits of internal staff under early retirement	10,666,424.84	13,547,075.57
Issuance of VAT invoice in advance (revenue not yet recognized)	19,429,740.37	32,795,049.48
Accounts payable overdue for two years	1,276,914.36	1,276,914.36
Depreciation of fixed assets in tax audit	6,230,202.52	5,469,196.00
Profits from internal sales not yet recognized	4,345,811.40	2,765,704.40
Withholding expenses	–	5,584,100.00
Loss coverage	8,013,861.90	–
Total	255,883,686.47	258,022,910.74

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

13. Short-term borrowings

Item	Closing balance	Opening balance
Credit borrowings	21,000,000.00	50,000,000.00
Secured borrowings	25,000,000.00	20,000,000.00
Total	46,000,000.00	70,000,000.00

The closing balance of short-term borrowings decreased by 34.29% compared with the opening balance, as a result of the repayment of principal due and payable during the period.

14. Bills payable

Type	Closing balance	Opening balance
Bank acceptance notes	20,426,973.00	8,370,000.00
Commercial acceptance notes	–	–
Total	20,426,973.00	8,370,000.00

The closing balance of bills payable increased by 144.05% compared with the opening balance, mainly due to the increased payment by bills for purchase of materials by Xi'an Ser.

15. Accounts payable

Item	Closing balance	Opening balance
Within one year	218,286,870.11	169,446,610.33
1-2 years	5,572,764.33	6,154,894.85
2-3 years	1,895,752.42	4,865,284.36
Over 3 years	4,501,023.82	2,719,750.53
Total	230,256,410.68	183,186,540.07

There were no accounts payable due to shareholders or their associates holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

16. Advances from customers

Item	Closing balance	Opening balance
Within one year	266,897,136.09	295,416,128.36
1-2 years	137,236,489.83	65,598,058.76
2-3 years	9,360,939.92	7,667,833.63
Over 3 years	1,230,557.38	5,531,149.20
Total	414,725,123.22	374,213,169.95

There were no advances from customers due from shareholders or their associates holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

17. Accrued salary

Item	Opening book balance	Increase during the year	Amount paid during the year	Closing book balance
1. Salary, bonus, subsidy and grants	17,829,962.68	166,543,218.82	167,198,666.67	17,174,514.83
2. Employees benefits	–	6,347,488.11	6,347,488.11	–
3. Social insurance	51,179.81	31,516,123.30	32,820,248.46	(1,252,945.35)
Including: (i) Medical insurance	107,854.45	10,969,794.68	10,510,570.80	567,078.33
(ii) Basic retirement insurance	459,663.57	18,522,230.12	20,215,916.48	(1,234,022.79)
(iii) Annuity	–	–	–	–
(iv) Unemployment insurance	(516,338.21)	969,052.00	1,038,714.68	(586,000.89)
(v) Work injury insurance	–	326,494.88	326,494.88	–
(vi) Maternity insurance	–	728,551.62	728,551.62	–
4. Housing fund	2,260,588.32	11,837,176.40	12,251,715.00	1,846,049.72
5. Union expenses and employees education expenses	6,239,171.63	3,432,238.08	3,384,508.96	6,286,900.75
6. Non-monetary benefits	–	–	–	–
7. Compensation for termination of labor service contract	–	16,426.30	16,426.30	–
8. Others	13,482,540.57	1,518,170.16	4,398,820.89	10,601,889.84
Including: cash-settled share-based payments	–	–	–	–
Total	39,863,443.01	221,210,841.17	226,417,874.39	34,656,409.79

Basic retirement insurance and unemployment insurance recorded a negative value due to the prepayments for the following year made at the end of the year

18. Taxes payable

Item	Closing balance	Opening balance
Value-add tax	(5,343,083.12)	14,290,157.18
Resource tax	–	–
Business tax	106,944.87	132,624.31
Consumption tax	–	–
City construction tax	31,288.55	(222,969.77)
Housing taxes	1,200,981.00	1,146,072.99
Vehicle and vessel usage tax	–	–
Land use tax	383,280.35	297,643.85
Personal income tax	1,399,701.10	485,012.41
Enterprise income tax	6,846,857.07	10,261,027.14
Others	244,673.75	(39,636.20)
Total	4,870,643.57	26,349,931.91

Taxes payable decreased over that in the previous year mainly due to the decrease in income tax incurred for the period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

19. Other payables

Item	Closing balance	Opening balance
Within one year	9,970,962.39	12,840,239.20
1-2 years	8,941,401.43	1,801,798.97
2-3 years	1,207,539.67	2,015,178.94
Over 3 years	542,143.66	268,442.96
Total	20,662,047.15	16,925,660.07

There were no other payables due to shareholders or their associates holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

20. Other non-current liabilities

Item	Opening balance	Increase during the period	Decrease during the period	Closing balance
Operating lease	1,054,999.24	–	87,916.60	967,082.64
Land use right	1,408,604.07	–	117,383.60	1,291,220.47
Government grants	9,400,000.00	20,389,000.00	5,900,000.00	23,889,000.00
Total	11,863,603.31	20,389,000.00	6,105,300.20	26,147,303.11

The closing balance increased compared with the opening balance due to the significant increase in government grants which were not carried forward for uncompleted projects.

21. Contingent liabilities

Item	Closing balance	Opening balance
Product quality warranty	16,301,190.59	11,885,194.70
Total	16,301,190.59	11,885,194.70

The closing balance increased by 37.16% compared with the opening balance due to the increase in provision for products sold during the period.

22. Long-term payables

Item	Closing balance	Opening balance
1. Finance lease payables	3,763,858.80	4,106,026.80
Total	3,763,858.80	4,106,026.80
Less: unrecognized finance expenses	1,418,558.80	1,547,518.60
Total	2,345,300.00	2,558,508.20

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

23. Specific payable

Item	Opening balance	Carried forward for the period	Closing balance
Specific appropriation from Shaanxi Intellectual Property Office	100,000.00	–	100,000.00
Total	100,000.00	–	100,000.00

24. Share capital

Item	Opening balance	Increase/decrease during the period (+, –)					Closing balance
		Issue of new shares	Bonus issue	Capitalization of capital reserve	Others	Sub-total	
1. Unlisted circulating shares	176,730,310.00	–	–	44,182,577.19	(133,227,868.60)	(89,045,291.41)	87,685,018.59
Promoter shares	47,018,331.00	–	–	11,754,582.67	–	11,754,582.67	58,772,913.67
Including: State-owned shares	47,018,331.00	–	–	11,754,582.67	–	11,754,582.67	58,772,913.67
Domestic legal person shares	129,711,979.00	–	–	32,427,994.52	(133,227,868.60)	(100,799,874.08)	28,912,104.92
2. Listed circulating shares	248,134,573.00	–	–	62,033,642.81	133,227,868.60	195,261,511.41	443,396,084.41
Including: RMB ordinary shares	135,418,673.00	–	–	33,854,668.01	133,227,868.60	167,082,536.61	302,501,209.61
Overseas listed foreign shares	112,715,900.00	–	–	28,178,974.80	–	28,178,974.80	140,894,874.80
3. Total number of shares	424,864,883.00	–	–	106,216,220.00	–	106,216,220.00	531,081,103.00

(1) Shenyang Machine Tool (Group) Co., Ltd. and Yunnan Industrial Investment Holding Group Co. Ltd. were committed not to selling their shares held through the stock exchange from the date of listing until 31st December 2010. To date the two shareholders have not sold their shares held through the stock exchange.

(2) On 2nd July 2010, the Company received the Letter of Approval from the Department of Commerce of Yunnan Province Concerning its Consent on the Proposal for Bonus Issue by Capitalization of Capital Reserve of Shenji Group Kunming Machine Tool Company Limited (Yun Nan Sheng Shang Wu Ting Shang Zi [2010] No. 130), under which the total share capital of the Company was approved to be increased from 424,864,883 shares to 531,081,103 shares and the registered capital would be increased from RMB424,864,883 to RMB531,081,103. The increased capital would be financed by the capitalization of the capital reserve.

(3) The capital verification report of this capitalization of capital reserve to increase share capital was issued by Zonzun Accounting Office Ltd., Liaoning branch (zonzun yan zi [2010] no.2001).

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

25. Capital reserve

Item	Opening balance	Increase during the period	Decrease during the period	Closing balance
Capital premium (share premium)	125,422,997.12	–	106,216,220.00	19,206,777.12
Other capital reserve	8,096,544.60	–	–	8,096,544.60
Total	133,519,541.72	–	106,216,220.00	27,303,321.72

1) Other capital reserve was transferred from the provision for the equity investment in TOS Kunming that would have been made upon the change in accounting system.

2) In July 2010, the Company received the Letter of Approval from the Department of Commerce of Yunnan Province Concerning its Consent on the Proposal for Bonus Issue by Capitalization of Capital Reserve of Shenji Group Kunming Machine Tool Company Limited (Yun Nan Sheng Shang Wu Ting Shang Zi [2010] No. 130), under which the total share capital of the Company was approved to be increased from 424,864,883 shares to 531,081,103 shares and the registered capital would be increased from RMB424,864,883 to RMB531,081,103. The increased capital would be financed by the capitalization of the capital reserve.

26. Surplus reserve

Item	Opening balance	Increase during the period	Decrease during the period	Closing balance
Statutory surplus reserve	90,250,998.55	18,773,825.07	–	109,024,823.62
Total	90,250,998.55	18,773,825.07	–	109,024,823.62

27. Undistributed profit

Item	Current period	Prior period
Net profits	178,324,801.52	215,847,994.25
Add: Undistributed profit at the beginning of the year	568,378,612.85	414,246,947.45
Gain or loss directly recognized in shareholders' interests	–	–
Less: Distribution of cash bonus dividend	21,213,558.22	40,064,470.40
Less: Transfer to statutory surplus reserve	18,773,825.07	21,651,858.45
Undistributed profit	706,716,031.08	568,378,612.85

During the year, the Company distributed a cash bonus dividend of RMB0.5 (tax inclusive) for every 10 shares held by Shareholders of the Company based on the existing total share capital of 424,864,883 shares according to the proposal on profit distribution for 2009 approved at the general meeting held on 23rd June 2010. The actual cash dividend after tax distributed to the individual shareholders, investment fund and qualified overseas institutional investors for A Shares was RMB0.45 for every 10 shares held. All dividends totaling RMB21,213,558.22 were paid. The registration date for entitlements was 15th July 2010.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

28. Operating income

(1) Operating income

Item	Current period	Prior period
Operating income	1,579,041,911.75	1,314,050,708.97
Other operating income	18,663,355.44	58,145,930.39
Total	1,597,705,267.19	1,372,196,639.36

(2) Operating income by product category

Item	Current period	Prior period
Sales of machine tool products	1,355,563,454.92	1,117,621,024.11
Sales of highly efficient energy-saving compressors	200,791,359.45	155,607,558.87
Sales of new products	20,555,555.56	51,848,860.68
Sales of intelligent electrical appliances	335,164.63	–
Sales of sensor equipment	–	6,495,054.73
Transportation of machine tools	1,913,627.00	4,181,548.00
Sales of materials	12,845,408.04	2,753,520.37
Leasing	121,400.00	241,167.08
Technical support	201,184.28	–
Other sales	5,378,113.31	33,447,905.52
Total	1,597,705,267.19	1,372,196,639.36

(3) Operating income from top five customers of the Company

Total sales revenue from the top 5 customers for 2010 amounted to RMB228,870,085.63, accounting for 14.32% of the total sales revenue.

Ranking	Operating income	Percentage to total operating income of the Company (%)
1st	103,670,940.25	6.49
2nd	40,532,478.72	2.54
3rd	29,846,153.84	1.87
4th	28,752,136.75	1.80
5th	26,068,376.07	1.63
Total	228,870,085.63	14.32

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

29. Operating expenses

(1) Operating expenses

Item	Current period	Prior period
Operating expenses	1,149,069,602.43	902,271,813.47
Other operating expenses	13,487,399.12	1,343,683.24
Total	1,162,557,001.55	903,615,496.71

(2) Operating expenses by product category

Item	Current period	Prior period
Sales of machine tool products	966,773,545.76	733,673,313.29
Sales of highly efficient energy-saving compressors	179,117,429.97	126,614,778.07
Sales of new products	–	–
Sales of intelligent electrical appliances	284,756.3	–
Sales of sensor equipment	–	8,418,121.66
Transportation of machine tools	1,410,629.00	3,432,037.90
Sales of materials	10,500,187.90	631,240.51
Leasing	20,734.64	218,734.37
Technical support	102,177.00	–
Other sales	4,347,540.98	30,627,270.91
Total	1,162,557,001.55	903,615,496.71

30. Business tax and additions:

Item	Current period	Prior period
Business tax	59,243.00	267,709.63
City construction tax	972,277.65	475,369.88
Education fee additions	526,765.54	229,019.43
Total	1,558,286.19	972,098.94

31. Impairment loss of assets

Item	Current period	Prior period
Bad debt provision	9,258,660.61	33,420,275.94
Provision for impairment of inventories	(7,844,614.41)	(5,356,926.32)
Provision for impairment of investment held-to-maturity	–	–
Provision for impairment of long-term equity investment	–	–
Provision for impairment of fixed assets	(57,580.42)	395,871.64
Provision for impairment of construction-in-progress	–	–
Provision for impairment of intangible assets	–	–
Total	1,356,465.78	28,459,221.26

Asset impairment loss decreased over that in the prior period mainly due to the changes in percentage of bad debt provision for accounts receivable. For details, please refer to 2.26. Change in major accounting policies and accounting estimates.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

32. Finance expenses

Item	Current period	Prior period
Interest expenses	4,124,378.67	3,632,970.91
Less: Interest income	2,438,175.60	1,685,039.64
Exchange loss/gain	927,446.33	2,389,529.72
Unrecognized finance expenses	827,992.46	612,802.63
Fee expenses	551,149.94	318,596.52
Others	–	178,419.93
Total	3,992,791.80	5,447,280.07

33. Investment income

Investee	Current period	Prior period
TOS Kunming	9,275,207.46	11,937,003.54
Xi'an Ruite	583,856.03	377,278.48
Gain from wealth management	–	–
Gain on disposal of subsidiary and proportionate share of net profits before disposal of subsidiary for the period	–	–
Total	9,859,063.49	12,314,282.02

34. Non-operating Income

Item	Current period	Prior period	Amount recognized as non-operating gains/losses for current period
Total gain on disposal of non-current assets	842,420.63	196,097.94	842,420.63
Including: Gain on disposal of fixed assets	801,390.63	142,431.69	801,390.63
Refund of VAT	–	17,172,846.19	–
Government grant	6,700,335.00	10,514,558.30	6,700,335.00
Others	6,525,552.25	1,676,015.72	6,525,552.25
Total	14,068,307.88	29,559,518.15	14,068,307.88

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

34. Non-operating Income *(Continued)*

(1) The breakdown of government grants is as follows:

Type of government grant	Amount	Approval document/ approving authority	Year of grant
International market expansion funding for small and medium enterprises (subsidies for 2009 European Machine Tool Exhibition) granted by the China Council for the Promotion of International Trade, Machinery Sub Council	40,000.00	China Council for the Promotion of International Trade, Machinery Sub Council	2010
Water recycling subsidies granted by Kunming Planned Water Supply and Water Saving Office (2009.10-2010.03)	19,085.50	Kunming Planned Water Supply and Water Saving Office	2010
Completed and accepted model project of development and application of comprehensive digital integration technology for Kunji (big) heavy precision CNC floor-type boring and milling machine series carried forward to the deferred income	600,000.00	Yunnan Provincial Department of Science & Technology	2010
2009 provincial settlement funding for foreign trade and development granted by Kunming Bureau of Finance	13,400.00	Kunming Bureau of Finance	2010
International market expansion funding for small and medium enterprises of Yunnan granted by the Department of Commerce of Yunnan Province	100,135.00	Department of Commerce of Yunnan Province	2010
Water recycling subsidies granted by Kunming Planned Water Supply and Water Saving Office	18,714.50	Kunming Planned Water Supply and Water Saving Office	2010
Completed and accepted model project of digital design, manufacturing and informationalization of machine tools carried forward to the deferred income	500,000.00	Kunming Municipal Bureau of Science and Technology	2010
Development and acceptance of CNC gantry boring and milling machine	1,600,000.00	Yunnan Provincial Department of Science & Technology	2007.1–2008.12
Research, development and acceptance of FMS (flexible manufacturing system)	3,200,000.00	Yunnan Provincial Department of Science & Technology	2008–2010
Fiscal subsidies	579,000.00	Department of Finance of Changsha County	2010
Enterprise support fund	30,000.00	Department of Finance of Nanan	2010
Total	6,700,335.00		

(2) Others include income from liquidation of subsidiaries of RMB2,655,728.39, insurance claims settlement of RMB1,026,521.00 and refund of taxes for previous years of RMB1,089,237.53.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

35. Non-operating expenses

Item	Current period	Prior period	Amount recognized as non-operating gains/losses for current period
Total loss on disposal of non-current assets	175,900.51	461,957.68	175,900.51
Including: Loss on disposal of fixed assets	175,900.51	461,957.68	175,900.51
Donation	6,000.00	684,437.50	6,000.00
Fines	1,638,271.55	307,854.17	1,638,271.55
Relief fund	–	–	–
Others	334,901.10	551,678.03	334,901.10
Total	2,155,073.16	2,005,927.38	2,155,073.16

36. Income tax expenses

Item	Current period	Prior period
Current income tax expenses	30,676,813.47	43,540,851.78
Deferred income tax	(3,279,689.53)	(8,694,483.24)
Total	27,397,123.94	34,846,368.54

37. Calculation of basic earnings per share and diluted earnings per share

Basic earnings per share=P0÷S
S= S0+S1+Si×Mi÷M0– Sj×Mj÷M0-Sk

Including: P0 refers to the net profit attributable to ordinary shareholders of the Company or net profit attributable to ordinary shareholders after non-recurring gains and losses; S refers to the weighted average number of the outstanding ordinary shares; S0 refers to the total number of shares at the beginning of the period; S1 refers to the increase in the number of shares as a result of capitalization of capital reserve or profit distribution during the reporting period; Si refers to the increase in the number of shares as a result of issue of new shares or debt to equity swap during the reporting period; Sj refers to the decrease in the number of shares as a result of repurchase during the period; Sk refers to the number of reduced shares during the reporting period; M0 refers to the number of months during the reporting period; Mi refers to the number of months from the next month of the increase of shares to the end of the reporting period; Mj refers to the number of months from the next month of the decrease of shares to the end of the reporting period.

In the presence of potential dilutive ordinary shares, the net profit attributable to ordinary shareholders for the reporting period and weighted average number of outstanding ordinary shares shall be adjusted and used in the calculation of diluted earnings per share.

In issuing the potential dilutive ordinary shares upon the exercise of convertible bonds, options and warrants, diluted earnings per share may be calculated as follows:

Diluted earnings per share=P1/(S0+S1+Si×Mi÷M0–Sj×Mj÷M0–Sk+increase in the weighted average number of ordinary shares upon exercise of warrants, options and convertible bonds)

Including: P1 refers to the net profit attributable to ordinary shareholders of the Company or net profit attributable to ordinary shareholders of the Company after non-recurring gains and losses and is adjusted according to the PRC GAAP and relevant requirements taking into account of the impact of potential dilutive ordinary shares.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

37. Calculation of basic earnings per share and diluted earnings per share *(Continued)*

In calculating the diluted earnings per share, the Company shall take into consideration of the impact of all potential dilutive ordinary shares on the net profit attributable to ordinary shareholders of the Company or net profit attributable to ordinary shareholders of the Company after non-recurring gains and losses and the weighted average number of shares and included in the diluted earnings per share according to the degree of dilution (from high to low) until the diluted earnings per share reaches its smallest value.

Net profit attributable to the ordinary shareholders for the period was RMB178,324,801.52; whereas net profit attributable to ordinary shareholders of the Company after non-recurring gains and losses was RMB167,747,132.70; and weighted average number of outstanding ordinary shares was 531,081,103.00 shares. Basic earnings per share based on the net profit attributable to ordinary shareholders for the period =178,324,801.52/531,081,103.00 = RMB0.34 per share; whereas basic earnings per share based on the net profit attributable to ordinary shareholders of the Company after non-recurring gains and losses = 167,747,132.70/531,081,103.00 = RMB0.32 per share.

38. Other cash paid relating to operating activities

Item	Current year	Explanation
Installation fee	70,000.00	
Office expense	7,249,054.21	
Packing charges	170,713.45	
Insurance fee	42,807.11	
Business traveling expense	16,462,111.22	
Telephone expense	222,125.67	
Expense of the Board of Directors and Supervisory Committee	22,529.00	
Leasing expense	5,714,442.60	
Listing management fee	1,992,051.78	
Advertising and exhibition fee	2,208,283.70	
Conference fee	36,000.00	
Labor protection fee	90,900.00	
Labor insurance fee	297,328.51	
Pollutant discharge fee	–	
Vehicles maintenance fee	759,819.20	
Repair and maintenance fee	134,945.05	
Research & development fee	6,425,094.02	
Design fee	249,000.00	
Communication fee	25,141.97	
Compensation fee for loss of land	–	
Entertainment fee	6,409,064.65	
Service fee due to acceptance of a bid	9,973,265.00	
Human resource administration fee	102,690.00	
Auditing and evaluation fee	3,624,655.00	
Consultation fee	7,915,755.51	
Transportation fee	28,588,978.38	
Others	1,968,705.62	
Total	100,755,461.65	

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

V. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

39. Supplementary information on cash flow statement

	2010	2009
1. Reconciliation of net profit to cash flows from operating activities:		
Net profit	173,463,321.48	213,127,151.34
Add: Provision for asset impairment	1,356,465.78	25,483,204.49
Depreciation of fixed assets, consumption of oil and gas assets and depreciation of productive biological assets	36,405,474.26	34,852,214.13
Amortization of intangible assets	2,743,298.11	2,769,180.37
Amortization of long term deferred expenses	175,362.69	542,529.41
Loss on disposal of fixed assets, intangible assets and other long-term assets	(625,490.12)	445,182.42
Loss on disposal of fixed assets ("–" for gain)	–	–
Loss on fair value changes ("–" for gain)	–	–
Finance expenses ("–" for gain)	4,497,041.44	4,818,295.94
Investment loss ("–" for income)	(9,859,063.47)	(12,314,282.04)
Decrease in deferred income tax assets ("–" for increase)	(3,279,689.53)	(9,514,862.62)
Increase in deferred income tax liabilities ("–" for decrease)	–	–
Decrease in inventory ("–" for increase)	(142,487,528.76)	53,007,875.10
Decrease in operating receivables ("–" for increase)	(82,477,863.29)	(79,064,773.74)
Increase in operating payables ("–" for decrease)	149,361,454.76	(128,402,248.63)
Others	–	–
Net cash flows from operating activities	129,272,783.34	105,749,466.18
2. Material investing and financing activities that do not involve cash receipts and payments		
Conversion of debt into capital	–	–
Convertible bonds due within one year	–	–
Fixed assets acquired under finance leases	2,610,055.82	2,610,055.82
3. Net increase/decrease in cash and cash equivalents:		
Cash at end of the period	296,294,409.56	280,102,559.13
Less: Cash at beginning of the period	280,102,559.13	327,941,401.88
Add: Cash equivalents at end of the period	–	–
Less: Cash equivalents at beginning of the period	–	–
Net increase in cash and cash equivalents	16,191,850.43	(47,838,842.75)

VI. RELATED PARTIES AND TRANSACTIONS

1. Largest shareholder of the Company and major changes in shareholdings

Name of the largest shareholder	Relationship with the Company	Type	Place of registration	Legal representative	Business nature	Registered capital	Percentage of shareholdings held by the largest shareholder in the Company (%)	Percentage of voting rights held by the largest shareholder in the Company (%)	Ultimate controlling shareholder of the Company	Organization code
Shenyang Machine Tool (Group) Co., Ltd.	Largest shareholder	Limited liability	Shenyang city	Guan Xiyou	Production and sales of machine tools	1,556,480,000	25.08	25.08	Shenyang State-owned Assets Supervision and Administration Commission	243381258

2. Subsidiaries of the Company

See note IV.1

3. Joint ventures and associated companies of the Company

See note V.7

4. Other related parties of the Company

Name	Relationship with the Company
TOS Kunming Machine Tool Manufacturing Co., Ltd.	Joint venture
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Associated company
Yunnan CY Group Co., Ltd., Products Trading Center	Subsidiary of the largest shareholder
Yunnan Yunji Group Import & Export Co., Ltd.	Subsidiary of the largest shareholder
Kunji Group Company	A company controlled by the second largest shareholder
Czech Tos Vansdorf Co.,Ltd.	Jointly-controlled party of the joint venture

VI. RELATED PARTIES AND TRANSACTIONS *(Continued)*

5. Connected Transactions

(1) Sales of Goods

1) The Company sold goods at market value amount of RMB8,547,017.27 and RMB8,980,033.95 to related party TOS Kunming Machine Tool Manufacturing Co., Ltd in 2010 and 2009 respectively;

2) The Company sold goods at market value amount of RMB917,809.08 to related party Czech Tos Vansdorf Co., Ltd. in 2009.

3) The Company entered into distribution agreements with Shenyang Machine Tool Import & Export Co., Ltd. ("Shenji EXIM") and Yunnan Yunji Group Import & Export Co., Ltd. ("Yunji EXIM") respectively. Pursuant to the agreements, the Company agreed to authorize Shenji EXIM and Yunji EXIM to distribute and export certain products from 1st April 2008 to 31st December 2010, effective from the date of the passing of the resolution by the independent shareholders at the EGM held on 12th June 2008. The annual caps were RMB40,000,000, RMB50,000,000, and RMB60,000,000 for Shenji EXIM respectively and RMB10,000,000, RMB15,000,000, and RMB20,000,000 for Yunji EXIM respectively. Such transactions were conducted on a regular and continuing basis in the ordinary and usual course of business of the Company as an effort to expand overseas market leveraging on the existing overseas distribution network of the export and import companies. The Directors of the Company (including four independent directors) reviewed such transactions and considered that the distribution agreements were entered into on normal commercial terms and conditions in the ordinary and usual course of business of the Company, negotiated on an arm's length basis and at prices and terms no less favorable than those charged and offered to other distributors of the Company (independent third parties).

   The Company sold goods at market value amount of RMB1,076,923.08 and RMB12,994,107.69 to related party Shenyang Machine Tool Import & Export Co., Ltd. in 2010 and 2009 respectively.

   The Company sold goods at market value amount of RMB1,837.61 and RMB252,136.75 to related party Yunnan Yunji Group Import & Export Co., Ltd. in 2010 and 2009 respectively.

4) The Company sold goods at market value amount of RMB220,611.97 to related party Yunnan CY Group Co., Ltd., Products Trading Center in 2009.

   The Company received processing fee and payment for spare parts at market value amount of RMB6,811.59 and RMB176,897.02 from related party Yunnan CY Group Co., Ltd. in 2010 and 2009 respectively.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

VI. RELATED PARTIES AND TRANSACTIONS *(Continued)*

5. Connected Transactions *(Continued)*

(2) Provision and Receipt of Services

1) On 15th November 1993, the Company entered into an agreement with Kunji Group Company relating to the provision of certain services to each other after the reorganization. Pursuant to this agreement, the Company agreed to provide certain public utility services such as water and electricity to Kunji Group Company, while Kunji Group agreed to provide certain services to the Company including property management, employee's medical services, education and administration of retired staff. Service fee is reviewed by both parties on an annual basis and is determined by reference first to the standards set by the relevant government department for that particular service. If there are no applicable state standards, the Company and Kunji Group Company will determine the service fee at arm's length negotiation between the parties. At the 2008 general meeting of the Company, the subsidiaries under Yunnan Industrial Investment Holding Group Co., Ltd. (formerly known as Yunnan State-owned Assets Operation Co., Ltd.) underwent a restructuring. The above administrative fee for retired staff was directly charged by Yunnan Industrial Investment Holding Group Co., Ltd., whereas the medical services were undertaken by its subsidiary Kunji Group Company and the property management was undertaken by its subsidiary Yunnan State-owned Assets Property Management Co., Ltd. The above transactions between Kunji Group Company and the Company for 2010 and 2009 are as follows:

Transaction	2010	2009
Property management fee paid to Yunnan State-owned Assets Property Management Co., Ltd.	510,861.12	613,510.26
Staff medical service fee paid to Kunji Group Company	98,000.00	99,000.00
Administrative fee for retired staff paid to Yunnan Industrial Investment Holding Group Co., Ltd.	–	178,166.67
Staff quarters rentals paid to Yunnan State-owned Assets Property Management Co., Ltd.	118,000.00	18,000.00
Total	726,861.12	908,676.93

2) The Company received consultation fee of RMB360,087.92 from the related party TOS Kunming Machine Tool Manufacturing Co., Ltd. in 2009.

(3) Purchase of Goods

1) The Company purchased goods of RMB103,239,306.30 and RMB51,035,735.29 from related party TOS Kunming Machine Tool Manufacturing Co., Ltd. in 2010 and 2009 respectively.

2) The Company purchased goods from Yunnan CY Group Co., Ltd., Jinhui Spraying Factory with a total value of RMB3,310,530.09 in 2010 and RMB1,152,014.19 in 2009.

VI. RELATED PARTIES AND TRANSACTIONS *(Continued)*

5. Connected Transactions *(Continued)*

(4) Leases

1) The 16th meeting of the 4th session of the Board held on 18th April 2004 approved that "The Premise Rental Supplemental Agreement" and "The Land Use Rental Supplemental Agreement" signed in 2001 between the Company and Kunji Group Company and would be continued. According to the resolution passed at 26th meeting of 4th session of the Board, on 17th August 2005, the Company and Kunji Group Company entered into the agreements "The Rent AmendmentAgreement of the Premises" and "The Rent Amendment Agreement of the Land Use Right", which stated that Kunji Group Company was authorized by Yunnan Government to succeed the rights and obligations of the "The Premise Rental Agreement" and "The Land Use Rental Agreement" signed by Yunnan Government on 12th November 2001 with the Company. The assets mentioned in the above agreements involved the leaseback of part of the premises and land use right from the Yunnan Government after the capital restructuring in 2001.

On 12th May 2008, the Company entered into an agreement with former Kunming Kunji Group, pursuant to which the Company would demolish the buildings formerly leased from Kunji Group Company and used as casting workshops for reconstruction. In return, the Company agreed to pay a one-off compensation of RMB1,949,943.00 to Kunji Group Company. At the 44th meeting of the 5th session of the Board held on 27th August 2008, the management was authorized to negotiate with Yunnan State-owned Assets Supervision and Administration Commission (Kunji Group Company) in respect of the above premises and land rentals.

In 2010, the rental provision made by the Company for the lease of premises and land use right amounted to RMB412,746.00 and RMB 4,245,086.00 respectively, and the rental paid by the Company for the lease of premises and land use right amounted to RMB412,746.00 and RMB 4,245,086.00 respectively.

In 2009, the rental paid by the Company amounted to RMB1,509,828.00, including the rental of RMB754,914.00 for 2008; in 2009, the actual payment for the lease of land use rights amounted to RMB8,490,172.00, including the rental of RMB4,245,086.00 for 2008.

6. Buyback of accounts receivable

On 29th December 2000, the Company transferred its accounts receivable to Kunming Kunji Group Company at an original value of RMB11,398,143.52. As of 30th June 2010, the outstanding balance of such accounts receivable amounted to RMB5,857,798.68. In 2010, the Company bought back such accounts receivable for RMB822,020.47 and generated unrealized financing income of RMB5,035,778.21.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

VI. RELATED PARTIES AND TRANSACTIONS *(Continued)*

7. Accounts receivable and payable from/to related parties

Related parties	Item	Closing balance	Opening balance	Nature
TOS Kunming Machine Tool Manufacturing Co., Ltd.	Accounts payable	22,635,320.30	14,858,154.60	Payment for goods
	Accounts receivable	6,632,213.38	2,042,770.94	Payment for goods
	Other receivables	233,675.62	194,506.14	Current account
Yunnan CY Group Co., Ltd., Products Trading Center	Accounts receivable	9,000.00	7,116.00	Payment for goods
Yunnan CY Group Company, Jinhui Spraying Factory	Accounts payable	134,076.07	327,061.16	Payment for goods
Shenji Group Import and Export Co., Ltd.	Advances from customers	4,000.00	1,260,000.00	Payment for goods

VII. CONTINGENCIES

1. Litigation

(1) The Company signed a sales contract with Yancheng Xinde Oil Machine Company ("Xinde Machine") in June 2002 for sales of four machine tools with a contract amount of RMB11.9 million. Related four machine tools have been delivered to Xinde Machine before October 2003. In June 2009, Xinde Machine filed a lawsuit against the Company alleging that the goods delivered by the Company were unqualified and sought for return of goods, refund of advances paid of RMB10.7 million and payment of penalty and compensation of RMB0.3 million and RMB3.7 million respectively. In consultation with legal counsels, the Company has denied the claim and filed a counter claim against Xinde Machine alleging that it was unreasonable for Xinde Machine to claim for return of goods after use of the Company's products for more than 6 years and requesting Xinde Machine to repay the unpaid amount of RMB1.3 million for the goods. In February 2010, the Company and Xinde Machine agreed to mediate the disputes through the court.

Up to the date of the financial statements, the above case is still under the mediation stage. Management considered it is too preliminary to reasonably estimate the outcome of the mediation at this stage. Therefore no provision has been made in respect of the above pending case in the financial statements.

(2) On 3rd March 2010, Zhucheng Guanghua Acetylene Oxygen Making Co., Ltd. refused to accept the final decision made by Weifang Intermediate People's Court on its contractual dispute with Xi'an Ser (Note: According the court decision, Zhucheng Guanghua Acetylene Oxygen Making Co., Ltd. is required to pay a total of RMB1,319,518.00 for goods price, interest accrued and transporation fee) and appealed to the People's Procuratorate of Shandong Province. On 25th May 2010, the People's Procuratorate of Shandong Province filed a protest to the Higher People's Court of Shandong Province. On 4th June 2010, the Higher People's Court of Shandong Province ordered a retrial by the Higher People's Court of Shandong Province and suspension of the execution of original court decision during the retrial. On 16th February 2011, the Higher People's Court of Shandong Province opened court session for the case and the result of the retrial has not yet been determined.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

VIII. COMMITMENTS

1. Lease commitments:

1) Fixed assets acquired under financial leases at cost at the year beginning and year end, accumulated depreciation and accumulated provision for impairment.

Premises	At the end of the year	At the beginning of the year
At cost	2,610,055.82	2,610,055.82
Accumulated depreciation	2,505,653.59	2,505,653.59
Provision for impairment	–	–

2) The minimum lease payment in the future years.

Remaining lease term	Minimum lease payment
Within 1 year (including 1 year)	342,168.90
1-2 years (including 2 years)	342,168.90
2-3 years (including 3 years)	342,168.90
Over 3 years	2,737,354.80
Total	3,763,861.502

2. As at 31st December 2010, the unsettled amount of the letters of credit issued by the Company was US$5,637,988.04.

IX. EVENTS AFTER BALANCE SHEET DATE

The Company has no disclosable major events after balance sheet date.

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY

1. Bills receivable

Item	Closing balance	Opening balance
Bank acceptance notes	85,692,620.42	154,667,406.36
Commercial acceptance notes	–	–
Total	85,692,620.42	154,667,406.36

Note: Bills receivables decreased by 44.60% over that at the beginning of the period, which was mainly due to the increase in current accounts and decrease in cash payment for the goods sold during the period under the market impact.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

2. Accounts receivable

(1) *Accounts receivable by customer type*

Item	Closing balance Book balance Amount	Proportion (%)	Bad debt provision	Opening balance Book balance Amount	Proportion (%)	Bad debt provision
Significant single other receivables	24,260,424.16	8.36	3,587,513.37	14,314,718.31	6.29	715,735.92
Insignificant single other receivables with similar credit risk characteristics	–	–	–	–	–	–
Other insignificant receivables	266,103,515.66	91.64	93,309,300.31	213,128,410.19	93.71	88,214,018.95
Total	290,363,939.82	100.00	96,896,813.68	227,443,128.50	100	88,929,754.87

Please refer to 2.10(2) for the recognition criteria on significant single accounts receivable.

(2) *Significant single accounts receivable*

The Company carries out impairment tests separately on significant single accounts receivable. Since there was no objective evidence to ascertain the occurrence of impairment as at 31st December 2010, bad debt provision was made according to the aging analysis of the significant single accounts receivable for the period. For any amount collected as of the date of audit, no bad debt provision will be made.

Age	Closing balance Book balance Amount	Proportion (%)	Bad debt provision	Opening balance Book balance Amount	Proportion (%)	Bad debt provision
Within one year	14,762,455.53	60.85	738,122.78	14,314,718.31	100.00	715,735.92
1-2 years	9,497,968.63	39.15	2,849,390.59	–	–	–
2-3 years	–	–	–	–	–	–
Over 3 years	–	–	–	–	–	–
Total	24,260,424.16	100.00	3,587,513.37	14,314,718.31	100.00	715,735.92

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

2. Accounts receivable *(Continued)*

(3) Other insignificant accounts receivable

For not significant single accounts receivable at the end of the period, bad debt provision will be made according to the percentage of the age balance of the accounts receivable and the difference between the bad debt provision at the end and at the beginning of the period will be carried at asset impairment loss. For any amount collected as of the date of audit, no bad debt provision will be made.

	Closing balance			Opening balance		
	Book balance			Book balance		
Age	**Amount**	**Proportion (%)**	**Bad debt provision**	**Amount**	**Proportion (%)**	**Bad debt provision**
Within one year	102,193,589.85	38.40	4,247,731.80	99,762,700.17	50.16	4,988,135.01
1-2 years	66,798,998.97	25.10	19,586,827.03	56,243,055.13	24.73	26,103,229.05
2-3 years	44,990,483.51	16.91	21,600,970.32	25,588,781.11	11.25	25,588,781.11
Over 3 years	52,120,443.33	19.59	47,873,771.16	31,533,873.78	13.86	31,533,873.78
Total	266,103,515.66	100.00	93,309,300.31	213,128,410.19	100.00	88,214,018.95

(2) Total amount of top five accounts receivable is RMB37,196,115.24, representing 12.81% of the total amount of accounts receivable at the end of the year.

Ranking	**Relationship with the Company**	**Amount**	**Term**	**Percentage to total accounts receivable** (%)
1st	Customer	9,497,968.63	Within one year	3.27
2nd	Customer	7,521,367.52	Within one year	2.59
3rd	Customer	7,241,088.01	Within one year	2.49
4th	Customer	6,632,213.78	Over one year	2.28
5th	Customer	6,303,477.30	Within one year	2.17
Total		37,196,115.24		12.81

(3) There were no accounts receivable due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

3. Other receivables

(1) Other receivables by customer type

Item	Closing balance Book balance Amount	Closing balance Book balance Proportion (%)	Closing balance Bad debt provision	Opening balance Book balance Amount	Opening balance Book balance Proportion (%)	Opening balance Bad debt provision
Significant single other receivables	29,513,906.14	86.57	10,935,182.64	28,327,929.55	95.60	14,576,230.90
Insignificant single other receivables with similar credit risk characteristic	–	–	–	–	–	–
Other insignificant receivables	4,580,568.21	13.43	661,761.90	1,304,981.20	4.40	902,974.79
Total	34,094,474.35	100.00	11,596,944.54	29,632,910.75	100.00	15,479,205.69

Please refer to 2.10(2) for the recognition criteria on significant single other receivables.

1) Significant single other receivables

The Company carries out impairment tests separately on significant single other receivables. Since there was no objective evidence to ascertain the occurrence of impairment as at 31st December 2010, bad debt provision was made according to the aging analysis of the significant single other receivables for the period. For any amount collected as at the date of audit, no bad debt provision will be made.

Age	Closing balance Book balance Amount	Closing balance Book balance Proportion (%)	Closing balance Bad debt provision	Opening balance Book balance Amount	Opening balance Book balance Proportion (%)	Opening balance Bad debt provision
Within one year	11,788,199.28	39.95	597,344.44	12,908,538.46	45.57	399,215.88
1-2 years	2,831,840.85	9.59	337,712.26	917,035.00	3.24	21,133.52
2-3 years	584,234.51	1.98	250,180.00	35,000.00	0.12	–
Over 3 years	14,309,631.50	48.48	9,749,945.94	14,467,356.09	51.07	14,155,881.50
Total	29,513,906.14	100.00	10,935,182.64	28,327,929.55	100.00	14,576,230.90

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

3. Other receivables *(Continued)*

(1) Other receivables by customer type (Continued)

2) Other insignificant receivables

For not significant single other receivables at the end of the period, bad debt provision will be made according to the percentage of the age balance of other receivables and the difference between the bad debt provision at the end and at the beginning of the period will be carried at asset impairment loss. For any amount collected as at the date of audit, no bad debt provision will be made.

	Closing balance			Opening balance		
	Book balance			Book balance		
Age	**Amount**	**Proportion (%)**	**Bad debt provision**	**Amount**	**Proportion (%)**	**Bad debt provision**
Within one year	4,067,301.78	88.79	190,780.08	–	–	–
1-2 years	84,569.23	1.85	42,284.62	450,728.06	34.54	48,721.65
2-3 years	44,808.79	0.98	44,808.79	35,000.00	2.68	35,000.00
Over 3 years	383,888.41	8.38	383,888.41	819,253.14	62.78	819,253.14
Total	4,580,568.21	100.00	661,761.90	1,304,981.20	100.00	902,974.79

(2) Total amount of top five other receivables is RMB8,821,745.63, representing 25.87% of the total amount of other receivables at the end of the year.

Ranking	Relationship with the Company	Amount	Term	Percentage to total accounts receivable (%)
1st	Staff	4,566,500.00	1 year	13.39
2nd	Staff	2,090,000.00	1 year	6.13
3rd	Staff	1,257,180.00	1 year	3.69
4th	Staff	674,390.01	1 year	1.98
5th	Related party	233,675.62	1 year	0.69
Total		8,821,745.63		25.87

(3) There were no other receivables due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

4. Prepayments

Aged	Closing balance Amount	Closing balance Proportion (%)	Opening balance Amount	Opening balance Proportion (%)
Within one year	2,250,338.90	24.60	7,348,386.14	72.79
1-2 years	210,066.92	2.30	361,800.00	3.59
2-3 years	4,481,038.40	49.00	2,295,533.60	22.74
Over 3 years	2,203,573.60	24.10	89,119.78	0.88
Total	9,145,017.82	100.00	10,094,839.52	100.00

There were no prepayments due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights during the reporting period

5. Long-term equity investment

(1) Long-term equity investment

Name of investee	Methodology	Investment cost	Opening balance	Increase/ decrease	Closing balance	Percentage of shareholding in the investee (%)	Percentage of voting rights in investee (%)	Explanation of inconsistence	Impairment provision	Impairment provision made for the period	Cash dividend for the period
TOS Kunming	Equity method	24,739,533.99	41,979,409.03	3,986,016.06	45,965,425.09	50	50	–	–	–	5,289,191.40
Xi'an Ruite	Equity method	14,000,000.00	14,040,478.03	583,856.03	14,624,334.06	23.34	23.34	–	–	–	–
Yunnan Cheng Jiang Copper Products Plant	Cost method	2,000,000.00	2,000,000.00	–	2,000,000.00	–	–	–	2,000,000.00	–	–
Xi'an Ser	Cost method	21,693,265.85	21,693,265.85	–	21,693,265.85	45	45	–	–	–	–
Kunji Transportation	Cost method	500,000.00	500,000.00	–	500,000.00	100	100	–	–	–	–
Winko Machines	Cost method	19,341,544.85	19,341,544.85	–	19,341,544.85	96.74	96.74	–	19,341,544.85	–	–
Kunming Kunji General Machine Co., Ltd.	Cost method	3,000,000.00	3,000,000.00	–	3,000,000.00	100	100	–	–	–	–
Fujian Kunji	Cost method	2,500,000.00	2,500,000.00	–	2,500,000.00	50	50	–	–	–	–
Total		87,774,344.69	105,054,697.76	4,569,872.09	109,624,569.85	–	–	–	21,341,544.85	–	5,289,191.40

(2) Full provision for impairment loss on long-term investment of Yunnan Cheng Jiang Copper Products Plant was made in 1999 because the plant has lost of the ability of sustainable operation. As approved at the 7th meeting of the 6th session of the Board of the Company in 2009, the Company was in the process of disposing such investment during the year.

(3) There is no significant difference between the accounting policies used by the investees and those used by the Company. There is no significant restriction to realization of investment and investment income outflow as foreign currency.

(4) Based on the resolution on the liquidation of Winko Machines proposed at the 32nd meeting of the 5th session of the Board of the Company, a general meeting was convened by Winko Machines Co., Ltd. on 30th June 2008 at the request of the Company and a resolution on dissolution and liquidation was formed. An announcement was published by the Company in this regard. As at 31st December 2010, all liquidation and cancellation work for the company was completed.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

5. Long-term equity investment *(Continued)*

(5) During the year, the interest of the dividends receivable was calculated at borrowing rate in the same period based on the agreement between the Company and Xi'an Ser Turbo Machinery Co., Ltd.. During the year, the accrued interest on the total dividends receivable amounted RMB584,100.00.

(6) The increase in long-term equity investment was due to the investment income recognized by equity method.

6. Deferred income tax assets

(1) Deferred income tax assets recognized

Causes for deferred tax assets	Closing balance	Opening balance
Bad debt provision	26,137,457.40	24,686,652.00
Impairment of available-for-sale financial assets	–	–
Provision for impairment of inventories	2,399,427.22	3,345,775.80
Provision for impairment of fixed assets	927,261.01	929,973.45
Provision for impairment of construction-in-progress	514,232.84	514,232.85
Long term equity investment	5,335,386.21	5,335,386.21
Contingent liabilities	2,445,178.59	1,781,179.20
Discounted value of retirement benefits of internal staff under early retirement	2,369,107.95	3,054,385.66
Issuance of VAT invoice in advance (revenue not yet recognized)	2,914,461.05	4,919,257.42
Government grants (deferred gain)	3,583,350.00	1,410,000.00
Depreciation of fixed assets	820,379.40	820,379.40
Accounts payable overdue for two years	191,537.15	191,537.15
Total	47,637,778.82	46,988,759.14

(2) Temporary differences arising from the assets that result in temporary differences

Item	Temporary difference
Bad debt provision	108,493,758.22
Provision for impairment of inventories	9,597,708.88
Provision for impairment of fixed assets	3,709,044.04
Provision for impairment of construction-in-progress	2,056,931.37
Impairment of long term equity investment	21,341,544.85
Government grants (deferred gain)	23,889,000.00
Contingent liabilities	16,301,190.59
Discounted value of retirement benefits of internal staff under early retirement	10,666,424.84
Accounts payable overdue for two years	1,276,914.36
Depreciation of fixed assets	5,469,196.00
Issuance of VAT invoice in advance (revenue not yet recognized)	19,429,740.37
Total:	222,231,448.3

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

7. Operating income

(1) Operating income

Item	Current period	Prior period
Operating income	1,385,669,586.95	1,122,636,207.61
Other operating income	9,278,693.96	46,145,682.51
Total	1,394,948,280.91	1,168,781,890.12

(2) Total sales revenue from the top 5 customers for 2010 amounted to RMB228,870,085.63, accounting for 16.41% of the total sales revenue.

Customer	Operating income	Percentage of total operating income of the Company (%)
1st	103,670,940.25	7.43
2nd	40,532,478.72	2.91
3rd	29,846,153.84	2.14
4th	28,752,136.75	2.06
5th	26,068,376.07	1.87
Total	228,870,085.63	16.41

8. Operating costs

Item	Current period	Prior period
Operating costs	971,018,127.97	729,510,290.13
Other operating costs	4,103,959.69	1,283,096.36
Total	975,122,087.66	730,793,386.49

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

X. NOTES TO THE MAJOR ITEMS OF THE FINANCIAL STATEMENTS OF THE PARENT COMPANY *(Continued)*

9. Supplementary information on cash flow statement

		2010	2009
1.	Reconciliation of net profit to cash flows from operating activities:		
	Net profits	187,738,250.72	216,518,584.73
	Add: Provision for asset impairment	394,749.38	28,252,860.44
	Depreciation of fixed assets, consumption of oil and gas assets and depreciation of productive biological assets	29,394,932.31	27,909,556.27
	Amortization of intangible assets	2,435,077.08	2,131,984.10
	Amortization of long term deferred expenses	175,362.69	498,654.41
	Loss on disposal of fixed assets, intangible assets and other long-term assets	(624,889.14)	209,589.48
	Loss on disposal of fixed assets ("–" for gain)	–	–
	Loss on fair value changes ("–" for gain)	–	–
	Finance expenses ("–" for gain)	2,644,083.44	2,744,377.35
	Investment loss ("–" for income)	(9,859,063.47)	(12,314,282.04)
	Decrease in deferred income tax assets ("–" for increase)	–	(7,977,447.88)
	Increase in deferred income tax liabilities ("–" for decrease)	(649,019.69)	–
	Decrease in inventory ("–" for increase)	(151,981,978.86)	9,019,709.62
	Decrease in operating receivables ("–" for increase)	(13,318,285.60)	(94,689,356.24)
	Increase in operating payables ("–" for decrease)	78,822,393.15	(66,209,440.37)
	Others	–	–
	Net cash flows from operating activities	125,171,612.02	106,094,789.88
2.	Material investing and financing activities that do not involve cash receipts and payments		
	Conversion of debt into capital	–	–
	Convertible bonds due within one year	–	–
	Fixed assets acquired under finance leases	2,610,055.82	2,610,055.82
3.	Net increase/decrease in cash and cash equivalents:		
	Cash at end of the period	248,304,966.05	237,844,655.24
	Less: Cash at beginning of the period	237,844,655.24	279,084,078.67
	Add: Cash equivalents at end of the period	–	–
	Less: Cash equivalents at beginning of the period	–	–
	Net increase in cash and cash equivalents	10,460,310.81	(41,239,423.43)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

XI. SUPPLEMENTARY INFORMATION

1. Non-recurring gains and losses

Item of non-recurring gains and losses	Amount	Remarks
1. Gain or loss on disposal of non-current assets, including the part offset by provision for asset impairment	666,520.12	
2. Tax refund, reduction or exemption with approval exceeding authority or without official approval or upon contingency	–	
3. Government grants included in current gains and losses (other than those closely related to the normal operating activities of the Company and those subject to a standard fixed amount or an ongoing lum sum amount in accordance with the government's policies)	6,700,335.00	
4. Capital appropriation charges for non-financial entities included in current gains and losses	–	
5. Gain arising from the excess of the fair value of identifiable net assets of the acquiree over the cost of investment in subsidiaries, associates and joint ventures acquired	–	
6. Exchange gain or loss of non-monetary assets	–	
7. Gain or loss arising from investment or assets managed by trustees	–	
8. Provision for assets impairment due to force majeure events such as natural disasters	–	
9. Gain or loss from debt restructuring	2,568,942.39	
10. Corporate restructuring expenses such as resettlement expenses and consolidation expenses	–	
11. Gain or loss from the excess of the price of unfairly priced transactions over its fair value	–	
12. Current net profits or losses from the beginning of the period to thedate of consolidation of subsidiaries arising from the business combination of companies under the same control	–	
13. Gain or loss arising from contingencies unrelated to the normal operating activities of the Company	–	
14. Gain or loss on fair value change arising from holding trading financial assets and trading financial liabilities and investment income arising from disposal of trading financial assets, trading financial liabilities and available-for-sale financial assets other than businesses under hedge accounting relating to the normal operating activities of the Company	–	
15. Reversal of provision for impairment of accounts receivable subject to separate impairment assessment	–	
16. Gain or loss arising from external entrusted loans	–	
17. Gain or loss arising from the fair value change of investment in real estate measured subsequently at fair value	–	
18. Effect of one-off adjustment to current gains and losses in accordance with taxation and accounting laws and regulations on current gains and losses	–	
19. Entrusted income from entrusted operations	–	
20. Other non-operating income and expenses other than those mentioned above	1,977,437.21	
21. Other items under non-recurring gains and losses	–	
Total non-recurring gains and losses	11,913,234.72	
Less: income tax	1,335,565.91	
Total non-recurring gains and losses after deducting income tax	10,577,668.81	
Net profits excluding non-recurring gains and losses (after deducting income tax)	162,885,652.66	
Net profits attributable to the ordinary shareholders of the Company excluding non-recurring gains and losses (after deducting income tax)	167,747,132.70	

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

XI. SUPPLEMENTARY INFORMATION *(Continued)*

2. Cash and cash equivalents

Item	Consolidated 31st December 2010	Consolidated 31st December 2009	Parent company 31st December 2010	Parent company 31st December 2009
1. Cash	296,294,409.56	280,102,559.13	248,304,966.05	237,844,655.24
Including: Cash on hand	1,107,200.04	423,310.35	1,031,490.85	345,996.04
Bank deposit readily available for payment	295,187,209.52	279,679,248.78	247,273,475.20	237,498,659.20
Other cash and cash equivalents readily available for payment	–	–	–	–
Deposits with central bank available for payment	–	–	–	–
Deposits with other banks	–	–	–	–
Loans to other banks	–	–	–	–
2. Cash equivalents				
Including: Bond investment due within 3 month	–	–	–	–
3. Balance of cash and cash equivalents at the end of the period	296,294,409.56	280,102,559.13	248,304,966.05	237,844,655.24
Including: Cash and cash equivalents restricted in use by parent company or subsidiaries within the Group	–	–	–	–

3. Return on net assets and earnings per share

Profit during the reporting period	Return on weighted average net assets (%)	Earnings per share (RMB) Basic earnings per share	Earnings per share (RMB) Diluted earnings per share
Net profits attributable to the ordinary shareholders of the Company	13.75	0.34	0.34
Net profits attributable to the shareholders of the Company excluding non-recurring gains and losses	12.98	0.32	0.32

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

XI. SUPPLEMENTARY INFORMATION *(Continued)*

4. Breakdown of provision for impairment of assets

(1) Breakdown of provision for impairment of consolidated assets

Item	Opening balance	Increase for the year	Decrease for the year: Reversal	Decrease for the year: Transfer for other reasons	Decrease for the year: Total	Closing balance
1. Provision for bad debts	147,642,826.97	17,254,739.63	7,712,816.81	13,062,288.17	20,775,104.98	144,122,461.62
Including: Accounts receivable	125,554,837.05	11,947,168.75	2,914,287.76	7,214,751.26	10,129,039.02	127,372,966.78
Other receivables	22,087,989.92	5,307,570.88	4,798,529.05	5,847,536.91	10,646,065.96	16,749,494.84
2. Provision for inventory impairment	19,822,443.65	7,508.10	–	8,099,116.92	8,099,116.92	11,730,834.83
Including: Inventory of merchandise	6,449,308.24	–	–	3,765,157.87	3,765,157.87	2,684,150.37
Raw materials	3,058,111.54	7,508.10	–	–	–	3,065,619.64
Unfinished products	10,232,242.87	–	–	4,333,959.05	4,333,959.05	5,898,283.82
Low value consumables	82,781.00	–	–	–	–	82,781.00
3. Provision for impairment of available-for-sale financial assets	–	–	–	–	–	–
Including: Trading equity instruments	–	–	–	–	–	–
4. Provision for impairment of held-to-maturity investments	–	–	–	–	–	–
5. Provision for impairment of long-term equity investments	2,000,000.00	–	–	–	–	2,000,000.00
6. Provision for impairment of real estate investments	–	–	–	–	–	–
7. Provision for impairment of fixed assets	3,777,474.24	–	–	68,430.20	68,430.20	3,709,044.04
Including: Buildings and structures	–	–	–	–	–	–
General equipment	3,650,136.96	–	–	68,430.20	68,430.20	3,581,706.76
Specialized equipment	–	–	–	–	–	–
Transportation equipment	–	–	–	–	–	–
Others	127,337.28	–	–	–	–	127,337.28
8. Provision for impairment of engineering materials	–	–	–	–	–	–
9. Provision for impairment of construction-in-progress	2,056,931.37	–	–	–	–	2,056,931.37
10. Provision for impairment of productive biological assets	–	–	–	–	–	–
Including: Provision for impairment of mature productive biological assets	–	–	–	–	–	–
11. Provision for impairment of oil and gas assets	–	–	–	–	–	–
12. Provision for impairment of intangible assets	2,323,453.26	–	–	2,323,453.26	2,323,453.26	–
13. Provision for impairment of goodwill	–	–	–	–	–	–
14. Others	–	–	–	–	–	–
Total	**177,623,129.49**	**17,262,247.73**	**7,712,816.81**	**23,553,288.55**	**31,266,105.36**	**163,619,271.86**

Note: The large amount of reversal for the period was due to the write-off of provision made for current accounts in relation to the liquidation of Winko Machines during the year.

For the year ended 31st December 2010 (Expressed in Renminbi Yuan)

XI. SUPPLEMENTARY INFORMATION *(Continued)*

4. Breakdown of provision for impairment of assets *(Continued)*

(2) Breakdown of impairment provision of the parent company

Item	Opening balance	Increase for the year	Decrease for the year: Reversal	Decrease for the year: Transfer for other reasons	Decrease for the year: Total	Closing balance
1. Provision for bad debts	104,408,960.56	8,941,483.22	4,559,685.56	297,000.00	4,856,685.56	108,493,758.22
Including: Accounts receivable	88,929,754.87	8,264,058.81	–	297,000.00	297,000.00	96,896,813.68
Other receivables	15,479,205.69	677,424.41	4,559,685.56	–	4,559,685.56	11,596,944.54
2. Provision for inventory impairment	13,383,103.17	7,508.10	–	3,792,902.39	3,792,902.39	9,597,708.88
Including: Inventory of merchandise	6,449,308.24	–	–	–	–	6,449,308.24
Raw materials	3,058,111.54	7,508.10	–	–	–	3,065,619.64
Unfinished products	3,792,902.39	–	–	3,792,902.39	3,792,902.39	–
Low value consumables	82,781.00	–	–	–	–	82,781.00
3. Provision for impairment of available-for-sale financial assets	–	–	–	–	–	–
Including: Trading equity instruments	–	–	–	–	–	–
4. Provision for impairment of held-to-maturity investments	–	–	–	–	–	–
5. Provision for impairment of long-term equity investments	21,341,544.85	–	–	–	–	21,341,544.85
6. Provision for impairment of real estate investments	–	–	–	–	–	–
7. Provision for impairment of fixed assets	3,719,893.82	–	–	10,849.78	10,849.78	3,709,044.04
Including: Buildings and structures	–	–	–	–	–	–
General equipment	3,592,556.54	–	–	10,849.78	10,849.78	3,581,706.76
Specialized equipment	–	–	–	–	–	–
Transportation equipment	–	–	–	–	–	–
Others	127,337.28	–	–	–	–	127,337.28
8. Provision for impairment of engineering materials	–	–	–	–	–	–
9. Provision for impairment of construction-in-progress	2,056,931.37	–	–	–	–	2,056,931.37
10. Provision for impairment of productive biological assets	–	–	–	–	–	–
Including: Provision for impairment of mature productive biological assets	–	–	–	–	–	–
11. Provision for impairment of oil and gas assets	–	–	–	–	–	–
12. Provision for impairment of intangible assets	–	–	–	–	–	–
13. Provision for impairment of goodwill	–	–	–	–	–	–
14. Others						
Total	**144,910,433.77**	**8,948,991.32**	**4,559,685.56**	**4,100,752.17**	**8,660,437.73**	**145,198,987.36**

XI. SUPPLEMENTARY INFORMATION *(Continued)*

5. DIFFERENCE BETWEEN THE PRC GAAP AND HK GAAP

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

The consolidated net profit for year 2010 and the consolidated net assets as at 31st December 2010 are RMB178,324,801.52 and RMB1,374,125,279.42 respectively. The major adjustments to consolidated net profits and the consolidated net assets in accordance with the HK GAAP are as follows:

Unit: RMB'000

Item	Net profits	Net assets
Consolidated results in accordance with PRC GAAP	178,325	1,374,125
Gain on investment in jointly controlled entity(ies)	–	(8,869)
Amortization of goodwill	–	(1,428)
Adjustment on deferred income	49	–
Others	(4)	185
Consolidated results in accordance with HK GAAP	178,370	1,364,013

The figures in the financial statements prepared in accordance with HK GAAP above and the difference between the HK GAAP and PRC GAAP were provided by KPMG.

Shenji Group Kunming Machine Tool Co., Ltd.
Mr. Gao Minghui,
Chairman
22nd March 2011

AUDITOR'S REPORT

Independent auditor's report to the shareholders of Shenji Group Kunming Machine Tool Company Limited
(Incorporated in the People's Republic of China with limited liability)

We have audited the consolidated financial statements of Shenji Group Kunming Machine Tool Company Limited ("the Company") and its subsidiaries (together "the Group") set out on pages 150 to 216, which comprise the consolidated and Company statements 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 cash flow statement 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 Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirement of Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of 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. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 judgement, 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 consolidated financial statements that give a true and fair view 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.

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

OPINION

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

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

23 March 2011

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2010 (Expressed in Renminbi Yuan)

	Note	2010 RMB'000	2009 RMB'000
Turnover	4	**1,588,301**	1,366,877
Cost of sales		**(1,154,363)**	(897,268)
Gross profit		**433,938**	469,609
Other revenue	5	**16,918**	33,546
Other net income	5	**6,470**	326
Distribution expenses		**(108,239)**	(70,359)
Administrative expenses		**(152,011)**	(191,529)
Other operating expenses		**(1,691)**	(1,534)
Profit from operations		**195,385**	240,059
Finance costs	6(a)	**(4,314)**	(4,512)
Share of profit of an associate	20	**584**	362
Share of profit of a jointly controlled entity	21	**9,275**	11,926
Profit before taxation	6	**200,930**	247,835
Income tax	7(a)	**(27,422)**	(34,846)
Profit and total comprehensive income for the year		**173,508**	212,989
Attributable to:			
Equity shareholders of the Company		**178,370**	215,710
Non-controlling interests		**(4,862)**	(2,721)
Profit and total comprehensive income for the year		**173,508**	212,989
Earnings per share	11		
– Basic		**RMB0.336**	RMB0.406

The notes on pages 157 to 216 form part of these financial statements. Details of dividends payable to equity shareholders of the Company attributable to the profit for the year are set out in note 36(b).

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2010 (Expressed in Renminbi Yuan)

	Note	2010 RMB'000	2009 RMB'000
Non-current assets			
Property, plant and equipment	*13(a)*	**495,234**	470,910
Construction in progress	*14*	**122,305**	99,822
Lease prepayments	*15*	**22,904**	23,508
Prepaid property lease rights	*16*	**3,085**	3,178
Intangible assets	*17(a)*	**1,391**	2,590
Goodwill	*18*	**5,844**	5,844
Interest in an associate	*20*	**14,814**	14,230
Interest in a jointly controlled entity	*21*	**37,086**	33,100
Deferred tax assets	*34(b)*	**47,383**	42,100
		750,046	695,282
Current assets			
Inventories	*22*	**752,776**	610,288
Trade and bills receivable	*23*	**359,940**	362,032
Deposits, other receivables and prepayments	*24*	**74,831**	60,574
Prepaid tax	*34(a)*	**839**	954
Amount due from a jointly controlled entity	*39(b)*	**6,576**	2,237
Restricted bank deposits	*25*	**10,412**	5,165
Cash at bank and on hand	*26(a)*	**285,882**	274,938
		1,491,256	1,316,188
Current liabilities			
Bank loans – due within one year	*27*	**46,000**	70,000
Trade and bills payable	*28*	**217,381**	175,491
Other payables	*29*	**473,926**	436,066
Amount due to a jointly controlled entity	*39(b)*	**22,635**	14,858
Obligations under finance leases due within one year	*30*	**213**	213
Early retirement benefits obligation due within one year	*31*	**2,975**	2,881
Deferred income	*32*	**23,989**	9,500
Income tax payable	*34(a)*	**4,790**	6,336
Provisions	*35*	**16,301**	11,885
		808,210	727,230
Net current assets		**683,046**	588,958
Total assets less current liabilities		**1,433,092**	1,284,240

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2010 (Expressed in Renminbi Yuan)

	Note	2010 RMB'000	2009 RMB'000
Non-current liabilities			
Obligations under finance leases	*30*	**2,132**	2,345
Early retirement benefits obligation	*31*	**7,691**	10,666
Deferred gain	*33*	**2,213**	2,468
		12,036	15,479
NET ASSETS		**1,421,056**	1,268,761
CAPITAL AND RESERVES			
Share capital	*36(c)*	**531,081**	424,865
Reserves		**832,932**	781,991
Total equity attributable to equity shareholders of the Company		**1,364,013**	1,206,856
Non-controlling interests		**57,043**	61,905
TOTAL EQUITY		**1,421,056**	1,268,761

Approved and authorised for issue by the board of directors on 23 March 2011.

Gao Minghui
Director

Pi Jianguo
Director

The notes on pages 157 to 216 form part of these financial statements.

STATEMENT OF FINANCIAL POSITION

At 31 December 2010 (Expressed in Renminbi Yuan)

	Note	2010 RMB'000	2009 RMB'000
Non-current assets			
Property, plant and equipment	*13(b)*	**441,849**	412,683
Construction in progress	*14*	**122,305**	99,822
Lease prepayments	*15*	**10,521**	10,841
Prepaid property lease rights	*16*	**3,085**	3,178
Intangible assets	*17(b)*	**1,391**	2,590
Investments in subsidiaries	*19*	**27,693**	27,693
Interest in an associate	*20*	**14,000**	14,000
Interest in a jointly controlled entity	*21*	**12,571**	12,571
Deferred tax assets	*34(b)*	**44,723**	42,069
		678,138	625,447
Current assets			
Inventories	*22*	**585,789**	430,396
Trade and bills receivable	*23*	**267,368**	288,384
Deposits, other receivables and prepayments	*24*	**29,222**	20,991
Amounts due from subsidiaries	*39(d)*	**24,193**	16,818
Amount due from a jointly controlled entity	*39(b)*	**6,576**	2,237
Restricted bank deposits	*25*	**–**	–
Cash at bank and on hand	*26(a)*	**248,305**	237,845
		1,161,453	996,671
Current liabilities			
Bank loans – due within one year	*27*	**21,000**	50,000
Trade and bills payable	*28*	**121,984**	104,884
Other payables	*29*	**314,204**	278,291
Amounts due to subsidiaries	*39(d)*	**12,798**	3,615
Amount due to a jointly controlled entity	*39(b)*	**22,635**	14,858
Obligations under finance leases due within one year	*30*	**213**	213
Early retirement benefits obligation due within one year	*31*	**2,975**	2,881
Deferred income	*32*	**23,889**	9,400
Income tax payable	*34(a)*	**4,216**	5,287
Provisions	*35*	**16,301**	11,875
		540,215	481,304
Net current assets		**621,238**	515,367
Total assets less current liabilities		**1,299,376**	1,140,814

STATEMENT OF FINANCIAL POSITION

At 31 December 2010 (Expressed in Renminbi Yuan)

	Note	2010 RMB'000	2009 RMB'000
Non-current liabilities			
Obligations under finance leases	*30*	**2,132**	2,345
Early retirement benefits obligation	*31*	**7,691**	10,666
Deferred gain	*33*	**2,213**	2,468
		12,036	15,479
NET ASSETS		**1,287,340**	1,125,335
CAPITAL AND RESERVES	*36(a)*		
Share capital	*36(c)*	**531,081**	424,865
Reserves		**756,259**	700,470
TOTAL EQUITY		**1,287,340**	1,125,335

Approved and authorised for issue by the board of directors on 23 March 2011.

Gao Minghui
Director

Pi Jianguo
Director

The notes on pages 157 to 216 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010 (Expressed in Renminbi Yuan)

		Attributable to equity shareholders of the Company							
	Note	Share capital RMB'000	Share premium RMB'000	Capital reserve RMB'000	Statutory surplus reserve RMB'000	Retained profits RMB'000	Total RMB'000	Non–controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2009		424,865	113,887	10,225	69,635	412,598	1,031,210	64,626	1,095,836
Changes in equity for 2009:									
Profit for the year		–	–	–	–	215,710	215,710	(2,721)	212,989
Total comprehensive income for the year		–	–	–	–	215,710	215,710	(2,721)	212,989
Appropriations		–	–	–	21,652	(21,652)	–	–	–
Dividends approved in respect of the previous year	*36(b)*	–	–	–	–	(40,064)	(40,064)	–	(40,064)
Balance at 31 December 2009 and 1 January 2010		424,865	113,887	10,225	91,287	566,592	1,206,856	61,905	1,268,761
Changes in equity for 2010:									
Profit for the year		–	–	–	–	178,370	178,370	(4,862)	173,508
Total comprehensive income for the year		–	–	–	–	178,370	178,370	(4,862)	173,508
Issue of ordinary shares	*36(c)*	106,216	(106,216)	–	–	–	–	–	–
Appropriations		–	–	–	18,774	(18,774)	–	–	–
Dividends approved in respect of the previous year	*36(b)*	–	–	–	–	(21,213)	(21,213)	–	(21,213)
Balance at 31 December 2010		531,081	7,671	10,225	110,061	704,975	1,364,013	57,043	1,421,056

The notes on pages 157 to 216 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2010 (Expressed in Renminbi Yuan)

	Note	2010 RMB'000	2009 RMB'000
Operating activities			
Cash generated from operations	*26(b)*	**145,562**	159,241
Income tax paid		**(34,137)**	(38,655)
Net cash generated from operating activities		**111,425**	120,586
Investing activities			
Payments for the purchase of property, plant and equipment and construction in progress		**(79,135)**	(136,282)
Proceeds from disposal of property, plant and equipment		**1,967**	1,254
Addition of deferred income		**20,389**	1,500
(Addition)/withdrawal of time deposits		**1,160**	(2,660)
Interest received		**1,837**	2,247
Dividend received from a jointly controlled entity		**5,289**	9,500
Net cash used in investing activities		**(48,493)**	(124,441)
Financing activities			
Proceeds from new bank loans		**46,000**	70,000
Repayments of bank loans		**(70,000)**	(70,000)
Interest paid		**(4,314)**	(4,512)
Repayments of obligations under finance leases		**(213)**	(213)
Dividends paid		**(21,213)**	(40,064)
Net cash used in financing activities		**(49,740)**	(44,789)
Net increase/(decrease) in cash and cash equivalents		**13,192**	(48,644)
Cash and cash equivalents at 1 January	*26(a)*	**272,278**	322,699
Effect of foreign exchange rate changes		**(1,088)**	(1,777)
Cash and cash equivalents at 31 December	*26(a)*	**284,382**	272,278

The notes on pages 157 to 216 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi Yuan unless otherwise indicated)

1 GENERAL

Shenji Group Kunming Machine Tool Company Limited (the "Company") was established in the People's Republic of China (the "PRC") as a Sino-foreign joint stock limited company, and its shares are listed on The Stock Exchange of Hong Kong Limited and the Shanghai Stock Exchange.

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

The Company acts as an investment holding company and it is also engaged in the design, development, manufacture and sale of machine tools, precision measuring equipment and precision transducers. The principal activities of its subsidiaries are set out in note 19.

The consolidated financial statements for the year ended 31 December 2010 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in an associate and a jointly controlled entity.

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

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

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

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

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is the historical cost basis.

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 41.

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(c) Subsidiaries and non-controlling interests

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

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

Non-controlling interests (previously known as "minority interests") represent the equity in a subsidiary not attributable directly or indirectly to the Company, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. For each business combination, the Group can elect to measure any non-controlling interests either at fair value or at their proportionate share of the subsidiary's net identifiable assets.

Non-controlling interests are presented in the consolidated statement of financial position within equity, separately from equity attributable to the equity shareholders of the Company. Non-controlling interests in the results of the Group are presented on the face of the consolidated statement of comprehensive income as an allocation of the total profit or loss and total comprehensive income for the year between non-controlling interests and the equity shareholders of the Company.

Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions, whereby adjustments are made to the amounts of controlling and non-controlling interests within consolidated equity to reflect the change in relative interests, but no adjustments are made to goodwill and no gain or loss is recognised.

When the Group loses control of a subsidiary, it is accounted for as a disposal of the entire interest in that subsidiary, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former subsidiary at the date when control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset or, when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity (see note 2(d)).

In the Company's statement of financial position, an investment in a subsidiary is stated at cost less impairment losses (see note 2(j)).

(d) Associates and jointly controlled entities

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

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(d) Associates and jointly controlled entities *(Continued)*

An investment in an associate or a jointly controlled entity is accounted for in the consolidated financial statements under the equity method. Under the equity method, the investment is initially recorded at cost, adjusted for any excess of the Group's share of the acquisition-date fair values of the investee's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the investee's net assets and any impairment loss relating to the investment (see notes 2(e) and (j)). Any acquisition-date excess over cost, the Group's share of the post-acquisition, post-tax results of the investees, any impairment losses and the post-acquisition post-tax items of the investees' other comprehensive income for the year are recognised in the consolidated statement of comprehensive income.

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

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

When the Group ceases to have significant influence over an associate or joint control over a jointly controlled entity, it is accounted for as a disposal of the entire interest in that investee, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former investee at the date when significant influence or joint control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset or, when appropriate, the cost on initial recognition of an investment in an associate (see note 2(d)).

In the Company's statement of financial position, investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 2(j)),

(e) Goodwill

Goodwill represents the excess of

(i) the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the Group's previously held equity interest in the acquiree; over

(ii) the net fair value of the acquiree's identifiable assets and liabilities measured as at the acquisition date.

When (ii) is greater than (i), then this excess is recognised immediately in profit or loss as a gain on a bargain purchase.

Goodwill is stated at cost less accumulated impairment losses. Goodwill arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination and is tested annually for impairment (see note 2(j)).

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(f) Property, plant and equipment

(i) Property, plant and equipment are stated in the statement of financial position at cost less accumulated depreciation and impairment losses (see note 2(j)).

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

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

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

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

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

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

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

No depreciation is provided for construction in progress.

(g) Intangible assets (other than goodwill)

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

Other intangible assets that are acquired by the Group are stated in the statement of financial position at cost less accumulated amortisation (where the estimated useful life is finite) and impairment losses (see note 2(j)).

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

Both the period and method of amortisation are reviewed annually.

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(h) Lease prepayments

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

(i) Leased assets

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

(i) Classification of assets leased to the Group

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

(ii) Assets acquired under finance leases

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

(iii) Operating lease charges

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(j) Impairment of assets

(i) Impairment of investments in equity securities and receivables

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

– significant financial difficulty of the debtor;

– a breach of contract, such as a default or delinquency in interest or principal payments;

– it becoming probable that the debtor will enter bankruptcy or other financial reorganisation;

– significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and

– a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

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

– For investments in associates and jointly controlled entities recognised using the equity method (see note 2(d)), the impairment loss is measured by comparing the recoverable amount of the investment as a whole with its carrying amount in accordance with note 2(j)(ii). The impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount in accordance with note 2(j)(ii).

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

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(j) Impairment of assets *(Continued)*

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

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

(ii) Impairment of other assets

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

- property, plant and equipment;
- construction in progress;
- lease prepayments;
- prepaid property lease rights;
- intangible assets;
- investments in subsidiaries;
- interest in an associate for the Company level;
- interest in a jointly controlled entity for the Company level, and
- goodwill.

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

- Calculation of recoverable amount

  The recoverable amount of an asset is the greater of its fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(j) Impairment of assets *(Continued)*

(ii) Impairment of other assets (Continued)

– Recognition of impairment losses

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

– Reversals of impairment losses

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

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

(iii) Interim financial reporting and impairment

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

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

(k) Inventories

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

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

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

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(l) Trade and other receivables

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

(m) Interest-bearing borrowings

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

(n) Trade and other payables

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

(o) Cash and cash equivalents

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

(p) Employee benefits

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

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

(ii) Early retirement benefits

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

(iii) Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(q) Income tax

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

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

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

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

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

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

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

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(q) Income tax *(Continued)*

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

– in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

– in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  – the same taxable entity; or

  – different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(r) Provisions and contingent liabilities

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

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

(s) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have been transferred to customers. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

(ii) Services

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

(iii) Rental income from operating leases

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

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(s) Revenue recognition *(Continued)*

(iv) Dividends

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

(v) Interest income

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

(vi) Government grants

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

(t) Translation of foreign currencies

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

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

(u) Borrowing costs

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

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

(v) Related parties

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

(i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;

(ii) the Group and the party are subject to common control;

(iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;

(iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;

2 SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(v) Related parties *(Continued)*

(v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or

(vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

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

(w) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

3 CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued two revised HKFRSs, a number of amendments to HKFRSs and two new Interpretations that are first effective for the current accounting period of the Group and the Company. Of these, the following developments are relevant to the Group's financial statements:

- HKFRS 3 (revised 2008), Business combinations
- Amendments to HKAS 27, Consolidated and separate financial statements
- Amendments to HKFRS 5, Non-current assets held for sale and discontinued operations – plan to sell the controlling interest in a subsidiary
- Improvements to HKFRSs (2009)
- HK(IFRIC) 17, Distributions of non-cash assets to owners
- HK (Int) 5, Presentation of Financial Statements – Classification by the Borrower of a Term Loan that contains a Repayment on Demand Clause

The group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

3 CHANGES IN ACCOUNTING POLICIES *(Continued)*

The developments resulted in changes in accounting policy but none of these changes in policy have a material impact on the current or comparative periods, for the following reasons:

- The impact of the majority of the revisions to HKFRS 3, HKAS 27, HKFRS 5, HKFRSs (2009), HK(IFRIC) 17 and HK (Int) 5 have not yet had a material effect on the Group's financial statements as these changes will first be effective as and when the Group enters into a relevant transaction (for example, a business combination, a disposal of a subsidiary or a noncash distribution) and there is no requirement to restate the amounts recorded in respect of previous such transactions.

- The impact of the amendments to HKFRS 3 (in respect of recognition of acquiree's deferred tax assets) and HKAS 27 (in respect of allocation of losses to non-controlling interests (previously known as minority interests) in excess of their equity interest) have had no material impact as there is no requirement to restate amounts recorded in previous periods and no such deferred tax assets or losses arose in the current period.

Further details of these changes in accounting policy are as follows:

- As a result of the adoption of HKFRS 3 (revised 2008), any business combination acquired on or after 1 January 2010 will be recognised in accordance with the new requirements and detailed guidance contained in HKFRS 3 (revised 2008). These include the following changes in accounting policies:

  – Transaction costs that the Group incurs in connection with a business combination, such as finder's fees, legal fees, due diligence fees, and other professional and consulting fees, will be expensed as incurred, whereas previously they were accounted for as part of the cost of the business combination and therefore impacted the amount of goodwill recognised.

  – If the Group holds interests in the acquiree immediately prior to obtaining control, these interests will be treated as if disposed of and re-acquired at fair value on the date of obtaining control. Previously, the step-up approach would have been applied, whereby goodwill was computed as if accumulated at each stage of the acquisition.

  – Contingent consideration will be measured at fair value at the acquisition date. Subsequent changes in the measurement of that contingent consideration unrelated to facts and circumstances that existed at the acquisition date will be recognised in profit or loss, whereas previously these changes were recognised as an adjustment to the cost of the business combination and therefore impacted the amount of goodwill recognised.

  – If the acquiree has accumulated tax losses or other temporary deductible differences and these fail to meet the recognition criteria for deferred tax assets at the date of acquisition, then any subsequent recognition of these assets will be recognised in profit or loss, rather than as an adjustment to goodwill as was previously the policy.

  – In addition to the Group's existing policy of measuring the non-controlling interests (previously known as the "minority interests") in the acquiree at the non-controlling interest's proportionate share of the acquiree's net identifiable assets, in future the Group may elect, on a transaction by transaction basis, to measure the non-controlling interest at fair value.

  In accordance with the transitional provisions in HKFRS 3 (revised 2008), these new accounting policies will be applied prospectively to any business combinations in the current or future periods. The new policy in respect of recognition in the movement of deferred tax assets will also be applied prospectively to accumulated tax losses and other temporary deductible differences acquired in previous business combinations. No adjustments have been made to the carrying values of assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this revised standard.

3 CHANGES IN ACCOUNTING POLICIES *(Continued)*

- As a result of the adoption of HKAS 27 (amended 2008), the following changes in policies will be applied as from 1 January 2010:

  – If the Group acquires an additional interest in a non-wholly owned subsidiary, the transaction will be accounted for as a transaction with equity shareholders (the non-controlling interests) in their capacity as owners and therefore no goodwill will be recognised as a result of such transactions. Similarly, if the Group disposes of part of its interest in a subsidiary but still retains control, this transaction will also be accounted for as a transaction with equity shareholders (the non-controlling interests) in their capacity as owners and therefore no profit or loss will be recognised as a result of such transactions. Previously the Group treated such transactions as step-up transactions and partial disposals, respectively.

  – If the Group loses control of a subsidiary, the transaction will be accounted for as a disposal of the entire interest in that subsidiary, with any remaining interest retained by the Group being recognised at fair value as if reacquired. In addition, as a result of the adoption of the amendment to HKFRS 5, if at the end of the reporting period the Group has the intention to dispose of a controlling interest in a subsidiary, the entire interest in that subsidiary will be classified as held for sale (assuming that the held for sale criteria in HKFRS 5 are met) irrespective of the extent to which the Group will retain an interest. Previously such transactions were treated as partial disposals.

  In accordance with the transitional provisions in HKAS 27, these new accounting policies will be applied prospectively to transactions in current or future periods and therefore previous periods have not been restated

- In order to be consistent with the above amendments to HKFRS 3 and HKAS 27, and as a result of amendments to HKAS 28, Investments in associates, and HKAS 31, Interests in joint ventures, the following policies will be applied as from 1 January 2010:

  – If the Group holds interests in the acquiree immediately prior to obtaining significant influence or joint control, these interests will be treated as if disposed of and reacquired at fair value on the date of obtaining significant influence or joint control. Previously, the step-up approach would have been applied, whereby goodwill was computed as if accumulated at each stage of the acquisition.

  – If the Group loses significant influence or joint control, the transaction will be accounted for as a disposal of the entire interest in that investee, with any remaining interest being recognised at fair value as if reacquired. Previously such transactions were treated as partial disposals.

  Consistent with the transitional provisions in HKFRS 3 and HKAS 27, these new accounting policies will be applied prospectively to transactions in current or future periods and therefore previous periods have not been restated.

Other changes in accounting policies which are relevant to the Group's financial statements are as follows:

- As a result of the amendments to HKAS 27, as from 1 January 2010 any losses incurred by a non-wholly owned subsidiary will be allocated between the controlling and non-controlling interests in proportion to their interests in that entity, even if this results in a deficit balance within consolidated equity being attributed to the non-controlling interests. Previously, if the allocation of losses to the non-controlling interests would have resulted in a deficit balance, the losses were only allocated to the non-controlling interests if the non-controlling interests were under a binding obligation to make good the losses. In accordance with the transitional provisions in HKAS 27, this new accounting policy is being applied prospectively and therefore previous periods have not been restated.

4 TURNOVER

The principal activities of the Group are design, development, manufacture and sale of machine tools, precision measuring equipment and other precision transducers.

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

	2010 RMB'000	2009 RMB'000
Sales of goods	**1,551,936**	1,307,556
Sales of prototype machines	**20,572**	41,592
Rendering of services	**15,793**	17,729
	1,588,301	1,366,877

The Group's customer base is diversified and there is no customer with whom transactions have exceeded 10% of the Group's revenues.

Further details regarding the Group's principal activities are disclosed in note 12 to these financial statements.

5 OTHER REVENUE AND NET INCOME

	Notes	**2010 RMB'000**	2009 RMB'000
Other revenue			
Government grants	*(i)*	**7,089**	27,688
Sales of raw materials		**4,222**	2,754
Interest income		**1,837**	2,247
Utility charges		**2,680**	–
Others		**1,090**	857
		16,918	33,546

Notes:

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

	2010 RMB'000	2009 RMB'000
Other net income		
Net gain/(loss) on sale of property, plant and equipment	**364**	(227)
Waiver of liabilities from external suppliers	**4,344**	–
Others	**1,762**	553
	6,470	326

6 PROFIT BEFORE TAXATION

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

(a) Finance costs

	2010 **RMB'000**	2009 RMB'000
Interest on bank loans	**3,540**	3,704
Finance charges on obligations under finance leases	**129**	129
Finance charges in respect of early retirement benefits	**645**	679
	4,314	4,512

(b) Staff costs

	2010 **RMB'000**	2009 RMB'000
Salaries, wages and other benefits	**230,095**	168,864
Contributions to retirement schemes *(note 31)*	**20,432**	19,352
	250,527	188,216

(c) Other items

	2010 **RMB'000**	2009 RMB'000
Amortisation#		
– lease prepayments	**604**	573
– intangible assets	**1,199**	1,177
– prepaid property lease rights	**93**	92
	1,896	1,842
Depreciation of property, plant and equipment#	**40,661**	35,523
Impairment losses		
– trade and bills receivables *(note 23(b))*	**8,490**	31,730
– property, plant and equipment *(note 13(c))*	**–**	223
	8,490	31,953
Operating lease charges: minimum lease payments for buildings	**5,066**	7,871
Net foreign exchange loss	**1,088**	1,777
Auditors' remuneration		
– audit services	**3,014**	3,000
– other services	**1,400**	–
	4,414	3,000
Research and development costs	**31,572**	45,734
Increase in provisions *(note 35)*	**15,502**	13,522
Cost of inventories# *(note 22(b))*	**1,131,705**	880,396

\# Cost of inventories includes RMB176,007,000 (2009: RMB139,475,747) relating to staff costs and depreciation expenses, which amount is also included in the respective total amounts disclosed separately above or in note 6(b) for each of these types of expenses.

7 INCOME TAX IN THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(a) Taxation in the consolidated statement of comprehensive income represents:

	2010 RMB'000	2009 RMB'000
Current tax		
Provision for the year	**32,705**	42,645
Deferred tax		
Origination and reversal of temporary differences	**(4,860)**	(5,886)
Effect on deferred tax balance at 1 January resulting from a change in tax rate	**(423)**	(1,913)
	27,422	34,846

No provision has been made for Hong Kong Profits Tax as the Group did not have assessable profits subject to Hong Kong Profits Tax during the year. Profits of the Company and the Company's subsidiaries in the PRC are subject to PRC income taxes at rates ranging from 15% to 25% (2009: 15% to 25%).

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC ("new tax law") which takes effect on 1 January 2008. As a result of the new tax law, the statutory income tax rate currently adopted by the Group, except that for the Company and certain of its subsidiaries which are entitled to preferential tax policies mentioned below, changed to 25% from 1 January 2008.

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

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

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2010 RMB'000	2009 RMB'000
Profit before taxation	**200,930**	247,835
Notional tax on profit before taxation, calculated at statutory tax rates	**50,232**	61,959
Tax effect of preferential tax rate	**(18,728)**	(23,707)
Tax benefits	**(2,357)**	(1,477)
Tax effect of non-deductible expenses	**2,212**	1,020
Tax effect of non-taxable income	**(2,465)**	(1,835)
Tax effect of unrecognized tax losses	**604**	603
Effect on deferred tax balance at 1 January resulting from a change in tax rate	**(706)**	(1,913)
Recognition of previously unrecognised tax losses	**(353)**	–
Others	**(1,017)**	196
Actual tax expense	**27,422**	34,846

8 DIRECTORS' REMUNERATION

Details of directors' remuneration for the year ended 31 December 2010 are as follows:

	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Retirement Scheme contributions RMB'000	Discretionary bonuses RMB'000	Total RMB'000
Executive directors:					
Gao Minghui (Chairman)	**81**	**367**	**45**	**50**	**543**
Zhang Xiaoyi	**67**	**463**	**39**	**150**	**719**
Pi Jianguo	**49**	**381**	**70**	**30**	**530**
Ye Nong[iii]	**20**	**425**	**45**	**110**	**600**
Non-executive directors:					
Guan Xin[iii]	**23**	**–**	**–**	**–**	**23**
Wang Xing	**43**	**–**	**–**	**–**	**43**
Sun Kai[ii]	**16**	**–**	**–**	**–**	**16**
Li Zhenxiong[i]	**–**	**–**	**–**	**–**	**–**
Zhang Tao[i]	**–**	**–**	**–**	**–**	**–**
Independent non-executive directors:					
Yu Weifeng Wayne	**171**	**–**	**–**	**–**	**171**
Chen Ying	**114**	**–**	**–**	**–**	**114**
Li Dongru	**114**	**–**	**–**	**–**	**114**
Liu Minghui	**115**	**–**	**–**	**–**	**115**
	813	**1,636**	**199**	**340**	**2,988**

Note:

(i) These directors had elected to waive any remuneration to them from the Group.

(ii) This director had resigned on 11 May 2010.

(iii) These directors were appointed on 23 June 2010.

8 DIRECTORS' REMUNERATION *(Continued)*

Details of directors' remuneration for the year ended 31 December 2009 are as follows:

	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Retirement Scheme contributions RMB'000	Discretionary bonuses RMB'000	Total RMB'000
Executive directors:					
Gao Minghui (Chairman)	74	215	–	50	339
Zhang Xiaoyi	69	519	35	100	723
Pi Jianguo	50	408	92	40	590
Non-executive directors:					
Wang Xing	43	–	–	–	43
Sun Kai	43	–	–	–	43
Wang Sheng[ii]	43	–	–	–	43
Li Zhenxiong[i]	–	–	–	–	–
Zhang Tao[i]	–	–	–	–	–
Independent non-executive directors:					
Yu Weifeng Wayne	171	–	–	–	171
Chen Ying	114	–	–	–	114
Li Dongru	114	–	–	–	114
Liu Minghui	114	–	–	–	114
	835	1,142	127	190	2,294

Note:

(i) These directors had elected to waive any remuneration to them from the Group.

(ii) This director had resigned on 6 November 2009.

9 INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments, four (2009: two) are directors whose emolument are disclosed in note 8. The aggregate of the emoluments in respect of the remaining individuals are as follows:

	2010 RMB'000	2009 RMB'000
Salaries and other emoluments	**376**	1,232
Discretionary bonuses	**38**	280
Retirement scheme contributions	**100**	70
	514	1,582

The emoluments of the one individual (2009: three) with the highest emoluments are within the following band:

	2010	2009
HKD Nil – HKD 1,000,000	**1**	3

10 PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a profit of RMB177,929,000 (2009: RMB204,145,000), which has been dealt with in the financial statements of the Company.

Reconciliation of the above amount to the Company's profit for the year:

	2010 **RMB'000**	2009 RMB'000
Amount of consolidated profit attributable to equity shareholders dealt with in the Company's financial statements	**177,929**	204,145
Final dividends from a subsidiary and a jointly controlled entity attributable to the profit of the previous financial year and approved during the year	**5,289**	9,500
Company's profit for the year *(note 36(a))*	**183,218**	213,645

Details of dividends paid and payable to the equity shareholders of the Company are set out in note 36(b).

11 EARNINGS PER SHARE

(a) Basic earnings per share

The calculation of basic earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of RMB178,370,000 (2009: RMB215,710,000) and the weighted average of 531,081,103 ordinary shares (2009: 531,081,103 shares after adjusting for the capitalisation issue in 2010) in issue during the year, calculated as follows:

	2010 **'000**	2009 '000
Issued ordinary shares at 1 January	**424,865**	424,865
Effect of capitalisation issue *(note 36(c)(i))*	**106,216**	106,216
Weighted average number of ordinary shares at 31 December	**531,081**	531,081

(b) Diluted earnings per share

No diluted earnings per share information has been presented because the Company does not have any potential dilutive shares in issue during the years ended 31 December 2010 and 2009.

12 SEGMENT REPORTING

The Group manages its business by business line all through. In a manner consistent with the way in which information is reported internally to the Group's most senior executive management for the purpose of resource allocation and performance assessment, the Group has presented the following three reportable segments. No operating segments have been aggregated to form the following reportable segments.

(i) the design, manufacture and sale of boring machines;

(ii) the design, manufacture and sale of sensors and turbo tables, and computerised embroidery machines; and

(iii) the design, manufacture and sale of turbo machines.

(a) Segment results, assets and liabilities

For the purpose of assessing segment performance and allocating resource between segments, the Group's senior execute management monitors the results, assets and liabilities attributable to each reportable segment on the following bases:

Segment assets included all tangible, intangible assets and current assets with the exception of interest in an associate, interest in a jointly controlled entity, deferred tax assets and other corporate assets. Segment liabilities include provision for warranties, trade and bills payable, income tax payable other payables attributable to manufacturing and sales activities of the individual segments and bank borrowings managed directly by the segments.

Revenue and expenses are allocated to the reportable segments with reference to sales generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments.

The measure used for reporting segment profit is "adjusted EBITDA" i.e. "adjusted earnings before interest, taxes, depreciation and amortisation", where "interest" is regarded as including investment income and "depreciation" and "amortisation" is regarded as including impairment losses on non-current assets. To arrive at adjusted EBITDA the Group's earnings are further adjusted for items not specifically attributed to individual segments, such as share of profit less losses of associates and jointly controlled entity, directors' remuneration and other corporate administrative cost.

In addition to receiving segment information concerning adjusted EBITDA, management is provided with segment information concerning revenue (including inter-segment sale), interest income and expense from cash balances and borrowings managed directly by the segments, depreciation, amortisation and impairment losses and additions to non-current segment assets used by the segments in their operation. Inter-segment sales are priced with reference to prices charged to external parties for similar orders.

12 SEGMENT REPORTING *(Continued)*

(a) Segment results, assets and liabilities *(Continued)*

Information regarding the Group's reportable segments as provided to the Group's most senior executive management for the purpose of resource allocation and assessment of segment performance for the years ended 31 December 2010 and 2009 is set out below:

	Boring machines		Sensor and turbo tables and computerised embroidery machines		Turbo machines		Total	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000	**2010 RMB'000**	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Revenue from external customers	**1,388,216**	1,204,782	**–**	6,227	**200,085**	155,868	**1,588,301**	1,366,877
Inter-segment revenue	**–**	3,812	**768**	988	**–**	–	**768**	4,800
Reportable segment revenue	**1,388,216**	1,208,594	**768**	7,215	**200,085**	155,868	**1,589,069**	1,371,677
Reportable segment profit/(loss) (adjusted EBITDA)	**238,567**	273,415	**1,351**	(1,108)	**(320)**	4,384	**239,598**	276,691
Interest income from bank deposits	**1,467**	2,002	**9**	8	**361**	237	**1,837**	2,247
Interest expense	**(2,355)**	(1,799)	**–**	–	**(1,185)**	(1,905)	**(3,540)**	(3,704)
Depreciation and amortisation for the year	**(35,446)**	(29,938)	**–**	(171)	**(7,111)**	(7,256)	**(42,557)**	(37,365)
Impairment of – property, plant and equipment	**–**	–	**–**	(223)	**–**	–	**–**	(223)
Reportable segment assets	**1,783,431**	1,570,670	**2,914**	7,245	**388,507**	360,303	**2,174,852**	1,938,218
Addition to non-current segment assets during the year	**49,947**	127,655	**(37)**	–	**(5,264)**	5,146	**44,646**	132,801
Reportable segment liabilities	**560,608**	502,052	**12,773**	18,465	**293,450**	256,388	**866,831**	776,905

12 SEGMENT REPORTING *(Continued)*

(b) Reconciliations of reportable segment revenues, profit or loss, assets and liabilities

	2010 RMB'000	2009 RMB'000
Revenues		
Total revenues for reportable segments	**1,589,069**	1,371,677
Elimination of inter-segment revenue	**(768)**	(4,800)
Consolidated revenue	**1,588,301**	1,366,877

	2010 RMB'000	2009 RMB'000
Profit		
Total profit for reportable segments	**239,598**	276,691
Elimination of inter-segment (gain)/loss	**(1,279)**	265
Reportable segment profit derived from Group's external customers	**238,319**	276,956
Share of profits of a jointly controlled entity	**9,275**	11,926
Share of profit of an associate	**584**	362
Interest income from bank deposits	**1,837**	2,247
Depreciation and amortization	**(42,557)**	(37,365)
Interest expenses	**(3,540)**	(3,704)
Impairment losses on non-current assets	**–**	(223)
Unallocated head office and corporate expenses	**(2,988)**	(2,364)
Consolidated profit before taxation	**200,930**	247,835

	2010 RMB'000	2009 RMB'000
Assets		
Total assets for reportable segments	**2,174,852**	1,938,218
Elimination of inter-segment receivables	**(46,585)**	(34,196)
	2,128,267	1,904,022
Interest in an associate	**14,814**	14,230
Interest in a jointly controlled entity	**37,086**	33,100
Deferred tax assets	**47,383**	42,100
Unallocated head office and corporate assets	**13,752**	18,018
Consolidated total assets	**2,241,302**	2,011,470

12 SEGMENT REPORTING *(Continued)*

(b) Reconciliations of reportable segment revenues, profit or loss, assets and liabilities *(Continued)*

	2010 RMB'000	2009 RMB'000
Liabilities		
Total liabilities for reportable segments	**866,831**	776,905
Elimination of inter-segment payables	**(46,585)**	(34,196)
Consolidated total liabilities	**820,246**	742,709

(c) Geographic information

The following table sets out information about the geographical location of the Group's revenue from external customers. The geographical location of customers is based on the location at which the goods delivered or the services were provided.

	2010 RMB'000	2009 RMB'000
PRC (place of domicile)	**1,584,133**	1,349,266
Czech	**389**	918
India	**–**	8,480
Canada	**44**	–
South Korea	**887**	7,272
Other countries	**2,848**	941
	1,588,301	1,366,877

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Renminbi Yuan unless otherwise indicated)

13 PROPERTY, PLANT AND EQUIPMENT

(a) The Group

	Buildings RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Total RMB'000
Cost:					
At 1 January 2009	294,895	327,246	44,639	28,078	694,858
Additions	9,807	14,004	6,529	358	30,698
Disposals	(418)	(5,451)	(2,263)	(1,859)	(9,991)
Transfers from construction in progress	23,078	8,853	–	–	31,931
At 31 December 2009	327,362	344,652	48,905	26,577	747,496
At 1 January 2010	327,362	344,652	48,905	26,577	747,496
Additions	513	5,065	11,812	1,878	19,268
Disposals	–	(2,316)	(5,025)	(1,992)	(9,333)
Transfers from construction in progress	1,416	44,899	426	579	47,320
At 31 December 2010	**329,291**	**392,300**	**56,118**	**27,042**	**804,751**
Accumulated depreciation and impairment:					
At 1 January 2009	54,102	159,241	25,475	10,532	249,350
Charge for the year	8,770	20,316	3,736	2,701	35,523
Impairment loss	–	74	67	82	223
Written back on disposal	(100)	(5,324)	(2,135)	(951)	(8,510)
At 31 December 2009	62,772	174,307	27,143	12,364	276,586
At 1 January 2010	62,772	174,307	27,143	12,364	276,586
Charge for the year	9,548	22,283	6,324	2,506	40,661
Written back on disposal	–	(1,524)	(4,444)	(1,762)	(7,730)
At 31 December 2010	**72,320**	**195,066**	**29,023**	**13,108**	**309,517**
Net book value:					
At 31 December 2010	**256,971**	**197,234**	**27,095**	**13,934**	**495,234**
At 31 December 2009	264,590	170,345	21,762	14,213	470,910

All the buildings are located outside Hong Kong.

(Expressed in Renminbi Yuan unless otherwise indicated)

13 PROPERTY, PLANT AND EQUIPMENT *(Continued)*

(b) The Company

	Buildings RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Total RMB'000
Cost:					
At 1 January 2009	250,055	282,773	37,871	24,353	595,052
Additions	7,129	11,928	6,127	358	25,542
Disposals	(418)	(595)	(217)	(823)	(2,053)
Transfers from construction in progress	23,078	8,853	–	–	31,931
At 31 December 2009	279,844	302,959	43,781	23,888	650,472
At 1 January 2010	279,844	302,959	43,781	23,888	650,472
Additions	513	3,899	11,095	925	16,432
Disposals	–	(1,304)	(4,852)	(1,619)	(7,775)
Transfers from construction in progress	1,416	44,899	426	579	47,320
At 31 December 2010	281,773	350,453	50,450	23,773	706,449
Accumulated depreciation and impairment:					
At 1 January 2009	45,025	136,554	20,895	8,241	210,715
Charge for the year	6,867	16,266	3,082	2,242	28,457
Written back on disposal	(100)	(469)	(182)	(632)	(1,383)
At 31 December 2009	51,792	152,351	23,795	9,851	237,789
At 1 January 2010	51,792	152,351	23,795	9,851	237,789
Charge for the year	7,592	18,029	5,839	2,180	33,640
Written back on disposal	–	(1,102)	(4,279)	(1,448)	(6,829)
At 31 December 2010	59,384	169,278	25,355	10,583	264,600
Net book value:					
At 31 December 2010	222,389	181,175	25,095	13,190	441,849
At 31 December 2009	228,052	150,608	19,986	14,037	412,683

All the buildings are located outside Hong Kong.

13 PROPERTY, PLANT AND EQUIPMENT *(Continued)*

(c) Impairment loss

There was no impairment loss charged by the Group for the year ended 31 December 2010 (2009: RMB223,000). In 2009, a number of items of property, plant and equipment were physically damaged or technically obsolete and the Group plans to dispose of these items, although no active programme to locate a buyer has been initiated. As a result, the Group had assessed the recoverable amounts of these items. Based on this assessment, the carrying amount of the assets was written down by RMB223,000 (included in "Other operating expenses") by the Group. There was no impairment loss charged by the Company for the year ended 31 December 2010 (2009: RMBnil). The estimates of the recoverable amounts were based on the assets' fair values less costs to sell, determined by reference to recent observable market prices for similar assets within the same industry.

(d) Property, plant and equipment held under finance leases

The Group leases certain buildings under finance leases with a remaining term of 11 years. As at 31 December 2010 and 2009, the buildings held under finance leases have been fully depreciated.

(e) Property, plant and equipment pledged for bank loans

As at 31 December 2010, buildings of the Group with carrying amounts of RMB11,231,000 (2009: RMB12,454,000) were pledged to banks to secure bank loans of RMB20,000,000(see note 27).

(f) Property without property title certificates

As at 31 December 2010 and up to the date of approval of these financial statements, the Group is in the process of applying for the property title certificates in respect of some properties in which the Group has interests and for which such certificates have not been granted. As at 31 December 2010, carrying value of such properties of the Group amounted to RMB43,637,000 (2009: RMB44,767,000). The directors of the Company are of the opinion that the use of and the conduct of operating activities at the properties referred to above are not affected by the fact that the Group has not yet obtained the relevant property title certificates.

14 CONSTRUCTION IN PROGRESS

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Cost:				
At 1 January	**101,879**	31,985	**101,879**	31,985
Additions	**69,803**	101,825	**69,803**	101,825
Transfers to property, plant and equipment	**(47,320)**	(31,931)	**(47,320)**	(31,931)
At 31 December	**124,362**	101,879	**124,362**	101,879
Impairment:				
At 1 January and 31 December	**2,057**	2,057	**2,057**	2,057
Net book value:				
At 31 December	**122,305**	99,822	**122,305**	99,822

15 LEASE PREPAYMENTS

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cost:				
At 1 January and 31 December	**30,141**	30,141	**15,989**	15,989
Accumulated amortisation:				
At 1 January	**6,633**	6,060	**5,148**	4,857
Charge for the year	**604**	573	**320**	291
At 31 December	**7,237**	6,633	**5,468**	5,148
Net book value:				
At 31 December	**22,904**	23,508	**10,521**	10,841

Lease prepayments represent payments for land use rights paid to the PRC authorities for land located in the mainland, PRC. The Group's land use rights have remaining terms ranging from 33 to 44 years as at 31 December 2010.

As at 31 December 2010, land use rights with the carrying amounts of RMB12,383,000 (2009: RMB12,667,000) were pledged to banks to secure bank loans of RMB20,000,000 (see note 27).

16 PREPAID PROPERTY LEASE RIGHTS

	The Group	The Company
	Prepaid rental for staff quarters	**Prepaid rental for staff quarters**
	RMB'000	RMB'000
Cost:		
At 31 December 2009 and 31 December 2010	4,486	4,486
Accumulated amortisation:		
At 1 January 2009	1,216	1,216
Charge for the year	92	92
At 31 December 2009	1,308	1,308
At 1 January 2010	1,308	1,308
Charge for the year	93	93
At 31 December 2010	1,401	1,401
Net book value:		
At 31 December 2010	3,085	3,085
At 31 December 2009	3,178	3,178

(i) Prepaid rental for staff quarters

The Company's lease for staff quarters has a remaining term of 33 years as at 31 December 2010.

(Expressed in Renminbi Yuan unless otherwise indicated)

17 INTANGIBLE ASSETS

(a) The Group

Intangible assets of the Group represent the technical know-how relating to the following operating segments purchased:

	Turbo machines RMB'000	Computerised embroidery machines RMB'000	Others RMB'000	Total RMB'000
Cost:				
At 1 January 2009	11,630	3,745	–	15,375
Addition for the year	–	–	278	278
At 31 December 2009	11,630	3,745	278	15,653
At 1 January 2010	11,630	3,745	278	15,653
Disposals	–	(3,745)	–	(3,745)
At 31 December 2010	11,630	–	278	11,908
Accumulated amortisation and impairment:				
At 1 January 2009	8,141	3,745	–	11,886
Charge for the year	1,163	–	14	1,177
At 31 December 2009	9,304	3,745	14	13,063
At 1 January 2010	9,304	3,745	14	13,063
Charge for the year	1,163	–	36	1,199
Written back on disposal	–	(3,745)	–	(3,745)
At 31 December 2010	10,467	–	50	10,517
Net book value:				
At 31 December 2010	1,163	–	228	1,391
At 31 December 2009	2,326	–	264	2,590

The amortisation charge for the year is included in "administrative expenses" in the consolidated statement of comprehensive income.

17 INTANGIBLE ASSETS *(Continued)*

(b) The Company

Intangible assets of the Company represent technical know-how relating to turbo machines and others as follows:

	Turbo Machines RMB'000	Others RMB'000	Total RMB'000
Cost:			
At 1 January 2009	11,630	–	11,630
Addition for the year	–	278	278
At 31 December 2009	11,630	278	11,908
At 1 January 2010	11,630	278	11,908
Addition for the year	–	–	–
At 31 December 2010	11,630	278	11,908
Accumulated amortisation:			
At 1 January 2009	8,141	–	8,141
Charge for the year	1,163	14	1,177
At 31 December 2009	9,304	14	9,318
At 1 January 2010	9,304	14	9,318
Charge for the year	1,163	36	1,199
At 31 December 2010	10,467	50	10,517
Net book value:			
At 31 December 2010	1,163	228	1,391
At 31 December 2009	2,326	264	2,590

18 GOODWILL

	The Group RMB'000
Cost:	
At 1 January 2009, 31 December 2009 and 31 December 2010	8,572
Accumulated impairment losses:	
At 1 January 2009, 31 December 2009 and 31 December 2010	2,728
Carrying amount:	
At 31 December 2009 and 31 December 2010	5,844

At 31 December 2010 and 2009, goodwill relates to the Group's turbo machine segment, which is a cash-generating units ("CGU") of the Group identified according to operating segments.

The recoverable amounts of the turbo machines unit is determined based on value in use calculations. The key assumptions for the calculation are those regarding the discount rates, growth rates and expected changes in selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGU. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next year and extrapolates cash flows for the following four years based on estimated steady growth rates of 5% for the turbo machines unit. These rates do not exceed the average long-term growth rates for the relevant markets. The rates used to discount the forecast cash flow for the CGU is 10% (2009: 10%) per annum.

19 INVESTMENTS IN SUBSIDIARIES

	The Company	
	2010 RMB'000	2009 RMB'000
Unlisted shares, at cost:	**47,263**	47,263
Less impairment losses:	**19,570**	19,570
	27,693	27,693

19 INVESTMENTS IN SUBSIDIARIES *(Continued)*

Details of the subsidiaries as at 31 December 2010 are set out below. The class of shares held is ordinary unless otherwise stated.

Name of subsidiary	Place and date of establishment and operation	Registered capital (RMB'000)	Proportion of ownership interest: Group's effective interest	Held by the Company	Held by a subsidiary	Principal activity
Xi'an Ser Turbo Machinery Equipment Company Limited ("Xi'an Ser")	PRC 3 July 2000	50,000	45% *(Note (i))*	45%		Design, development and sale of turbo-machinery
Changsha Ser Turbo Machinery Equipment Company Limited ("Changsha Ser")	PRC 16 January 2004	10,000	45% *(Note (i))*		100%	Design, development and sale of turbo-machinery
Hangzhou Ser Gas Engineering Company Limited ("Hangzhou Ser")	PRC 29 April 2004	1,200	23% *(Note (i))*		51%	Design, development and sale of turbo-machinery
Winko Machine Company Limited ("Winko")	PRC 18 November 2002	20,230	96.74% *(Note (ii))*	96.74%		Research, development, manufacture and sale of sensors, turbo tables and computerised embroidery machines
Kunming Machine Shipping Company Limited ("Shipping")	PRC 13 October 2006	500	100% *(Note (iii))*	100%		Provision of transportation services
Kunming Kunji General Machine Company Limited ("General Machine")	PRC 16 October 2007	3,000	100% *(Note (iii))*	100%		Manufacture and sale of boring machines
Fujian Kunji Machine Company Limited ("Fujian Kunji")	PRC 23 January 2008	5,000	50% *(Note (i)* and *(iii))*	50%		Manufacture and sale of common machines tools

Note:

(i) The Group has the power directly or indirectly through the subsidiary, to govern the financial and operating policies of the entities. Accordingly, these entities are accounted for as subsidiaries of the Company.

(ii) The resolution regarding the dissolution of Winko was approved at the extraordinary general meeting of Winko on 30 June 2008. The liquidation team comprised by all shareholders of Winko was established and have performed the liquidation work to Winko. Subsequent to the reporting period end, the deregistration procedures of Winko have been completed.

(iii) The resolutions regarding the dissolutions of Shipping, General Machine and Fujian Kunji were approved by the Board of Directors on 24 March 2010, 19 October 2010 and 19 November 2010 respectively.

20 INTEREST IN AN ASSOCIATE

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Unlisted shares, at cost	**–**	–	**14,000**	14,000
Share of net assets	**14,609**	14,025	**–**	–
Unrealised loss on disposal of a subsidiary to an associate	**205**	205	**–**	–
	14,814	14,230	**14,000**	14,000

As at 31 December 2010, details of the Group's interest in the associate are as follows:

Name of associate	Form of business structure	Place of establishment and operation	Registered capital (RMB'000)	Proportion of ownership interest: Group's effective interest	Proportion of ownership interest: Held by the Company	Principal activity
Xi'an Ruite Laser Prototyping Manufacturing& Engineering Research Co., Ltd. ("Xi'an Ruite")	Limited liability corporation	PRC	60,000	23.34%	23.34%	Design, development, and sale of prototyping machine tools, car moulds and manufacturing moulds

The summarised consolidated financial information of the associate is as follows:

	Assets	Liabilities	Equity	Revenue	Profit/(Loss)
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
2010					
100 per cent	**122,066**	**(59,474)**	**62,592**	**23,286**	**2,502**
Group's effective interest	**28,490**	**(13,881)**	**14,609**	**5,435**	**584**
2009					
100 per cent	102,125	(42,035)	60,090	20,417	1,552
Group's effective interest	23,836	(9,811)	14,025	4,765	362

21 INTEREST IN A JOINTLY CONTROLLED ENTITY

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Unlisted shares, at cost	**–**	–	**12,571**	12,571
Share of net assets	**37,086**	33,100	**–**	–
	37,086	33,100	**12,571**	12,571

As at 31 December 2010, details of the Group's interest in the jointly controlled entity are as follows:

Name of joint venture	Form of business structure	Place of establishment and operation	Registered capital (RMB'000)	Proportion of ownership interest: Group's effective interest	Proportion of ownership interest: Held by the Company	Principal activity
TOS Kunming Machine Tool Company Limited ("TOS")	Sino-foreign joint venture	PRC	49,457	50%	50%	Design, development, manufacture and sale of machine tools

The summarised financial information (Group's effective interest), after elimination of the effect of unrealised fair value adjustment of property, plant and equipment contributed to the jointly controlled entity, in respect of the Group's jointly controlled entity which is accounted for using the equity method is as follows:

	2010 RMB'000	2009 RMB'000
Non-current assets	**3,360**	4,759
Current assets	**78,463**	62,427
Current liabilities	**(44,737)**	(34,086)
Net assets	**37,086**	33,100
Income	**63,467**	62,594
Expenses	**(54,192)**	(50,668)
Profit for the year	**9,275**	11,926

22 INVENTORIES

(a) Inventories in the statement of financial position comprise:

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Raw materials	**129,674**	101,644	**105,560**	70,496
Work in progress	**429,303**	338,011	**290,649**	191,832
Finished goods	**193,799**	170,633	**189,580**	168,068
	752,776	610,288	**585,789**	430,396

22 INVENTORIES *(Continued)*

(b) The analysis of the amount of inventories recognised as an expense is as follows:

	The Group 2010 RMB'000	The Group 2009 RMB'000
Carrying amount of inventories sold	**1,131,705**	880,217
Write-down of inventories	**–**	179
	1,131,705	880,396

23 TRADE AND BILLS RECEIVABLE

	The Group 2010 RMB'000	The Group 2009 RMB'000	The Company 2010 RMB'000	The Company 2009 RMB'000
Trade and bills receivable	**487,318**	486,143	**364,265**	377,314
Less: Allowance for doubtful debts *(note 23(b))*	**(127,378)**	(124,111)	**(96,897)**	(88,930)
	359,940	362,032	**267,368**	288,384

At 31 December 2009, the Group's bills receivable of RMB 9,000,000 were pledged with the bank to secure the Group's the outstanding bills payable of RMB 8,500,000 (see note 28), with a maturity of less than one year from 31 December 2009. At 31 December 2010, there are no bills receivable which were pledged with the bank to secure the Group's the outstanding bills payable.

(a) Ageing analysis

An ageing analysis of trade and bills receivable (net of allowance for doubtful debts) is as follows:

	The Group 2010 RMB'000	The Group 2009 RMB'000	The Company 2010 RMB'000	The Company 2009 RMB'000
Current	**272,737**	328,285	**198,220**	265,783
Less than 1 month past due	**12,974**	6,602	**10,529**	4,975
1 to 3 months past due	**19,507**	8,607	**16,582**	7,316
More than 3 months but less than 12 months past due	**31,674**	16,450	**24,775**	10,310
More than 12 months past due	**23,048**	2,088	**17,262**	–
Amounts past due	**87,203**	33,747	**69,148**	22,601
	359,940	362,032	**267,368**	288,384

In general, debts other than amounts relating to quality guarantee deposits are due for payment after the negotiated credit terms, which are decided within a range of one to three months on the basis of historical payment record and performance of customers. The quality deposits are due for payment upon one year from date of installation. Further details on the Group's credit policy are set out in note 40(a).

23 TRADE AND BILLS RECEIVABLE *(Continued)*

(b) Impairment of trade and bills receivable

Impairment losses in respect of trade and bills receivable are recorded using an allowance account unless the Group is satisfied that recovery of the amount is remote, in which case the impairment loss is written-off against trade and bills receivable directly (see note 2(j)(i)).

The movement in the allowance for doubtful debts during the year, including both specific and collective loss components, is as follows:

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
At 1 January	**124,111**	92,381	**88,930**	60,817
Impairment loss recognised	**8,490**	31,730	**7,967**	28,113
Uncollectible amounts written off	**(5,223)**	–	**–**	–
At 31 December	**127,378**	124,111	**96,897**	88,930

At 31 December 2010, the Group's and the Company's trade and bills receivable of RMB64,038,345 (2009: RMB73,448,762) and RMB49,727,731 (2009: RMB45,592,800) respectively, were individually determined to be impaired.

The individually impaired receivables related to customers that were in financial difficulties and management assessed that only a portion of the receivables is expected to be recovered. Consequently, specific allowances for doubtful debts of RMB61,551,404 (2009: RMB73,448,762) and RMB47,873,771 (2009: RMB45,592,800) were recognised. The Group does not hold any collateral over these balances.

24 DEPOSITS, OTHER RECEIVABLES AND PREPAYMENTS

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Advances to suppliers	**53,317**	36,496	**9,145**	6,713
Deposits for bidding, construction work and equipment purchase	**5,873**	8,994	**5,873**	8,923
Staff advances	**5,010**	4,479	**4,466**	2,971
Taxes recoverable	**5,839**	1,114	**5,780**	–
Others	**4,792**	9,491	**3,958**	2,384
	74,831	60,574	**29,222**	20,991

25 RESTRICTED BANK DEPOSITS

The amount represents restricted bank deposits for performance guarantees and bills payable with maturity of more than three months.

26 CASH AT BANK AND ON HAND

(a) Cash at bank and on hand comprise:

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Cash and cash equivalents	**284,382**	272,278	**248,305**	237,845
Time deposits with original maturity over three months	**1,500**	2,660	**–**	–
	285,882	274,938	**248,305**	237,845

(b) Reconciliation of profit before taxation to cash generated from operations:

	Note	**2010 RMB'000**	2009 RMB'000
Profit before taxation		**200,930**	247,835
Adjustments for:			
Depreciation of property, plant and equipment	*6(c)*	**40,661**	35,523
Impairment loss on property, plant and equipment	*6(c)*	**–**	223
Amortisation of lease prepayments	*6(c)*	**604**	573
Amortisation of prepaid property lease rights	*6(c)*	**93**	92
Amortisation of intangible assets	*6(c)*	**1,199**	1,177
Finance costs	*6(a)*	**4,314**	4,512
Interest income	*5*	**(1,837)**	(2,247)
Share of profit of an associate	*20*	**(584)**	(362)
Share of profit of a jointly controlled entity	*21*	**(9,275)**	(11,926)
(Gain)/loss on disposal of property, plant and equipment	*5*	**(364)**	227
Recognition of deferred income		**(5,900)**	(8,000)
Amortisation of deferred gain		**(255)**	(147)
Foreign exchange loss		**1,088**	1,777
Changes in working capital:			
(Increase)/decrease in inventories		**(142,488)**	53,008
Decrease/(increase) in trade and bills receivable		**2,092**	(121,410)
(Increase)/decrease in deposits, other receivables and prepayments		**(17,165)**	10,337
Increase in trade and bills payable		**41,890**	10,149
Increase/(decrease) in other payables		**30,833**	(29,911)
Increase/(decrease) in provisions		**4,416**	(1,919)
(Increase)/decrease in restricted bank deposits		**(5,247)**	77
Increase/(decrease) in amounts due to a jointly controlled entity		**3,438**	(24,894)
Decrease in early retirement benefits obligation		**(2,881)**	(5,453)
Cash generated from operations		**145,562**	159,241

27 BANK LOANS

The bank loans were repayable as follows:

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within 1 year or on demand	**46,000**	70,000	**21,000**	50,000

The bank loans were secured as follows:

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Bank loans				
– secured	**20,000**	20,000	**–**	–
– unsecured	**26,000**	50,000	**21,000**	50,000
	46,000	70,000	**21,000**	50,000

At 31 December 2010, the banking facilities of certain subsidiaries were secured by mortgages over their land use right and buildings with an aggregate carrying amount of RMB23,614,000 (2009: RMB25,121,000). Such banking facilities amounted to RMB40,000,000 (2009: RMB60,020,000). The facilities were utilised to the extent of RMB20,000,000 (2009: RMB20,000,000).

All of the Group's banking facilities are subject to the fulfilment of covenants relating to certain of the Group's statement of financial position ratios, as are commonly found in lending arrangements with financial institutions. If the Group were to breach the covenants the drawn down facilities would become payable on demand. The Group regularly monitors its compliance with these covenants. Further details of the Group's management of liquidity risk are set out in note 40(b). As at 31 December 2010, none of the covenants relating to drawn down facilities had been breached (2009: Nil).

The annual rates of interest charged on the bank loans were ranging from 4.59% to 6.31% for the year ended 31 December 2010 (2009: 4.78% to 5.31%).

28 TRADE AND BILLS PAYABLE

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Trade creditors	**196,934**	167,121	**121,984**	104,884
Bills payable	**20,447**	8,370	**–**	–
	217,381	175,491	**121,984**	104,884

At 31 December 2009, the bills payable of certain subsidiaries was secured by the Group's bills receivable of RMB 9,000,000. At 31 December 2010, there is no bills payable which was secured by the Group's bills receivable.

28 TRADE AND BILLS PAYABLE *(Continued)*

An ageing analysis of trade and bills payable of the Group is as follows:

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Due within 1 month or on demand	**122,930**	99,260	**63,964**	89,661
Due after 1 month but within 3 months	**61,964**	25,800	**54,037**	11,114
Due after 3 months but within 6 months	**32,487**	50,431	**3,983**	4,109
	217,381	175,491	**121,984**	104,884

All the trade and bills payable are expected to be settled within one year.

29 OTHER PAYABLES

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Advances from customers	**413,915**	373,782	**264,996**	230,321
Payables for construction work	**12,442**	832	**12,442**	832
Other taxes payable	**3,665**	17,348	**2,940**	14,420
Employees' bonus and welfare	**23,577**	26,208	**21,860**	24,784
Others	**20,327**	17,896	**11,966**	7,934
	473,926	436,066	**314,204**	278,291

30 OBLIGATIONS UNDER FINANCE LEASES

At 31 December 2010, the Group and the Company had obligations under finance leases repayable as follows:

	2010		2009	
	Present value of the minimum lease payments RMB'000	**Total minimum lease payments RMB'000**	Present value of the minimum lease payments RMB'000	Total minimum lease payments RMB'000
Within 1 year	**213**	**342**	213	342
After 1 year but within 2 years	**213**	**342**	213	342
After 2 years but within 5 years	**640**	**1,026**	640	1,026
After 5 years	**1,279**	**2,054**	1,492	2,396
	2,132	**3,422**	2,345	3,764
	2,345	**3,764**	2,558	4,106
Less: total future interest expenses		**(1,419)**		(1,548)
Present value of lease obligations		**2,345**		2,558

31 RETIREMENT BENEFITS

The Group participates in government pension schemes whereby it is required to pay annual contributions at the rate of 20% of the basic salaries of its employees. Under these schemes, retirement benefits of the existing and retired employees are payable by the relevant authorities and the Group has no further obligations beyond the annual contributions.

Early retirement benefits obligation

The Group has a number of employees who were made to retire from employment of the Group prior to their official retirement dates. However, the Group is obligated to continue to make monthly payments to these employees commencing from the date of their early retirement up until their respective official retirement dates. The payments are calculated based on a certain percentage of their last drawn salaries. The amounts recognised as at year end represent the Group's obligation discounted to present value determined by reference to market yields at the end of the reporting period on high quality corporate bonds of similar maturities.
The Group does not operate any other retirement benefits schemes for its employees.

32 DEFERRED INCOME

As at 31 December 2010, deferred income mainly represents research and development funds obtained from the government for the purpose of developing horizontal boring machine. The funds will be recognised as income over the useful lives of the relevant assets when the development project has been completed and put into use.

33 DEFERRED GAIN

Deferred gain represents the gain on disposal of certain buildings that were subsequently leased back by the Group in 2001. Such leases qualify as finance leases (see note 30) and the gain is deferred and amortised to profit or loss over the lease term of 20 years.

34 INCOME TAX IN THE STATEMENT OF FINANCIAL POSITION

(a) Current taxation in the statement of financial position represents:

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Provision for income tax for the year	**32,705**	42,645	**32,100**	40,484
Provisional income tax paid	**(28,754)**	(37,263)	**(27,884)**	(35,197)
	3,951	5,382	**4,216**	5,287

Reconciliation to the statement of financial position:

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Income tax payable	**4,790**	6,336	**4,216**	5,287
Prepaid tax	**(839)**	(954)	**–**	–
	3,951	5,382	**4,216**	5,287

34 INCOME TAX IN THE STATEMENT OF FINANCIAL POSITION *(Continued)*

(b) Deferred tax assets recognised

	The Group					The Company				
	At 1 January 2009 RMB'000	Credited/ (charged) to profit or loss RMB'000	At 31 December 2009 RMB'000	Credited/ (charged) to profit or loss RMB'000	At 31 December 2010 RMB'000	At 1 January 2009 RMB'000	Credited/ (charged) to profit or loss RMB'000	At 31 December 2009 RMB'000	Credited/ (charged) to profit or loss RMB'000	At 31 December 2010 RMB'000
Impairment losses for trade and other receivables	19,352	8,096	27,448	2,513	29,961	17,623	7,063	24,686	1,452	26,138
Write-down of inventories	3,734	(68)	3,666	(947)	2,719	3,346	–	3,346	(946)	2,400
Provision for product warranties	2,089	(305)	1,784	661	2,445	2,044	(263)	1,781	664	2,445
Early retirement benefits obligation	4,742	(1,688)	3,054	(685)	2,369	4,742	(1,688)	3,054	(685)	2,369
Impairment of property, plant and equipment and construction in progress	1,444	–	1,444	(3)	1,441	1,444	–	1,444	(3)	1,441
Deferred income	1,186	225	1,411	2,172	3,583	1,186	225	1,411	2,172	3,583
Intra-group unrealised profits	1,166	(337)	829	367	1,196	–	–	–	–	–
Depreciation	–	820	820	–	820	–	820	820	–	820
Impairment losses for investment in subsidiaries	–	–	–	–	–	5,423	(87)	5,336	–	5,336
Others	588	1,056	1,644	1,205	2,849	–	191	191	–	191
Net deferred tax assets	34,301	7,799	42,100	5,283	47,383	35,808	6,261	42,069	2,654	44,723

(c) Deferred tax assets not recognised

In accordance with the accounting policy set out in note 2(q), the Group has not recognised deferred tax assets in respect of cumulative tax losses of RMB20,648,000 (2009: RMB19,608,000) as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdiction and entity. The tax losses will expire between 2011 and 2014.

35 PROVISIONS

Provision for product warranties

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
At 1 January	**11,885**	13,804	**11,875**	13,630
Additional provisions made	**15,502**	13,522	**15,502**	13,107
Provisions utilised	**(11,086)**	(15,441)	**(11,076)**	(14,862)
At 31 December	**16,301**	11,885	**16,301**	11,875

Under the normal terms of the Group's sales agreements, the Group will rectify any product defects arising within one year of the date of sale. Provision is therefore made for the best estimate of the expected settlement under these agreements in respect of sales made within the one year prior to the end of reporting period.

36 CAPITAL, RESERVES AND DIVIDENDS

(a) Movement in components of equity

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity. At 31 December 2010, the retained profits of the Group includes statutory surplus reserves in respect of the Company's subsidiaries of RMB8,115,000 (2009: RMB8,022,000), which are not distributable to the equity shareholders of the Company.

Details of the changes in the Company's individual components of equity between the beginning and the end of the year are set out below:

The Company

		Attributable to equity shareholders of the Company					
	Note	Share capital RMB'000	Share premium RMB'000	Capital reserve RMB'000	Statutory surplus reserve RMB'000	Retained profits RMB'000	Total RMB'000
Balance at 31 and 1 January 2009		424,865	113,887	10,225	68,594	334,183	951,754
Changes in equity for 2009:							
Total comprehensive income for the year		–	–	–	–	213,645	213,645
Appropriations		–	–	–	21,652	(21,652)	–
Dividends approved in respect of the previous year	*36(b)*	–	–	–	–	(40,064)	(40,064)
Balance at 31 December 2009		424,865	113,887	10,225	90,246	486,112	1,125,335
Balance at 31 December 2009 and 1 January 2010		424,865	113,887	10,225	90,246	486,112	1,125,335
Changes in equity for 2010:							
Capitalisation issue	*36(c)*	106,216	(106,216)	–	–	–	–
Total comprehensive income for the year		–	–	–	–	183,218	183,218
Appropriations		–	–	–	18,774	(18,774)	–
Dividends approved in respect of the previous year	*36(b)*	–	–	–	–	(21,213)	(21,213)
Balance at 31 December 2010		531,081	7,671	10,225	109,020	629,343	1,287,340

36 CAPITAL, RESERVES AND DIVIDENDS *(Continued)*

(b) Dividends

(i) Dividends payable to equity shareholders of the Company attributable to the year

	2010 RMB'000	2009 RMB'000
Final dividend proposed after the end of reporting period of RMB0.05 per ordinary share (2009: RMB0.05 per ordinary share)	**26,554**	21,213

The final dividend proposed after the end of reporting period has not been recognised as a liability at the end of the reporting period.

(ii) Dividends payable to equity shareholders of the Company attributable to the previous financial year, approved and paid during the year

	2010 RMB'000	2009 RMB'000
Final dividend in respect of the previous financial year, approved and paid during the year of RMB0.05 per share (2009: RMB0.09)	**21,213**	40,064

(c) Share capital

(i) Authorised and issued share capital

	2010 RMB'000	2009 RMB'000
Authorised:		
Ordinary shares of RMB1.00 each	**531,081**	424,865

Ordinary shares, issued and fully paid:

	2010		2009	
	No. of shares ('000)	**RMB'000**	No. of shares ('000)	RMB'000
At 1 January	**424,865**	**424,865**	424,865	424,865
Capitalisation issue	**106,216**	**106,216**	–	–
At 31 December	**531,081**	**531,081**	424,865	424,865

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the meetings of the Company.

Except for the currency in which dividends are paid and the restrictions as to whether the shareholders can be PRC investors or foreign investors, A-shares and H-shares rank pari passu in all material respects with each other.

(ii) Increase in authorised share capital

By an ordinary resolution passed at the annual general meeting held on 23 June 2010, the company's authorised ordinary share capital was increased to RMB531,081,000 by the creation of an additional 106,216,000 ordinary shares of RMB1 each, ranking pari passu with the existing ordinary shares of the company in all respects.

36 CAPITAL, RESERVES AND DIVIDENDS *(Continued)*

(c) Share capital *(Continued)*

(iii) Capitalisation issue

On 23 June 2010, an amount of RMB106,216,000 standing to the credit of the share premium account was applied in paying up in full 106,216,000 ordinary shares of RMB1 each which were allotted and distributed as fully paid to existing shareholders in the proportion of one for every four shares then held.

(d) Nature and purpose of reserves

(i) Share premium

The application of the share premium account of the Company is governed by the PRC Company Law.

(ii) Capital reserve

The capital reserve represents the profit of Kunming Machine Tool Plant for the period from 1 July 1993 to 18 October 1993 less an amount of RMB7,000,000 which the Company paid in cash to the Yunnan Provincial People's Government pursuant to a demerger agreement dated 20 November 1993 between Kunming Kunji Group Co., Ltd. ("Kunji Group") and the Company.

(iii) Statutory surplus reserve

The statutory surplus reserve represents appropriations from profit after taxation in accordance with the PRC Company Law. Statutory surplus reserve is part of the shareholders' equity and when its balance reaches an amount equal to 50% of the relevant company's registered capital, further appropriation need not be made. According to the PRC Company Law, the statutory surplus reserve may be used to make up past losses or to increase capital by means of conversion. However, when funds from the statutory surplus reserve are converted to capital, the funds remaining in such reserve shall not be less than 25% of the registered capital.

(e) Distributability of reserves

The distributable profits for the year is determined based on the Company's distributable profits as reflected in its financial statements prepared in accordance with the China Accounting Standards for Business Enterprise or HKFRS, whichever is lower.

At 31 December 2010, the aggregate amount of reserves available for distribution to equity shareholders of the Company was RMB629,343,000 (2009: RMB486,112,000).

(f) Capital management

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

Consistent with industry practice, the Group monitors its capital structure on the basis of an adjusted net debt-to-capital ratio. For this purpose adjusted net debt is defines as total debt (which includes interest-bearing loans and borrowings, trade and bills payable, other payables, obligation under finance lease and amounts due to a jointly controlled entity) plus unaccrued proposed dividends, less cash at bank and on hand. Adjusted capital comprises all components of equity, less unaccrued proposed dividends.

36 CAPITAL, RESERVES AND DIVIDENDS *(Continued)*

(f) Capital management *(Continued)*

During 2010, the Group's and the Company's strategy, which was unchanged from 2009, was to maintain an adjusted net debt-to-capital ratio in the range of 30% to 50% and 20% to 35%, respectively. In order to maintain or adjust the ratio, the Group may adjust the amount of dividends paid to shareholders, issue new shares, return capital to shareholders, raise new debt financing or sell assets to reduce debt.

The adjusted net debt-to-capital ratio at 31 December 2010 and 2009 was as follows:

	The Group		The Company	
	2010 RMB'000	2009 RMB'000	**2010 RMB'000**	2009 RMB'000
Bank loans due within one year	**46,000**	70,000	**21,000**	50,000
Trade and bills payable	**217,381**	175,491	**121,984**	104,884
Other payables	**473,926**	436,066	**314,204**	278,291
Obligations under finance leases due within one year	**213**	213	**213**	213
Amounts due to subsidiaries	**–**	–	**12,798**	3,615
Amounts due to a jointly controlled entity	**22,635**	14,858	**22,635**	14,858
Obligations under finance leases due after one year	**2,132**	2,345	**2,132**	2,345
Total debt	**762,287**	698,973	**494,966**	454,206
Add: Proposed dividends	**26,554**	21,213	**26,554**	21,213
Less: Cash at bank and on hand	**(285,882)**	(274,938)	**(248,305)**	(237,845)
Restricted bank deposits	**(10,412)**	(5,165)	**–**	–
Adjusted net debt	**492,547**	440,083	**273,215**	237,574
Total equity	**1,421,056**	1,268,761	**1,287,340**	1,125,335
Less: Proposed dividends	**(26,554)**	(21,213)	**(26,554)**	(21,213)
Adjusted capital	**1,394,502**	1,247,548	**1,260,786**	1,104,122
Adjusted net debt-to-capital ratio	**35%**	35%	**22%**	22%

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

37 COMMITMENTS

(a) Capital commitments outstanding at 31 December 2010 not provided for in the financial statements were as follows:

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Contracted for	**19,482**	49,062	**19,482**	48,066
Authorised but not contracted for	**241,279**	40,675	**241,279**	40,675
	260,761	89,737	**260,761**	88,741

(b) At 31 December 2010, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group		The Company	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within 1 year	**5,067**	4,744	**5,031**	4,694
After 1 year but within 5 years	**20,000**	18,781	**20,000**	18,706
After 5 years	**30,000**	37,412	**30,000**	37,412
	55,067	60,937	**55,031**	60,812

Significant leasing arrangements in respect of buildings classified as being held under finance leases and land held under operating leases are described in note 13 and 15.

Apart from these leases, the Group is the lessee in respect of the land use right, office properties, factories and staff quarters under operating leases. The leases typically run for an initial period of 20 years. None of the leases includes contingent rentals.

38 CONTINGENT LIABILITIES

(a) Contingent liability in respect of legal claim

The Company signed a sales contract with Yancheng Xinde Oil Machine Company ("Xinde Machine") in June 2002 for sales of four machine tools with contract amount of RMB11.9 million. Related four machine tools have been delivered to Xinde Machine before October 2003. In June 2009, Xinde Machine filed a lawsuit against the Company alleging that the goods delivered by the Company were unqualified and sought for return of goods, refund of advances paid of RMB10.7 million and payment of penalty and compensation of RMB0.3 million and RMB3.7 million respectively. In consultation with legal counsels, the Company has denied the claim and filed a counter claim against Xinde Machine alleging that it was unreasonable for Xinde Machine to claim for return of goods after use of the Company's products for more than 6 years and requesting Xinde Machine to repay the unpaid amount of RMB1.3 million for the goods. In February 2010, the Company and Xinde Machine agreed to mediate the disputes through the court.

Up to the date of the financial statements, the above case is still under the mediation stage. Management considered it is too preliminary to reasonably estimate the outcome of the mediation at this stage. Therefore no provision has been made in respect of the above pending case in the financial statements.

39 MATERIAL RELATED PARTY TRANSACTIONS

As at the end of the reporting period, the material related parties of the Group are as follows:

Name of related party	**Relationship with the Group**
Shenyang Machine Tool (Group) Co., Ltd. ("Shenji Group")	The largest shareholder
Yunnan Industrial Investment Holding Group Co., Ltd.	The second largest shareholder
Shenyang Machine Tool Import and Export Co., Ltd. ("Shenji EXIM")	Subsidiary of the largest shareholder
Yunnan CY (Group) Co., Ltd. ("CY Group")	Subsidiary of the largest shareholder
Yunnan Machine Tool Group Import and Export Co., Ltd ("Yunji EXIM")	Subsidiary of the largest shareholder
Kunji Group	Subsidiary of the second largest shareholder
TOS	Jointly controlled entity

(a) Transactions with jointly controlled entity and other related parties

(i) Transactions with a jointly controlled entity

			The Group and the Company	
Name of party	**Nature of transactions**		**2010 RMB'000**	2009 RMB'000
TOS	Sales of materials	*(1)*	**8,323**	8,980
	Consultancy fees		**128**	360
	Purchases	*(2)*	**94,245**	51,036
	Processing fees	*(3)*	**8,547**	–

Notes:

(1) These mainly represent the sales of materials to TOS for production purposes.

(2) These mainly represent the sales of machine tools by TOS to the Group.

(3) These mainly represent the process of machine tools by the Group to TOS.

39 MATERIAL RELATED PARTY TRANSACTIONS *(Continued)*

(a) Transactions with jointly controlled entity and other related parties *(Continued)*

(ii) Transactions with other related parties

			The Group and the Company	
Name of party	**Nature of transactions**		**2010 RMB'000**	2009 RMB'000
Shenji EXIM	Sales of products	*(1)*	**1,077**	12,994
CY Group	Sales of products		**485**	398
	Purchases		**3,311**	1,152
Yunji EXIM	Sales of products	*(1)*	**–**	252
Kunji Group	Rental fee	*(2)*		
	– in respect of current year		**5,000**	5,000
	– in respect of prior year		**–**	2,600
	Acquisition for trade receivables	*(3)*	**822**	–

Notes:

(1) These mainly represent the sales of machine tools to Shenji EXIM and Yunji EXIM. The Company entered into distribution agreements with Shenji EXIM and Yunji EXIM respectively. Pursuant to the agreements, the Company agreed to authorize Shenji EXIM and Yunji EXIM to distribute and export certain products from 1 April 2008 to 31 December 2010.

(2) This mainly represents the rental fee of premises and land use rights to Kunji Group. Kunji Group was authorized by Yunnan Government to succeed the rights and obligations of the "The Premise Rental Agreement" and "The land use right Rental Agreement" signed by Yunnan Government on 12th November 2001 with the Company. On 12th August 2009, the Company entered into a supplementary agreement with Kunji Group to adjust the annual rent of land use right from RMB1,320,000 to RMB4,245,086 and the annual rent of premises from RMB832,228 to RMB754,914 for the three year periods from 12 November 2007 to 11 November 2010. Pursuant to the supplementary agreement, the annual rent will be adjusted to the market price after 11 November 2010. Up to the date of issue of these financial statements, no agreement was arrived to adjust the annual rent.

(3) In 2000, the Company transferred the trade receivables with contractual amount of RMB 11,398,144 to Kunji Group. On 30 June 2010, the outstanding amount of RMB 5,857,799 of the trade receivables was purchased back by the Company at the consideration of RMB 822,000.

39 MATERIAL RELATED PARTY TRANSACTIONS *(Continued)*

(b) Balances with a jointly controlled entity and other related parties

As at the end of the reporting period, the Group and the Company have the following balances with related parties:

(i) Balances with a jointly controlled entity

		The Group and the Company	
		2010	2009
		RMB'000	RMB'000
TOS	Balance due from/(to)		
	Trade and other receivables	**6,576**	2,237
	Trade and other payables	**(22,635)**	(14,858)
		(16,059)	(12,621)

(ii) Balances with other related parties

		2010 RMB'000	2009 RMB'000
CY Group	Trade and other receivables	**134**	334
Shenji EXIM	Trade and other payables	**–**	(1,260)

The amounts due from/to a jointly controlled entity and related parties are unsecured, interest free and have no fixed terms of repayment.

(c) Key management personnel remuneration

Remuneration for key management personnel of the Group, including amounts paid to the Company's directors as disclosed in note 8 and certain of the highest paid employees as disclosed in note 9, is as follows:

	2010	2009
	RMB'000	RMB'000
Short-term employee benefits	**5,656**	4,969

Total remuneration is included in "staff costs" *(note 6(b))*.

39 MATERIAL RELATED PARTY TRANSACTIONS *(Continued)*

(d) Balances with subsidiaries

The amounts due from subsidiaries as at 31 December 2010 mainly represent receivables due from Xi'an Ser for prior years' dividend and related interest of 5.31% per annum.

As at 31 December 2010, the amounts due to subsidiaries mainly represent advances received from third party customers by the Company on behalf of General Machine. These amounts are unsecured, interest-free and have no fixed terms of repayment.

(e) Transactions with other state-owned entities in the PRC

The Group operates in an economic regime currently dominated by entities directly or indirectly controlled by the PRC government through its government authorities, agencies, affiliations and other organisations ("state-owned entities"). Transactions with other state-owned entities include but are not limited to the following:

– purchase, sale and leases of property and other assets; and

– rendering and receiving of utilities and other services.

These transactions are conducted in the ordinary course of the Group's business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services. Such pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. Having due regard to the substance of the relationship, the directors of the Company are of the opinion that none of these transactions are related party transactions that require separate disclosure.

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES

Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

(a) Credit risk

The Group's credit risk is primarily attributable to trade and bills receivable. Management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis. In respect of trade and bills receivable, individual credit evaluations are performed on all customers requiring credit over a certain amount. These evaluations focus on the customer's past history of making payments when due and current ability to pay, and take into account information specific to the customer as well as pertaining to the economic environment in which the customer operates. Normally, the Group does not obtain collateral from customers.

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The default risk of the industry and country in which customers operate also has an influence on credit risk but to a lesser extent. At the end of the reporting period, 4% (2009: 4%) and 14% (2009: 6%) of the total trade receivables was due from the Group's largest customer and the five largest customers respectively.

The maximum exposure to credit risk without taking account of any collateral held is represented by the carrying amount of each financial asset in the statement of financial position after deducting any impairment allowance. The Group does not provide financial guarantees to parties outside the Group which would expose the Group or the Company to credit risk.

Further quantitative disclosures in respect of the Group's exposure to credit risk arising from trade and bills receivable are set out in note 23.

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES *(Continued)*

(b) Liquidity risk

Individual operating entities within the Group are responsible for their own cash management, including the raising of loans to cover expected cash demands, subject to approval by the parent company when the borrowings exceed certain predetermined levels of authority. The Group's policy is to regularly monitor its liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

The following table details the remaining contractual maturities at the end of the reporting period of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the end of the reporting period) and the earliest date the Group can be required to pay:

The Group

	2010 Contractual undiscounted cash outflow					
	Within 1 year or on demand RMB'000	**More than 1 year but less than 2 years RMB'000**	**More than 2 years, but less than 5 years RMB'000**	**More than 5 years RMB'000**	**Total RMB'000**	**Balance sheet carrying amount RMB'000**
Bank loans	**47,221**	**–**	**–**	**–**	**47,221**	**46,000**
Trade and bills payable and accrued expenses	**277,392**	**–**	**–**	**–**	**277,392**	**277,392**
Amounts due to a jointly controlled entity	**22,635**	**–**	**–**	**–**	**22,635**	**22,635**
Obligations under finance leases	**342**	**342**	**1,026**	**2,054**	**3,764**	**2,345**
Early retirement benefits obligation	**3,130**	**2,866**	**4,154**	**2,286**	**12,436**	**10,666**
	350,720	**3,208**	**5,180**	**4,340**	**363,448**	**359,038**

	2009 Contractual undiscounted cash outflow					
	Within 1 year or on demand RMB'000	More than 1 year but less than 2 years RMB'000	More than 2 years, but less than 5 years RMB'000	More than 5 years RMB'000	Total RMB'000	Balance sheet carrying amount RMB'000
Bank loans	72,598	–	–	–	72,598	70,000
Trade and bills payable and accrued expenses	237,775	–	–	–	237,775	237,775
Amounts due to a jointly controlled entity	14,858	–	–	–	14,858	14,858
Obligations under finance leases	342	342	1,026	2,396	4,106	2,558
Early retirement benefits obligation	3,497	3,279	5,967	3,190	15,933	13,547
	329,070	3,621	6,993	5,586	345,270	338,738

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES *(Continued)*

(b) Liquidity risk *(Continued)*

The Company

	2010 Contractual undiscounted cash outflow					
	Within 1 year or on demand RMB'000	**More than 1 year but less than 2 years RMB'000**	**More than 2 years, but less than 5 years RMB'000**	**More than 5 years RMB'000**	**Total RMB'000**	**Balance sheet carrying amount RMB'000**
Bank loans	**21,579**	**–**	**–**	**–**	**21,579**	**21,000**
Trade and bill payable and accrued expenses	**171,192**	**–**	**–**	**–**	**171,192**	**171,192**
Amounts due to subsidiaries	**12,798**	**–**	**–**	**–**	**12,798**	**12,798**
Amounts due to a jointly controlled entity	**22,635**	**–**	**–**	**–**	**22,635**	**22,635**
Obligations under finance leases	**342**	**342**	**1,026**	**2,054**	**3,764**	**2,345**
Early retirement benefits obligation	**3,130**	**2,866**	**4,154**	**2,286**	**12,436**	**10,666**
	231,676	**3,208**	**5,180**	**4,340**	**244,404**	**240,636**

	2009 Contractual undiscounted cash outflow					
	Within 1 year or on demand RMB'000	More than 1 year but less than 2 years RMB'000	More than 2 years, but less than 5 years RMB'000	More than 5 years RMB'000	Total RMB'000	Balance sheet carrying amount RMB'000
Bank loans	52,309	–	–	–	52,309	50,000
Trade and bills payable and accrued expenses	152,854	–	–	–	152,854	152,854
Amounts due to subsidiaries	3,615	–	–	–	3,615	3,615
Amounts due to a jointly controlled entity	14,858	–	–	–	14,858	14,858
Obligations under finance leases	342	342	1,026	2,396	4,106	2,558
Early retirement benefits obligation	3,497	3,279	5,967	3,190	15,933	13,547
	227,475	3,621	6,993	5,586	243,675	237,432

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES *(Continued)*

(c) Interest rate risk

The Group's interest rate risk arises primarily from floating rate bank deposits and borrowings issued at fixed rates expose the Group to cash flow interest rate risk and fair value interest rate risk respectively. The Group adopts a policy of ensuring that its borrowings are effectively on a fixed rates basis through the contractual terms of the interest-bearing borrowings. The Group's interest rate profile as monitored by management is set out in (i) below.

(i) Interest rate profile

The following table details the interest rate profile of the Group's and the Company's floating rate bank deposits and borrowings issued at fixed interest rate at the end of the reporting period.

The Group

	2010		2009	
	Effective interest rate %	**RMB'000**	Effective interest rate %	RMB'000
Floating rate bank deposits	**0.36%**	**295,003**	0.36%	279,689
Borrowings issued at fixed interest rate	**4.59%~6.31%**	**46,000**	4.78%~5.31%	70,000

The Company

	2010		2009	
	Effective interest rate %	**RMB'000**	Effective interest rate %	RMB'000
Floating rate bank deposits	**0.36%**	**247,107**	0.36%	237,499
Borrowings issued at fixed interest rate	**4.59%~4.78%**	**21,000**	4.78%	50,000

(ii) Sensitivity analysis

At 31 December 2010, it is estimated that a general increase/decrease of 9 basis points in interest rates of floating rate bank deposits, with all other variables held constant, would have increased/decreased the Group's profit after tax and retained profits by approximately RMB226,000 (2009: RMB214,000). Other components of consolidated equity would not increase/decrease in response to the general increase/decrease in interest rates.

At 31 December 2010, it is estimated that a general increase/decrease of 27 basis points in interest rates of borrowings issued at fixed interest rate, with all other variables held constant, would have decreased/increased the Group's profit after tax and retained profits by approximately RMB106,000 (2009: RMB161,000). Other components of consolidated equity would not increase/decrease in response to the general increase/decrease in interest rates.

The sensitivity analysis above indicates the instantaneous change in the Group's profit after tax (and retained profits) that would arise assuming that the change in interest rates had occurred at the end of the reporting period and had been applied to re-measure those financial instruments held by the Group which expose the Group to fair value interest rate risk at the end of the reporting period. In respect of the exposure to cash flow interest rate risk arising from floating rate non-derivative instruments held by the Group at the end of the reporting period, the impact on the Group's profit after tax (and retained profits) is estimated as an annualised impact on interest expense or income of such a change in interest rates. The analysis is performed on the same basis for 2009.

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES *(Continued)*

(d) Currency risk

(i) Forecast transactions

The Group is exposed to currency risk primarily through sales and purchases that are denominated in a currency other than the functional currency of the operations to which they relate. The currencies giving rise to this risk are primarily the United States dollars, Hong Kong dollars, Euros and Japanese Yen.

Depreciation or appreciation of the Renminbi against foreign currencies can affect the Group's results. The Group did not hedge its foreign currency exposure other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange.

(ii) Recognised assets and liabilities

In respect of other trade receivables and payables denominated in currencies other than the functional currency of the operations to which they relate, the Group ensures that the net exposure is kept to an acceptable level, by buying or selling foreign currencies at spot rates where necessary to address short-term imbalances.

All the Group's borrowings are denominated in Renminbi. Given this, management does not expect that there will be any significant currency risk associated with the Group's borrowings.

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES *(Continued)*

(d) Currency risk *(Continued)*

(iii) Exposure to currency risk

The following table details the Group's and the Company's exposure at the end of the reporting period to currency risk arising from recognised assets or liabilities denominated in a currency other than the Renminbi. For presentation purpose, the amounts of the exposure are shown in Renminbi, translated using the spot rate at the year end date.

The Group

	Exposure to foreign currencies (expressed in RMB)							
	2010				2009			
	United States Dollars (RMB'000)	Hong Kong Dollars (RMB'000)	Euros (RMB'000)	Japanese Yen (RMB'000)	United States Dollars (RMB'000)	Hong Kong Dollars (RMB'000)	Euros (RMB'000)	Japanese Yen (RMB'000)
Cash and cash equivalents	14,224	7,697	47	–	22,869	7,897	24	–
Trade and bills receivable	495	–	–	–	3,887	–	–	–
Deposits, other receivables and prepayments	444	–	15	–	11,874	–	–	–
Trade and bills payable	(3,498)	–	(11,062)	(312)	–	–	(337)	–
Other payables	(4,272)	–	–	–	–	–	–	–
Overall net exposure	7,393	7,697	(11,000)	(312)	38,630	7,897	(313)	–

The Company

	Exposure to foreign currencies (expressed in RMB)							
	2010				2009			
	United States Dollars (RMB'000)	Hong Kong Dollars (RMB'000)	Euros (RMB'000)	Japanese Yen (RMB'000)	United States Dollars (RMB'000)	Hong Kong Dollars (RMB'000)	Euros (RMB'000)	Japanese Yen (RMB'000)
Cash and cash equivalents	14,207	7,697	22	–	22,830	7,897	24	–
Trade and bills receivable	–	–	–	–	–	–	–	–
Trade and bills payable	(2,288)	–	(11,024)	–	11,874	–	–	–
Other payables	(4,272)	–	–	–	–	–	–	–
Overall net exposure	7,647	7,697	(11,002)	–	34,704	7,897	24	–

40 FINANCIAL RISK MANAGEMENT AND FAIR VALUES *(Continued)*

(d) Currency risk *(Continued)*

(iv) Sensitivity analysis

The following table indicates the instantaneous change in the Group's profit after tax (and retained profits) that would arise if foreign exchange rates to which the Group has significant exposure at the end of the reporting period had changed at that date, assuming all other risk variables remained constant.

	2010		2009	
	Increase/ (decrease) in foreign exchange rates %	**Effect on profit after tax and retained profits RMB'000**	Increase/ (decrease) in foreign exchange rates %	Effect on profit after tax and retained profits RMB'000
United States Dollars	**2%**	**119**	2%	657
	(2%)	**(119)**	(2%)	(657)
Hong Kong Dollars	**2%**	**135**	2%	134
	(2%)	**(135)**	(2%)	(134)
Euros	**4%**	**(479)**	5%	(13)
	(4%)	**479**	(5%)	13
Japanese	**4%**	**(12)**	–	–
	(4%)	**12**	–	–

Results of the analysis as presented in the above table represent an aggregation of the instantaneous effects on each of the Group entities' profit after tax and equity measured in the respective functional currencies, translated into Renminbi at the exchange rate ruling at the end of the reporting period for presentation purposes.

The sensitivity analysis assumes that the change in foreign exchange rates had been applied to re-measure those financial instruments held by the Group which expose the Group to foreign currency risk at the end of the reporting period. The analysis is performed on the same basis for 2009.

(e) Fair values

The carrying amounts of the significant financial assets and liabilities are not materially different from their fair values as at 31 December 2010.

(i) Cash and cash equivalents, trade and bills receivable, other receivables, trade and bills payable, other payables and amounts due from/to related parties

The carrying values are not materially different from their fair values because of the short maturities of these items.

(ii) Bank loans

The carrying amounts of bank loans are not materially different from their fair values based on the borrowing rates currently available for bank loans with similar terms and maturities.

41 ACCOUNTING JUDGEMENTS AND ESTIMATES

(a) Critical accounting judgements in applying the Group's accounting policies

In the process of applying the Group's accounting policies, management has made the following accounting judgements:

(i) Impairment

In considering the impairment losses that may be required for certain of the Group's assets which include property, plant and equipment, construction in progress, intangible assets and lease prepayments (see note 2(j)(ii)), the recoverable amount of the asset needs to be determined. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for these assets may not be readily available. In determining the value in use, expected cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to items such as level of sale volume, selling price and amount of operating costs. The Group uses all readily available information in determining an amount that is reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of items such as sale volume, selling price and amount of operating costs.

In considering the impairment losses that may be required for current receivables and other financial assets, future cash flows need to be determined. One of the key assumptions that have to be applied is the ability of the debtors to settle the receivables. Notwithstanding that the Group has used all available information to make this estimation, inherent uncertainty exists and actual write-offs may be higher than the amount estimated.

(ii) Contingencies and provisions

Contingencies, representing an obligation that are neither probable nor certain at the date of the financial statements, or a probable obligation for which the cash outflow is not probable, are not recorded.

Provisions are recorded when, at the end of period, there is an obligation of the Group to a third party, without at least an equivalent return expected from the third party. This obligation may be legal, regulatory or contractual in nature.

To estimate the expenditure that the Group is likely to bear in order to settle an obligation, the management of the Group takes into consideration all of the available information at the closing date for its consolidated financial statements. If no reliable estimate of the amount can be made, no provision in recorded. For details, please refer to note 38 of contingent liabilities.

41 ACCOUNTING JUDGEMENTS AND ESTIMATES *(Continued)*

(b) Sources of estimation uncertainty

Notes 18 and 40 contain information about the assumptions and their risk factors relating to goodwill impairment and fair value of financial instruments respectively. Other key sources of estimations uncertainty are as follows:

(i) Warranty provisions

As explained in note 35, the Group makes provisions under the warranties it gives on sale of its machine tools taking into account the Group's recent claim experience. As the Group is continually upgrading its product designs and launching new models, it is possible that the recent claim experience is not indicative of future claims that it will receive in respect of past sales. Any increase or decrease in the provision would affect profit or loss in future years.

(ii) Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets regularly. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

42 NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD

(a) On 22 March 2011, the Board of Directors proposed a final cash dividend. Further details are disclosed in note 36 (b).

(Expressed in Renminbi Yuan unless otherwise indicated)

43 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2010

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments and Interpretations and one new standard which are not yet effective for the year ended 31 December 2010 and which have not been adopted in these financial statements. These include the following which may be relevant to the Group.

	Effective for accounting periods beginning on or after
Improvements to HKFRSs 2010	1 July 2010 or 1 January 2011
Revised HKAS 24, Related party disclosures	1 January 2011
Amendment to HK(IFRIC) 14, HKAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction - Prepayments of a minimum funding requirement	1 January 2011
Amendments to HKFRS 7, Financial instruments: Disclosures - Transfers of financial assets	1 July 2011
Amendments to HKAS 12, Income taxes - Deferred tax: Recovery of underlying assets	1 January 2012
HKFRS 9, Financial instruments	1 January 2013

The Group is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Company's results of operations and financial position.

DOCUMENTS AVAILABLE FOR INSPECTION

1. Financial statements signed and stamped by legal representative and financial officer of the Company;

2. Original copy of Auditors' Report bearing the signatures and seals of the Accounting Firm and Certified Public Accountants;

3. Original copy of all documents and the announcements as disclosed in newspapers as specified by the CSRC during the reporting period;

4. 2010 Annual Report;

5. Written confirmation for the 2010 Annual Report by Directors and senior management officers;

6. Written approval by Supervisory Committee for 2010 Annual Report prepared by the Board.

By Order of the Board
Shenji Group Kunming Machine Tool Co., Ltd.
Gao Minghui
Chairman
22nd March 2011

Note: Written confirmation by Directors and senior management officers for the 2010 Annual Report

DECLARATION

The Board, Directors and senior management officers of the Company confirmed that the information in the 2010 Annual Report does not contain any false information, misleading statements or material omissions. They also jointly and severally accept full responsibility for the truthfulness, accuracy and completeness of the contents of the report.

Signature of declaratory persons:

Directors:

Gao Minghui	Zhang Xiaoyi	Li Zhenxiong	Guan Xin
Wang Xing	Ye Nong	Pi Jianguo	Zhang Tao
Wayne Yu	Liu Minghui	Chen Ying	Li Dongru

Senior management officers:

Zhu Xiang	Zhou Guoxing	Xu Kunping	Luo Tao

Board of Directors
Shenji Group Kunming Machine Tool Co., Ltd.
22nd March 2011

Note: Written approval by Supervisory Committee for 2010 Annual Report prepared by the Board.

DOCUMENTS AVAILABLE FOR INSPECTION

OPINIONS OF THE SUPERVISORY COMMITTEE

Regarding the 2010 Annual Report (hereafter as the "Annual Report") provided by the Board, we have the following opinions:

1. The preparation of the Annual Report and the auditing procedures are in strict compliance with laws and regulations, the Articles of Association and rules of the Company's internal management system.

2. The content and format of the Annual Report were in strict compliance with the regulations of the China Securities Regulatory Commission and Shanghai Stock Exchange. The information included in the Annual Report can truly reflect in all respects the Company's operating management and financial status and other matters of the year.

3. Before providing the above opinions, we did not discover any person related in the preparation of the Annual Report nor has any auditing personnel violated the rule of confidentiality.

Supervisors:

Shao Li Fan Hong Xiang Rong

Supervisory Committee
Shenji Group Kunming Machine Tool Co., Ltd.
22nd March 2011