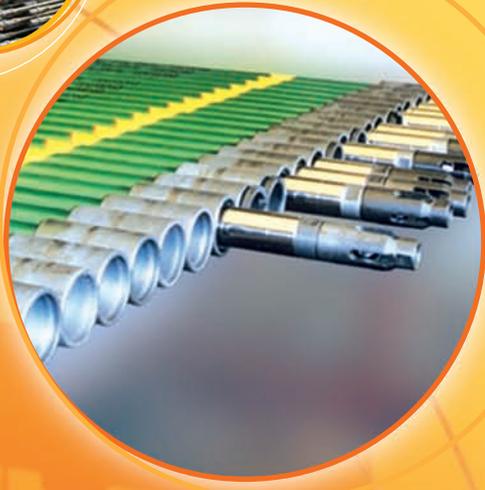




山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited*

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



2011
Annual
Report



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



Important

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

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

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

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

I. Company Information



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



I. Company Information

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

II. Summary of Financial and Operating Results



I. Major Financial Data for the Year of the Group

Financial highlights prepared in accordance with Accounting Standards for Business Enterprises

Unit: RMB

No.	Key financial indicators	Amount
1	Operating profit	166,267,521.27
2	Total profit	200,064,524.46
3	Net profit attributable to equity holders of the Company	168,330,282.50
4	Net profit after extraordinary gains or losses attributable to equity holders of the Company	139,722,024.21
5	Net cash flows from operating activities	87,628,575.07

Extraordinary gains or losses items

Unit: RMB

Extraordinary gains or losses items	Amount
Gains or losses arising from the disposal of non-current assets	-276,322.51
Government grant recognised in current profit or loss	31,474,069.50
Reversal of bad debt provision for accounts receivable provided for impairment separately	50,816.55
Non-operating gain or loss other than the above	2,599,256.20
Effect of extraordinary gains or losses on income tax	-5,229,933.99
Amount of the affected minority equity (after tax)	-9,627.46
Total	28,608,258.29



II. Summary of Financial and Operating Results

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

Consolidated Balance Sheet

Unit: RMB

Item	2011.12.31	2010.12.31	2009.12.31
Current assets:			
Cash and bank balances	413,632,018.60	892,286,589.93	305,509,495.54
Held for trading financial assets	—	—	—
Dividends receivable	—	150,000.00	—
Bills receivable	73,528,915.23	19,120,729.91	34,631,397.12
Accounts receivable	460,164,130.15	500,867,640.05	455,109,180.76
Prepayments	42,127,891.20	158,601,512.56	54,615,164.00
Other receivable	29,820,567.73	30,281,650.63	24,369,143.50
Inventory	1,176,981,854.52	743,553,547.47	713,655,725.39
Other current assets	72,538,796.17	41,054,637.00	—
Total current assets	2,268,794,173.60	2,385,916,307.55	1,587,890,106.31
Non-current assets:			
Long-term equity investment	12,580,624.11	12,477,279.82	12,436,028.87
Fixed assets	1,831,368,142.96	1,648,583,610.99	908,171,388.20
Construction in progress	83,523,080.85	131,446,242.52	391,594,169.80
Construction materials	—	—	7,540,351.49
Intangible assets	333,019,939.03	249,918,129.97	165,630,624.75
Goodwill	142,973,383.21	142,973,383.21	142,973,383.21
Long-term deferred expenses	—	—	—
Deferred income tax assets	16,672,092.94	15,095,861.12	17,091,629.15
Other non-current assets	—	—	23,279,221.87
Total non-current assets	2,420,137,263.10	2,200,494,507.63	1,668,716,797.34
Total assets	4,688,931,436.70	4,586,410,815.18	3,256,606,903.65

II. Summary of Financial and Operating Results



	Unit: RMB		
Item	2011.12.31	2010.12.31	2009.12.31
Current liabilities:			
Short-term borrowings	710,502,077.23	712,866,417.20	274,648,512.00
Held for trading financial liabilities	—	—	—
Bills payable	383,690,165.06	482,816,088.17	373,611,268.50
Accounts payable	616,716,194.34	501,771,570.34	345,188,404.83
Advance receipts	20,713,521.63	34,721,719.22	52,528,174.61
Salaries payable	19,905,460.32	17,839,689.76	15,713,925.78
Taxes payable	35,749,257.97	29,428,377.89	40,385,354.67
Interests payable	5,557,955.40	955,547.63	563,315.00
Dividends payable	—	23,788,680.00	39,591,725.86
Other payables	22,561,056.57	25,991,912.66	17,271,010.07
Non-current liabilities due within 1 year	—	—	193,000,000.00
Total current liabilities	1,815,395,688.52	1,830,180,002.87	1,352,501,691.32
Non-current liabilities:			
Long-term loans	—	—	580,000,000.00
Deferred income tax liabilities	11,518,019.83	13,027,452.38	10,470,001.64
Other non-current liabilities	9,040,000.00	—	—
Total non-current liabilities	20,558,019.83	13,027,452.38	590,470,001.64
Total liabilities	1,835,953,708.35	1,843,207,455.25	1,942,971,692.96
Shareholders' equity:			
Share capital	398,924,200.00	398,924,200.00	328,924,200.00
Capital reserve	1,248,424,858.42	1,248,406,190.92	121,667,859.42
Surplus reserve	157,965,274.48	140,393,447.06	108,376,005.02
Retained earnings	989,669,698.87	898,749,873.79	694,089,054.29
Foreign currency translation differences	30,361.41	(483,325.64)	(736,933.63)
Total equity attributable to owners of the Company	2,795,014,393.18	2,685,990,386.13	1,252,320,185.10
Minority interests	57,963,335.17	57,212,973.80	61,315,025.59
Total shareholders' equity	2,852,977,728.35	2,743,203,359.93	1,313,635,210.69
Total liabilities and shareholders' equity	4,688,931,436.70	4,586,410,815.18	3,256,606,903.65



II. Summary of Financial and Operating Results

Balance Sheet of the Company

Unit: RMB

Item	2011	2010	2009
I. Total revenue from operations	2,738,691,830.21	2,703,906,835.19	2,075,551,285.67
Including: operating revenue	2,738,691,830.21	2,703,906,835.19	2,075,551,285.67
II. Total cost of operations	2,572,677,653.23	2,427,381,354.95	1,805,362,399.46
Including: Operating cost	2,407,671,724.80	2,237,506,663.67	1,678,634,536.19
Business tax and surcharges	1,931,536.70	4,812,307.46	3,706,491.83
Selling expenses	57,586,499.79	51,360,828.52	61,250,637.79
Administrative expenses	87,944,411.71	91,383,971.04	63,829,412.03
Finance costs	14,649,473.96	44,341,872.74	10,656,881.54
Asset impairment losses	2,894,006.27	(2,024,288.48)	(12,715,559.92)
Add: Gains from changes in fair value	—	—	(5,270,000.00)
Investment income	253,344.29	191,250.95	5,827,137.15
Including: Gains from investment in associates and joint ventures	253,344.29	191,250.95	247,137.15
III. Operating profit	166,267,521.27	276,716,731.19	270,746,023.36
Add: Non-operating income	34,476,972.35	50,431,757.52	54,154,013.57
Less: Non-operating expenses	679,969.16	2,664,687.26	619,598.32
Including: Loss from disposal of non-current assets	429,020.39	2,123,471.06	312,747.82
IV. Total profit	200,064,524.46	324,483,801.45	324,280,438.61
Less: Income tax expenses	31,022,289.46	47,503,492.81	50,458,156.21
V. Net profit	169,042,235.00	276,980,308.64	273,822,282.40
Net profit attributable to shareholders of the Company	168,330,282.50	276,149,165.54	268,315,157.33
Minority interests	711,952.50	831,143.10	5,507,125.07

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

	Rate of Return on net assets (%)		Earnings per share (RMB)	
	Fully diluted	Weighted average	Basic	Diluted
Net profit attributable to shareholders of the Company	6.02	6.14	0.42	N/A
Net profit after extraordinary gains or losses attributable to shareholders of the Company	5.00	5.10	0.35	N/A

III. Changes in Share Capital and Shareholders



I. Changes in Share Capital

Unit: Shares

	Prior to the change		Increase/decrease as a result of the change (+, -)					After the change	
	Number of shares	Percentage (%)	New issue	Bonus issue	Transfer from capital reserve	Others	Sub-total	Number of share	Percentage (%)
I. Shares subject to lock-up	214,861,000	53.86%				-16,622,000	-16,622,000	198,239,000	49.69%
I.1 State-owned shares									
I.2 State-owned corporate shares									
I.3 Other domestic shares	20,031,500	5.02%				-16,622,000	-16,622,000	3,409,500	0.85%
Comprising:									
Domestic non-state-owned corporate shares	2,622,000	0.66%				-2,622,000	-2,622,000	0	0%
Domestic natural person shares	17,409,500	4.36%				-14,000,000	-14,000,000	3,409,500	0.85%
I.4 Foreign shares									
Comprising:									
Foreign corporate shares	194,829,500	48.84%							
Foreign natural person shares	184,063,200	46.14%				16,622,000	16,622,000		
I.5 Senior management shares	56,000,000	14.04%				16,622,000	16,622,000	194,829,500	48.84%
II. Shares not subject to lock-up								200,685,200	50.31%
II.1 RMB ordinary shares	128,063,200	32.10%						72,622,000	18.21%
II.2 Domestic-listed foreign shares									
II.3 Overseas-listed foreign shares (H shares)	398,924,200	100%						128,063,200	32.10%
II.4 Others									
III. Total number of shares	398,924,200	100%				0	0	398,924,200	100%

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

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



III. Changes in Share Capital and Shareholders

III. Shareholders' Profiles

1. Change in restricted shares

Unit: Shares

Names of shareholders	Restricted shares at the beginning of the year	Restricted Shares released this year	Restricted Shares increased this year	Restricted Shares at the end of the year	Reason for restriction	Date of release from restriction
Zhang En Rong	139,758,500	0	0	139,758,500	Not yet reach date of release of the shareholder	2013-10-21
Lin Fu Long	17,108,000	0	0	17,108,000	Not yet reach date of release of the shareholder	2013-10-21
Zhang Yun San	15,304,000	0	0	15,304,000	Not yet reach date of release of the shareholder	2013-10-21
Xie Xin Cang	10,705,000	0	0	10,705,000	Not yet reach date of release of the shareholder	2013-10-21
Liu Yun Long	7,335,000	0	0	7,335,000	Not yet reach date of release of the shareholder	2013-10-21
Cui Huan You	4,619,000	0	0	4,619,000	Not yet reach date of release of the shareholder	2013-10-21
Liang Yong Qiang	3,409,500	0	0	3,409,500	Not yet reach date of release of the shareholder	2013-10-21
Shengli Oil Field Kaiyuan Petroleum Development Company	2,622,000	2,622,000	0	0	Reduced holdings after the lock-up shares lifting of the ban	2011-10-21
Off-line allotment	14,000,000	14,000,000	0	0	Reduced holdings after the lock-up shares lifting of the ban	2011-1-21
Total	214,861,000	16,622,000	0	198,239,000		—

III. Changes in Share Capital and Shareholders



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

Unit: shares

Total number of shareholders

The total number of shareholders was 26,267, of which, 26,217 were holders of A shares, 50 were holders of H shares.

Shareholdings of the top ten shareholders

Name of shareholders	Nature of shareholders	Percentage of shareholding	Total number of shares held	Number of Restricted shares held	Number of shares pledged or locked-up
Zhang En Rong	Domestic natural person	35.03%	139,758,500	139,758,500	0
HKSCC Nominees Limited	Overseas legal person	32.03%	127,769,945	0	0
Lin Fu Long	Domestic natural person	4.29%	17,108,000	17,108,000	0
Zhang Yun San	Domestic natural person	3.84%	15,304,000	15,304,000	0
Xie Xin Cang	Domestic natural person	2.68%	10,705,000	10,705,000	0
Liu Yun Long	Domestic natural person	1.84%	7,335,000	7,335,000	0
Cui Huan You	Domestic natural person	1.16%	4,619,000	4,619,000	0
Liang Yong Qiang	Domestic natural person	0.85%	3,409,500	3,409,500	0
Agricultural Bank of China —中郵核心成長股票型證券 投資基金	Domestic non-state- owned legal person	0.35%	1,380,040	0	0
China Everbright Bank Co., Everbright Pramerica Quantifies Core Securities Investment Fund) (光大保德信量化核心證券 投資基金)	Domestic non-state- owned legal person	0.25%	1,000,000	0	0



III. Changes in Share Capital and Shareholders

Shareholdings of the top ten shareholders of non-restricted shares

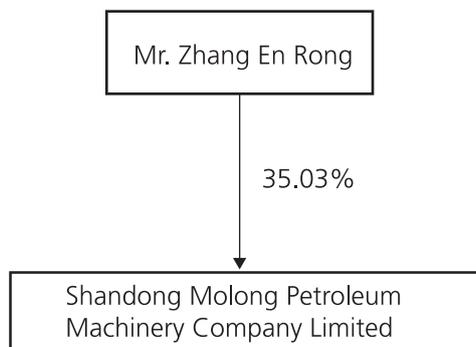
Name of shareholders	Number of non-restricted shares held	Class of shares
HKSCC Nominees Limited	127,769,945	H share
Agricultural Bank of China — 中郵核心成長股票型證券投資基金	1,380,040	A share
China Everbright Bank Co., — Everbright Pramerica Quantifies Core Securities Investment Fund (光大保德信量化核心證券投資基金)	1,000,000	A share
Xu Lan Zhi	572,298	A share
Customer Credit Collateral Securities Trading Account of Huatai Securities Co., Ltd	459,700	A share
Zhang Yu Ping	418,823	A share
Feng Jing Juan	418,600	A share
Qi Lin	392,290	A share
Song Ge	309,648	A share
Gao Ming Zhen	283,750	A share

Connected relationship or concert-party relationship among the above shareholders

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

3. Profile of controlling shareholders and beneficial controller

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



III. Changes in Share Capital and Shareholders



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

As at 31 December 2011, so far as it is known to the Directors, Supervisors or chief executive of the Company, the following persons (other than a Director, Supervisor or chief executive of the Company) had, or were deemed or taken to have interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO:

Long positions in the Shares of the Company

Name	Type of interest	Number of H Shares	Percentage of H Shares	Percentage of total registered capital
Desmarais Paul G. (Note 1)	Interest of controlled corporation	30,750,000	24.01%	7.71%
Gelco Enterprises Ltd. (Note 1)	Interest of controlled corporation	30,750,000	24.01%	7.71%
IGM Financial Inc (Note 1)	Interest of controlled corporation	30,750,000	24.01%	7.71%
Nordex Inc.(Note 1)	Interest of controlled corporation	30,750,000	24.01%	7.71%
Power Corporation of Canada (Note 1)	Interest of controlled corporation	30,750,000	24.01%	7.71%
Power Financial Corporation (Note 1)	Interest of controlled corporation	30,750,000	24.01%	7.71%
Cheah Capital Management Limited (Note 2)	Interest of controlled corporation	10,177,600	7.94%	2.55%
Cheah Company Limited (Note 2)	Interest of controlled corporation	10,177,600	7.94%	2.55%
Hang Seng Bank International Limited (Note 2)	Trustee	10,177,600	7.94%	2.55%
Value Partners Limited (Note 2)	Investment Manager	10,177,600	7.94%	2.55%
謝清海 Xie Qing Hai (Note 2)	Interest of founder of Discretionary trust	10,177,600	7.94%	2.55%
杜巧賢 Du Qiao Xian (Note 2)	Interest of spouse	10,177,600	7.94%	2.55%
Value Partners Group Limited (Note 2)	Interest of controlled	9,868,000	7.70%	2.47%



III. Changes in Share Capital and Shareholders

Note 1: According to the best knowledge of the Directors of the Company and the disclosure of interest notices filed by Desmarais. Paul G, Gelco Enterprises Ltd., IGM Financial Inc., Nordex Inc., Power Corporation of Canada and Power Financial Corporation, each of these companies was interested in 30,750,000 H Shares as at 31 December 2011.

Mackenzie Cundill Investment Management Ltd. is a wholly-owned subsidiary of Mackenzie Financial Corporation, which in turn is a wholly-owned subsidiary of Mackenzie Inc. Mackenzie Inc. is a wholly-owned subsidiary of IGM Financial Inc., which in turn is owned as to 55.99% by Power Financial Corporation, Power Financial Corporation is owned as to 66.40% by 171263 Canada Inc, which in turn is a wholly-owned subsidiary of 2,795,957 Canada Inc. 2,795,957 Canada Inc is a wholly-owned subsidiary of Power Corporation of Canada, which in turn is owned as to 53.83% by Gelco Enterprise Ltd., Gelco Enterprise Ltd. is owned as to 94.95% by Nordex Inc., which in turn is owned as to 68% by Paul G. Desmarais.

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

Note 2: According to the best knowledge of the Directors, Supervisor or chief executive of the Company and the disclosure of interest notices filed by Cheah Capital Management Limited, Cheah Company Limited, Hang Seng Bank Trustee International Limited, Value Partners Group Limited, Value Partners Limited, Ms. Du Qiao Xian and Mr. Xie Hai Qing, each of these companies and individuals was interested in 10,177,600 H Shares as at 31 December 2011.

Value Partners Limited was interested in H Shares as investment manager. Value Partners Limited is a wholly-owned subsidiary of Value Partners Group Limited, which in turn is owned as to 31.23% by Cheah Capital Management Limited, which in turn is a wholly-owned subsidiary of Cheah Company Limited. Hang Seng Bank Trustee International Limited wholly owned Cheah Company Limited as trustee of The C H Cheah Family Trust. Mr. Xie Hai Qing is the founder of the above-mentioned trust, and own the whole control power of Cheah Company Management Limited. Ms. Du Qiao Xian is the spouse of Mr. Xie Hai Qing.

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

IV. Directors, Supervisors and Senior Management and the Staff



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

Name	Position	Sex	Age	Terms in office	Shares held		Reasons for change	Total remuneration received from the Company during the reporting period (in ten thousands RMB) (pre-tax)
					at the beginning of the year (share)	at the end of the year (share)		
I. Executive Directors								
Zhang En Rong	Chairman of the Company	M	71	25 May 2010 to 24 May 2013	139,758,500	139,758,500	—	70.19
Zhang Yun San	Deputy Chairman and General Manager	M	49	25 May 2010 to 24 May 2013	15,304,000	15,304,000	—	60.61
Lin Fu Long	Director	M	59	25 May 2010 to 24 May 2013	17,108,000	17,108,000	—	32.99
Xie Xin Cang	Director, Deputy general manager and Secretary to the Board	M	49	25 May 2010 to 24 May 2013	10,705,000	10,705,000	—	39.23
II. Non-executive Directors								
Chen Jian Xiong (Note 1)	Directors	M	56	6 May 2008 to 5 May 2011	0	0	—	0.00
Xiao Qing Zhou (Note 1)	Directors	M	63	6 May 2011 to 24 May 2013	0	0	—	2.20
Wang Ping	Directors	M	56	12 May 2009 to 11 May 2012	0	0	—	0.00
III. Independent non-executive Directors								
Wang Chun Hua	Independent Director	F	58	12 May 2009 to 11 May 2012	0	0	—	3.60
John Paul Cameron	Independent Director	M	46	12 May 2009 to 11 May 2012	0	0	—	9.06
Chau Shing Yim, David	Independent Director	M	48	12 May 2010 to 11 May 2013	0	0	—	9.06
IV. Supervisors								
Liu Huan Duo	Chairman of Supervisory Committee	M	36	12 May 2009 to 11 May 2012	0	0	—	7.31
Liu Wan Fu	Supervisor	M	72	12 May 2009 to 11 May 2012	0	0	—	2.40
Fan Ren Yi	Supervisor	M	46	12 May 2009 to 11 May 2012	0	0	—	1.20
V. Senior Management								
Guo Huan Ran	Deputy general manager	M	44		0	0	—	41.74
Zhang Shou Kui	Deputy general manager	M	41		0	0	—	18.87
Cui Huan You	financial controller of the Company	M	62		4,619,000	4,619,000	—	8.08
Liu Yun Long	Deputy general manager	M	42		7,335,000	7,335,000	—	39.20
Total	—	—	—		194,829,500	194,829,500	—	345.74

Note 1: The term of appointment of Mr. Chen Jian Xiong expired on 5 May 2011 and the Board has decided not to renew his term of appointment. The Board proposed that Mr. Xiao Qing Zhou to be appointed as a non-executive director, whose appointment effective from the date on which the resolution to regarding his appointment was passed at the 2010 AGM.

Note 2: None of the Directors, Supervisors and Senior Management of the Company had received any remunerations from shareholder or other related entities. The remuneration for Chan Wing Nang, Billy, the company secretary of the Company, was RMB198,000.



IV. Directors, Supervisors and Senior Management and the Staff

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

1. Directors

Executive Directors

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

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

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

Mr. Zhang held an advanced certificate in Training Course of Chinese Communist Party School for Entrepreneurs and was granted the "Excellent Private Enterpriser of Weifang City" in 2004, "Top Ten Young Entrepreneurs of Weifang City" in 2005, "Excellent Chief Information Officer of Weifang City" in 2006 and was appointed as the member of the 10th session of the Weifang City People's Congress of the PRC and the member of the 15th session of the Shouguang City People's Congress of the PRC in 2007, and was awarded the "Model Worker of Shandong Province", "Top Ten Persons of 'Moving State Duty' of Weifang in 2007", and was awarded "Excellent Chief Information Officer of Shouguang City" in 2010. Mr. Zhang was a member of the 15th session of the Standing Committee of Shouguang City People's Congress of the PRC, and he is currently a member of the 16th session of the Standing Committee of Shouguang City People's Congress of the PRC, Deputy Chairman of Shouguang City Association of Entrepreneurs and Vice President of Shouguang City Industries and Commerce Association.

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

IV. Directors, Supervisors and Senior Management and the Staff



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

Mr. Xie Xin Cang graduated from Xian Jiaotong University with a Bachelor of Engineering degree in mechanical engineering and majored in metal materials and their heat treatment. Mr. Xie has successfully applied the nickel plating phosphorus alloy technology in the manufacturing of petroleum drilling and extraction machinery and invented the "MB424 steel wire teasel" that possess international advanced level. Mr. Xie was awarded the "Shandong Province Town and Village Enterprise Technology Innovation Leader" certificate by the Shandong Province Town and Village Enterprise Management Bureau in 1998. Mr. Xie was a standing committee member of the seventh session of the Shouguang City committee of the National Committee of the Chinese People's Political Consultative Conference and is a member of the 9th Session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference.

Non-executive directors

Mr. Xiao Qing Zhou, born in June 1949, Chinese nationality with no right of permanent residence abroad, Bachelor Degree, is a non-executive Director of the Company. Mr. Xiao has rich experience in managing listed company. He served as the director of the Party committee of Shandong Haihua Group Company Limited (山東海化集團有限公司). He has attended the training for senior management of listing company organised by SZSE for many times and obtained a certificate of training for senior management (independent director) from SZSE (深圳證券交易所高管(獨立董事)培訓字(05418)號證書). Mr. Xiao is currently a consultant of Haihua Group and the chairman of Shandong Hengwei Investment Management Co., Ltd. (山東恒偉投資管理有限公司). Mr. Xiao has served as a non-executive Director of the Company since 6 May 2011.

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

Independent non-executive Directors

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



IV. Directors, Supervisors and Senior Management and the Staff

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

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

2. Supervisory

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

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

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

IV. Directors, Supervisors and Senior Management and the Staff



3. Senior Management

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

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

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

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

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

4. Company Secretary

Mr. Chan Wing Nang, Billy, born in June 1961, is the company secretary of the Company. Mr. Chan graduated from the University of Newcastle, United Kingdom with a bachelor degree in Civil Engineering in 1986. He also has a master degree in business administration from the University of Warwick, United Kingdom. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants and the Institute of Chartered Accountants in England and Wales. Mr. Chan has over 10 years of experience in the accounting and consulting field. Prior to joining the Group, Mr. Chan was a director in a consulting company. Mr. Chan joined the Group on 13 December 2004.



IV. Directors, Supervisors and Senior Management and the Staff

III. Information Concerning Directors, Supervisors, and Senior Management Holding Position in Shareholder of the Company

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

IV. Directors, Supervisors and Senior Management and the Staff



IV. Annual Remunerations of Directors, Supervisors and Senior Management

1. The Company will pay each of the external Directors of the Company annual allowance of RMB0–RMB90,000 (before tax). The external Directors of the Company don't get remuneration from the Company. The travel expenses for attending board meetings and shareholders' meeting of the Company and fees incurred reasonably in the performance of their duties under the Articles of Association by independent non-executive Directors and non-executive Directors are reimbursed as expensed.
2. The annual remuneration of each of the executive Directors and senior management of the Company fall between the range of RMB80,800–RMB710,000 (before tax), while actual amount shall be determined based on the main financial indicators and operation target completion of the Company, the scope of work and main responsibilities of the Directors and senior management of the Company, the target completion of Directors and senior management as assessed by the duty and performance appraisal system, as well as business innovation capability and profit generation ability of the Directors and senior management. The actual implementation proposal shall be determined by the internal remuneration committee of the Board as well as considered and decided by the Board.
3. For the remunerations received from the Company by Directors, Supervisors and Senior Management in 2011, please refer to Part I of this section.

V. Change of Directors, Supervisors and Senior Management

During the annual general meeting of the Company held on 20 May 2011, an ordinary resolution has been passed in which Mr. Xiao Qing Zhou was appointed to replace Mr. Chen Jian Xiong who had his term of office expired as the non-executive Director. The term of office of Mr. Xiao Qing Zhou will expired on the date of expiry of the third session of the Board.

For more details, please refer to the related resolution announcement which was published on China Securities Journal, Securities Daily, Securities Times, Shanghai Securities News and the website of CHINF (<http://www.cninfo.com.cn>) on 21 May 2011 and the website of SEHK (www.hkex.com) on 20 May 2011.

VI. Personnel of the Company

At the end of the reporting period, the Group had 2,832 employees in aggregate, including 2,511 production staff, 65 sales staff, 77 technical staff, 39 financial staff, and 140 administrative staff. By level of education, there were 170 employees with bachelor's degree or above, 303 employees with college degree, 1,350 employees with technical secondary school education and 1,009 employees with high school, technical school education and levels below technical secondary school education.

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



V. Corporate Governance Report

I. Corporate Governance

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

In line with the new Articles of Association adopted by the Company subsequent to the issue of A shares, the Company held a shareholders' meeting to seek shareholders' approval for the corresponding amendments to the Procedural Rules of the Shareholders' General Meetings, the Procedural Rules of the Board Meetings, the Procedural Rules of the Supervisory Committee Meetings and the Independent Director System, the adoption of the Implementation Rules of the Cumulative Voting System, to further improved and optimized its governance structure.

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

V. Corporate Governance Report



- (IV) **Supervisors and the Supervisory Committee:** The Supervisors possess professional knowledge and work experience in legal, accounting and other areas and are elected by way of cumulative voting. They monitor the financial affairs and supervise the lawful and regulatory performance of duties by the Company's Directors, the General Manager and other members of the senior management, and safeguard the legal rights and interests of the Company and shareholders. The Company has formulated rules of procedure for the Supervisory Committee meetings. Meetings of the Supervisory Committee are convened and held in strict compliance with the Articles and the Rules of Procedure for Supervisory Committee Meetings.
- (V) **Performance appraisal and incentive mechanism:** During the year, the Remuneration and Evaluation Committee of the Board of Directors linked the salaries of the senior management with the results of the Company and personal performance in accordance with the Articles of Association of the Company. Senior management personnel are recruited and appointed in strict compliance with relevant rules, regulations and the Articles of Association of the Company
- (VI) **Information disclosure and transparency:** the Secretary to the Board of Directors is responsible for handling information disclosure, arranging receptions of visiting shareholders and answering enquiries on behalf of the Company. Relevant information is disclosed in strict compliance with Rules on Fair Information Disclosure by Companies Listed on the Shenzhen Stock Exchange and the Articles in a true, accurate, complete and timely manner, ensuring that all shareholders have equal access to information. There were no instances of majority shareholders or de facto controllers owning information otherwise not publicly disclosed or other irregularities in corporate governance during 2011.
- (VII) **Stakeholders:** the Company respects the legal rights and interests of banks and other stakeholders such as creditors, employees, consumers, and suppliers, and works actively with these stakeholders to promote the sustainable and healthy development of the Company.



V. Corporate Governance Report

II. Performance of the independent non-executive Directors

In the reporting period, each of the independent non-executive Directors continued to suggest constructive opinion on the material matters relating to operations and management and internal control of the Company. They issued their independent opinion on related matter pursuant to related requirements, thus raising the science and objectiveness of Board decisions. Attendance of independent non-executive Directors at Board meetings in 2011 is as follows:

Name of independent non-executive Directors	Number of Board meetings requiring attendance	Number of Attendance in person	Number of Attendance by proxy	Number of Absence
Wang Chun Hua	9	9	0	0
John Paul Cameron	9	9	0	0
Chau Shing Yim, David	9	9	0	0

In the reporting period, independent non-executive Directors of the Company issued their independent opinions on the connected proposals pursuant to the related laws and regulations, they raised no objection opinion on the proposals of Board meetings or other issues except that John Paul Cameron abstained for the resolution regarding found Shouguang Maolong Micofinance Co., Ltd on the tenth meeting of the third session.

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

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



IV. Internal Control of the Company

1. Internal control overview

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

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

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

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

(1) Administration of and control over controlling subsidiaries

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

(2) Administration of and control over connected transactions

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



V. Corporate Governance Report

(3) Administration of and control over external guarantee

The authority of external guarantee was stipulated by the Articles of Association and the Company had implemented the requirements relating to aggregate amount of external guarantees according to the Rules Governing Listing of Stocks on Shenzhen Stock Exchange. Meanwhile the Company had set up "Administration System of External Guarantees". During the reporting period, the six meeting of the third session of the Board held on 29 March 2011 approved the resolution regarding to offering guarantees to its subsidiaries, Shouguang Baolong and Weihai Baolong, for their banking credit facilities with lines of credit of RMB200,000,000 and RMB100,000,000 respectively. Overall, external guarantees of the Company were in compliance with "Shenzhen Stock Exchange Guidelines on Internal Controls of Listed Companies" (《深圳證券交易所上市公司內部控制指引》) and the related laws and regulations.

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

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

(5) Administration of and control over capital

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

(6) Administration of and control over material investments

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

(7) Administration of and control over finance

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



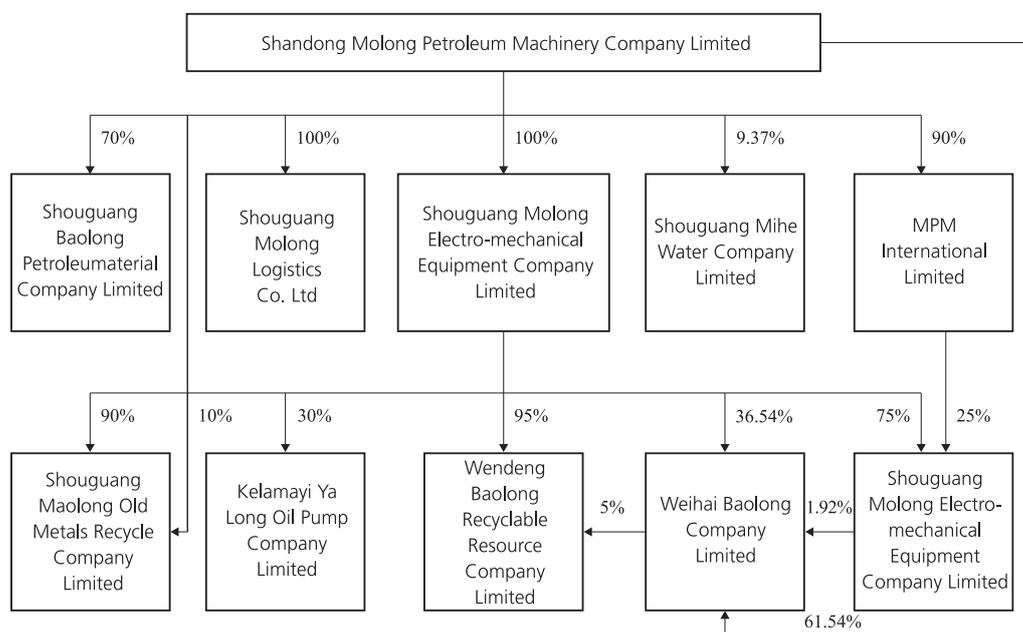
(8) Administration of and control over information disclosure

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

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

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

(10) Shareholding structure of the subsidiaries of the Company



3. Implementation of internal control system

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



V. Corporate Governance Report

4. Overall assessment on the internal control system

The Board is of opinion that during the reporting period, the Company has set up internal control for items included in the evaluation scope, which has been implemented effectively, and reached the internal control goals of the Company, without any material or significant deficiencies.

There is no material changes of internal control happened between the base date and the reporting date of internal control evaluation report which could exert any material influence on the evaluation result.

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

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



6. Establishment and implement of the internal audit system

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



V. Corporate Governance Report

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

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

VI. Disclosures in accordance with the Listing Rules of SEHK

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

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

2. Directors’ Securities Transactions

The Company has adopted the Model Code, which requires the securities transactions of the Directors to be conducted in accordance with the Model Code. The Model Code is also applicable to the senior management of the Company. After making specific enquiries, all Directors have confirmed that they had fully complied with the Model Code throughout 2011.

3. The Board

The Board is responsible for planning and overseeing the overall development and management of the Group with the objective of enhancing Shareholders’ value. The Board, led by the Chairman, is responsible for the approval and monitoring of the overall strategies and policies of the Group, approval of annual budgets and business plans, evaluation of the Company’s performance and oversight of the works of management. In 2011, the Board comprised nine Directors, including four executive Directors, two non-executive Directors and three independent non-executive Directors. Biographical details of the Directors are set out in the section 4 in this annual report. Pursuant to Rule 3.13 of the Listing Rule, the Company has received the confirmation letter from each independent non-executive Director. The independent non-executive Director will only be regarded as independent by the Board if it is confirmed that such Director does not have any other direct or indirect relationship with the Group. The Chairman of the Board, Mr. Zhang En Rong, is the father of Mr. Zhang Yun San, an executive Director. Aside from this, there is no financial, business and relatives relationship among members of the Board.

In 2011, the Board had convened nine meetings.



Attendance record of the Directors:

Members of Directors	Position	Number of meetings attended
Zhang En Rong	Chairman and executive Director	9/9
Zhang Yun San	Vice Chairman and executive Director	9/9
Lin Fu Long	Executive Director	9/9
Xie Xin Cang	Executive Director	9/9
Chen Jian Xiong	Non-executive Director	3/3
Xiao Qing Zhou	Non-executive Director	6/6
Wang Ping	Non-executive Director	9/9
Chau Shing Yim David	Independent non-executive Director	9/9
John Paul Cameron	Independent non-executive Director	9/9
Wang Chun Hua	Independent non-executive Director	9/9

Note: The term of appointment of Mr. Chen Jian Xiong expired on 5 May 2011 and the Board has decided not to renew his term of appointment. The Board proposed that Mr. Xiao Qing Zhou to be appointed as a non-executive director, whose appointment effective from the date on which the resolution to regarding his appointment was passed at the 2010 AGM.

4. Chairman and General Manager

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

5. Non-executive Director

The appointment of non-executive Director, Mr. Wang Ping, is valid from 12 May 2009 to 11 May 2012. The appointment of non-executive Director, Mr. Xiao Qing Zhou, is valid from 6 May 2011 to 24 May 2013.

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

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

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

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

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



V. Corporate Governance Report

8. Internal Control

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

The Company has an Internal Audit Department which plays a major role in monitoring the internal governance of the Company. The major tasks of the Internal Audit Department are reviewing the financial condition and management of the Company and conducting comprehensive audits of all branches and subsidiaries of the Company on a regular basis. The Company has taken many steps to enhance the internal control of the Company in 2011, such as having all departments internal control inspection and appraisal, strengthening the checks and supervision of implementation of the internal control systems by the Audit Department and according to some weakness found during examination of the internal control, further improving the internal control system and strengthening the implementation of all the internal control systems.

During the year of 2011, the Internal Audit Department issued reports to the senior management covering various operational and financial units of the Company and also conducted reviews of areas of concern identified by the Company's management.

9. Going Concern

For 2011, there was no uncertainty or conditions of a material nature that would affect the Company's ability to continue as a going concern.

10. Investor Relations

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

11. Directors Training

The Board of directors of the Company organize the Directors to take part in training activities which organized by HKEX, SZSE, and other regulators. Meanwhile, the Board pass on information from HKEX, SZSE, and other regulators to the Directors, including rules amendment, system update, and the latest market trend, so that they understand the latest regulatory system and rules.

VI. Particulars about the Shareholders' Meeting



I. Shareholders' Annual Meeting

The 2010 shareholders' annual meeting was held on 20 May 2011. 9 resolutions, among other things, regarding cessation of appointment of the overseas auditor for the year 2010, directors' reports, supervisory committee's report of the Company for 2010, profit distribution plan for 2010, Change of a non-executive director, and application for the integrated banking credit facilities in the year of 2011 were passed at the meeting. For specific details, please refer to the relevant announcements published on the website of the Hong Kong Stock Exchange (www.hkex.com.hk) on 20 May 2011.

II. Shareholders' Extraordinary Meetings

The first shareholders' extraordinary meeting was held on 11 February 2011. Seven resolutions, among other things, regarding use of surplus net proceeds of the A Share Issue, amendments and adoption of new procedural rules, amendments and adoption of new independent directors' rules, adoption of the implementation rules of the cumulative voting system were passed at the meeting. The related resolution announcement was published on China Securities Journal, Securities Daily, Securities Times, Shanghai Securities News, the website of CHINF (<http://www.cninfo.com.cn>) on 12 February 2011, and the website of the Hong Kong Stock Exchange (www.hkex.com) on 11 February 2011.



VII. Directors' Report

I. Management Discussion and Analysis

1. Overall operations during the reporting period

2011 is the first year of the "Twelfth-Five Year Plan", the Company enter to a new period of development. The Company has an opportunity to develop rapidly with which the new project put into production successfully, the original projects achieved full capacity, and the production capacity increased. The domestic economy has gradually walked out of the negative impact on the international financial crisis and shown steady growth. As oil machinery equipment, being the specialized equipment for oil extraction, has a high concentration of application scope, professional and falls within an industry with complex market situation, market competition is increasingly keen with the co-existence of both opportunities and challenges as well as development and elimination. In 2011, With the continuous increase in efforts on technology research, steady exploration of the scope of market and the active enhancement on management standard, the Company has gradually strengthened the construction of its own culture and overcome the influence from internal and external difficulties, thereby completing its targets.

2. Business Review

The Company reported RMB2,738,690,000 in operating revenue for the year 2011, representing a 1.29% growth compared with the previous year. Total profit in 2011 of RMB200,060,000, representing a 38.34% decrease compared with the previous year. The net profit attributable to shareholders of the Company in 2011 decreased by 39.04% as compared with the previous year to RMB168,330,000. The net profit of the Company after non-recurring profit and loss was RMB139,720,000, decreased by 44.52% compared with last year.

In terms of production capacity, our A Share proceeds-funded project, the "180mm special petroleum pipes technical reconstruction project" (the "180mm Project"), has successfully been put into production in 2011, which netting the influence of the products' structure, has achieved the anticipated target. The project will also substantially increase the production capacity of the oil tubular of the Company and in turn strengthen the future development of business and the competitiveness of the Group.

In terms of domestic market expansion, the Group's main customers are major oil fields in the PRC, including the Daqing Oil Field (大慶油田), Changqing Oil Field (長慶油田), Xinjiang Oil Field (新疆油田), Liaohe Oil Field (遼河油田), Qinghai Oil Field (青海油田), Talimu Oil Field (塔里木油田), Huabei Oil Field (華北油田), Jidong Oil Field (冀東油田) and Jilin Oil Field (吉林油田), all of which are oil fields of PetroChina Company Limited and its subsidiaries (collectively, "PetroChina Group"), as well as Shengli Oil Field (勝利油田), Zhongyuan Oil Field (中原油田), Jiangsu Oil Field (江蘇油田) and Jiangnan Oil Field (江漢油田), all of which are oil fields of China Petroleum & Chemical Corporation and its subsidiaries (collectively, "Sinopec Group"). During the reporting period, the Group increased its efforts to cooperate with existing oil field customers, and gained wide market evaluation. The sales to the above oil fields under the PetroChina Group and the Sinopec Group accounted for approximately 29.60% of the Group's sales revenue.

During the reporting period, the Group successfully bid for an order of 14,016 tons of oil country tubular goods ("OCTG") (including 1,090 tons of non-API OCTGs), which account for 40.05% of the total target tender from CNOOC for the first half of 2011, which has significantly increased the market during the reporting Period.

VII. Directors' Report



The cooperation between the Group and China National Petroleum Corporation (“CNPC”) was further strengthened. During the reporting period, the OCTG of the Company has entered the coal bed gas market of CNPC and the gas field of Changqing Oil Field respectively, the non-API OCTGs entered into CNPC and become a qualified supplier of CNPC. The fluid seamless tubes also entered into the OCTG market successfully, and has been massively used in Changqing Oil Field, Daqing Oil Field, Qinghai Oil Field, Liaohe Oil Field and Xinjiang Oil Field. During the current year, the cooperation between the Group with the four major domestic oil groups has greatly increased, and further implemented the stated strategies of overall cooperation with the four major domestic oil groups.

In addition, the Company's products such as oil well pipes, oil well pumps and oil well pumping machines have continually being supplied to its customers such as Zhongyu Group (中裕集團), and Shanxi Qinshui Lanyan Coalbed Methane Corp (山西沁水蘭焰煤層氣有限公司) which is a subsidiary of Shanxi Jinmei Group (山西晉煤集團). Due to the rapid development of the scales of the emerging field of coalbed gas, the demand for the Company's products will continue to increase. Mean while, the sales of the non-oil well tubes and seamless tubes has also increased largely, the sales volume approached to 100,000 tons, including 6,842.75 tons of high alloy pipes.

In terms of overseas market, during the reporting period, apart from further strengthening the existing markets and customers, the Group also continued to increase its efforts in developing its business in other regions including the Middle East, South America, North Africa and Australia. The Group has developed new customers which are major in casing and tubing sales, line pipe products and sucker rods. In addition, during the reporting period, the casing and tubing of the Group has achieved the product certification from many well-known international oil companies, including Abu Dhabi National Oil Company, Total 5.A. Company, Ecuador Oil Company, Oman Western Oil Company and Venezuela Oil Company. The sucker rod has also achieved the production certification of Thailand National Oil Company. With the development of new customers and achieving the production certifications of international oil companies, the Group has further expanded its market shares in the overseas market, and increase its popularity in the international oil drilling equipment market. Currently, the Group has established and maintained good and long-term cooperative relationships with many overseas stock companies and oil field service companies, which in turn boosted the sales of its products in the overseas markets. During the reporting period, the Group's revenue generated from exports accounted for approximately 38.38% of the Group's total sales revenue.



VII. Directors' Report

In terms of development of new products, with the scientific research advantages of "Province-class Enterprise Technical Center of Shandong Province" and "Shandong Molong post-doctoral research station", the Group continued to strengthen its technological cooperations with research institutes such as Xi'an Jiaotong University, Northeastern University, and Xi'an Goods Research Institute of CNPC to increase its efforts to develop high-end products, expand product structures and enrich product categories. The Group has successively developed products including MLT-3 anti-twisting and galling tube, ML90SS Anti-H₂S tube, Acid-resisting casing, suspension monomer pillar tube, axle tubes for car, cracking tube, thin-wall high-pressure boiler tube, seamless ferrite alloy steel tubes for high temperature, nickel plating anticorrosion sucker rod, anti-gas sucker rod, oil well pumps with large passage and high efficiency, rod-type oil well pumps with fixed gas emission in bottom, three-way valve, non-return valve, Orbit valve (奥比特阀) and duplex stainless steel pulleys, all of which have been completed the production trials and have been sold to domestic and overseas market. In particular, ML110SS anti-H₂S corrosive casing and tubing, highly wearable and anti-corrosion cast iron cylinder casting, anti-low temperature and anti-H₂S valves and ultra-high temperature bearable and anti-twisting sucker rod have been classified as the province-level technology innovation projects of the Shandong Province. The pumping unit, oil-well pump, and Tubing and Casing were classified as "Famous-brand product of the Shandong Province". Moreover, the Company has achieved national patents in seven new product's researches including "adjustable fixture for the use in three-way valves", "non-standard oil pipes for the use in lined tube made of macromolecular materials", "automatic lifting devices for tube drift", "subsequent guidance devices for seamless steel pipes and mills (utility model)", "zincized coupling", "anti-twisting and gluing oil tubing connectors" and "sucking rods", and the Company's three patent applications including "tools for quenching of metal parts", "subsequent guidance devices for seamless steel pipes and mills (invention)" and "production method for clean steel" have officially been accepted by the State Intellectual Property Office of the PRC.



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

(1) Business scope of the Company

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

(2) Principal operations by industry and by product

Unit: RMB'000

By industry or by product	Revenue from operations		Revenue from operations by industry		Year-on-year increase/decrease in	
	Revenue from operations	Cost of sales	Gross profit margin (%)	Year-on-year increase/decrease in revenue from Operations (%)	Year-on-year Increase/decrease in cost of sales (%)	Year-on-year increase/decrease in gross profit margin (%)
Tubings & Casings	2,334,250	2,055,300	11.95	9.77	19.29	-7.03
Three kinds of pumping units	78,300	65,380	16.50	-29.88	-26.11	-4.25
Petroleum machinery	165,950	138,060	16.81	11.76	10.41	1.02
Others	105,620	105,780	-0.15	-60.29	-58.28	-4.85
Total	2,684,120	2,364,520	11.91	1.18	7.97	-5.54

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

Unit: RMB'000

Geographical segment	Revenue from operations	Year-on-year increase/decrease in revenue from operations (%)
PRC	1,653,960	-2.88
Abroad	1,030,160	8.47
Total	2,684,120	1.18

(4) Gross Profit

The Group's gross profit decreased from approximately RMB462.82 million for the year ended 31 December 2010 to approximately RMB319.60 million for the current year, with RMB143.22 decreased, which was mainly due to that sales revenue increased, price of steels increased and fixed cost share to unit product increased after "180mm Project" put into production.



VII. Directors' Report

(5) Consolidated Gross Profit Margin

The consolidated gross profit margin of the Group is approximately 11.91% for the year ended 31 December 2011, decreased 5.54% compared with 17.45% of 2010, which mainly due to the price of materials increased more than the product price and the manufacturing cost of 180 mm Project was too high.

(6) Net Profit Attributable to shareholders of the Company

The Group's net profit attributable to shareholders of the Company decreased from approximately RMB276.15 million for the year ended 31 December 2010 to approximately RMB168.33 million for the current year, representing a decrease of approximately 39.04%. The decrease of net profit was mainly due to the price of materials increased more than the product price and the manufacturing cost of 180 mm Project was too high.

(7) Cost of Operation

The Group's cost of operation increased from approximately RMB2,189.92 million for the year ended 31 December 2010 to approximately RMB2,364.52 million for the current year, representing an increase of approximately 7.97%. The significant increase in cost of sales was mainly due to that sales revenue increased, price of steels increased and fixed cost share to unit product increased after "180mm Project" put into production.

(8) Operation Expenses

The selling expenses increased from approximately RMB51.36 million for the year ended 31 December 2010 to approximately RMB57.59 million for the year ended 31 December 2011. The increase of selling expenses is mainly due to that the export port miscellaneous expenses and freight charges increased resulted from the increased sales volume, and the price of domestic transportation increased. Operation expenses was approximately 1.90% of the Group's total revenue in 2010 and decreased to approximately 2.10% in 2011.

(9) Administrative Expenses

The Group's administrative expenses decreased from approximately RMB91.38 million for the year ended 31 December 2010 to approximately RMB87.94 million for the current year, representing a decrease of approximately 3.76%. Administrative expenses was approximately 3.38% of the Group's total revenue in 2010 and decreased to approximately 3.21% in 2011, representing a decrease of approximately 0.17%. The decrease of proportion is mainly due to that most of the line pipe and casing research project succeeded, the research and development expense for new production included in the current profits and losses decreased.

(10) Finance Cost

The finance cost of the Group for the current year was approximately RMB14.65 million, representing approximately 0.53% of the Group's total revenue and a decrease of RMB29.69 million when compared to the finance cost of the Group for the year ended 31 December 2010 over the same period. The decrease in finance costs was principally due to that long-term loans of RMB730 million was repaid back at the end of previous year, and the interest expense of the current year decreased largely result from the decreased loan amount.



(11) Research and Development Cost

The research and development cost of the Group for the current year was approximately RMB7.98 million, representing a decrease of approximately RMB13.35 million when compared to the research and development cost of RMB21.33 million for the year ended 31 December 2010. The decrease was mainly due to that most of the line pipe and casing research project succeeded, the research and development expense for new production included in the current profits and losses decreased.

(12) Liquidity and Financial Resources

As at 31 December 2011, the total current assets of the Group amounted to approximately RMB2,268.79 million (2010: approximately RMB2,385.92 million) which comprises: (1) cash and bank balances for the total amount of approximately RMB413.63 million (2010: approximately RMB892.29 million) and pledged time deposit to RMB188.54 million (2010: approximately RMB235.51 million). (2) Trade receivable and notes receivable amounted to approximately RMB533.69 million (2010: approximately RMB519.99 million). (3) Inventories amounted to approximately RMB1,176.98 million (2010: approximately RMB743.55 million).

As at 31 December 2011, the total current liabilities of the Group amounted to approximately RMB1,815.40 million (2010: RMB1,830.18 million) which comprises: (1) trade and bills payables approximately RMB1,000.41 million (2010: RMB984.59 million), the increase of which was mainly attributable to the decrease in the cost of raw materials and use to Bank Acceptance Bill in the reporting period; (2) bank loans amounted to approximately RMB710.50 million (2010: approximately RMB712.87 million), this is due to the increased short-term bank loans for the expansion of the scale of the Company. According to the planned arrangement of the present current asset condition and future cash flow, the Company anticipates that it will have sufficient repayment ability to support the Group's operation.

(13) Banking Facilities

For the current year, the Group had interest-bearing bank credit loans amounting to approximately RMB710.50 million (2010: approximately RMB712.87 million). In addition, eleven banks, including the Agricultural Bank of China, have granted credit facilities to the Group amounting to approximately RMB4,523.10 million (2010: approximately RMB2,549.89 million) that have not been utilised.

(14) Cash Flow

As at 31 December 2011, the cash and cash equivalents of the Company decreased by approximately RMB403.59 million as compared with that of the year ended 31 December 2010. The net cash flow from operations of the year amounted to approximately RMB3,314.48 million (2010: RMB2,377.45 million). Such increase is primarily attributable to an increase in the cost of raw materials and service payment. Other cash flow items decreased approximately RMB50.12 million as the additional pledged fixed deposits, approximately RMB408.92 million as capital expenditures for the purchase of certain property, plant and equipment and intangible assets, approximately RMB61.19 million for distribution of dividends for 2010, and decreased approximately RMB2.37 million for bank loan facilities.

(15) Capital Structure

As at 31 December 2011, the liability ratio of the Group was approximately 64.35% (2010: approximately 67.19%). The increase was mainly attributable to the proceeds from the Company successfully listing and repay bank loans for the proceeds funded projects. At present, the Company has strong debt repayment ability and has strong fund raising abilities in the future.



VII. Directors' Report

(16) Gearing Ratio

The Group's gearing ratio was approximately 39.16% (2010: approximately 40.19%) which is calculated based on the Group's total liabilities of approximately RMB1,835.95 million (2010: approximately RMB1,843.21 million) and total assets of approximately RMB4,688.93 million (2010: approximately RMB4,586.41 million).

(17) Pledge of Assets

The pledged deposits of the Group are as security for bills payable which amounted to approximately RMB161.12 million (2010: approximately RMB229.47 million).

(18) Foreign Exchange Exposure

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

(19) Segment Information

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

(20) Capital Commitment

For the current year, the Group had capital commitments of approximately RMB45.72 million (2010: approximately RMB75.56 million) in respect of fixed assets.

(21) Significant Investments

In the year ended 31 December 2011, the Group has completed investment of approximately RMB149.91 million in the high-end Petroleum Equipment Project.

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

In the year ended 31 December 2011, the Group did not have other relevant acquisitions, disposals or significant investment plans.

VII. Directors' Report



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

Unit: RMB millions

Item		31 December 2011	31 December 2010	Increase/decrease from the last year (%)
Cash and bank balances	(1)	413.63	892.29	(53.64)
Bills receivable	(2)	73.53	19.12	284.55
Accounts receivable	(3)	460.16	500.87	(8.13)
Prepayments	(4)	42.13	158.60	(73.44)
Inventory	(5)	1,176.98	743.55	58.29
Other current assets	(6)	72.54	41.06	76.69
Fixed assets	(7)	1,831.37	1,648.58	11.09
Construction in progress	(8)	83.52	131.45	(36.46)
Intangible assets	(9)	333.02	249.92	33.25
Short-term borrowings	(10)	710.50	712.87	(0.33)
Bills payable	(11)	383.69	482.82	(20.53)
Accounts payable	(12)	616.72	501.77	22.91
Dividends payable	(13)	—	23.79	(100.00)

- 1) The increase in currency fund was mainly due to the acquisition and construction of fixed assets and intangible assets as well as the payment of dividends and interests during the year.
- 2) The decrease in bills receivables was mainly due to the fact that most of the Company's receivables in the year were in the form of bills of exchange of banks, which together with the concentrated collection for the accounts receivables at the end of the year, resulted in an increase of the balance of bills receivables as compared with the end of last year.
- 3) The accounts receivable decreased in the current year, which is mainly because the Company strengthen the collection efforts of accounts receivable, and the cash collection improved.
- 4) The prepayments in the current year decreased, which is mainly because the prepaid money accordance with the contract signed by Shouguang Baolong Petroleum Material Company Limited ("Shouguang Baolong Company") and Shandong Luli Steel Co., Ltd has been settled during the current year.
- 5) The inventory increased during the current year, which is mainly because (1) the Company expanded its production and reserved more raw materials; (2) the unit cost of production increased resulted from the high fixed cost of "180mm Project", which put into production at the end of 2010; and (3) the semi-finished casing and tubing of the Company haven't been processed to finished product and sold out at the end of 2011.
- 6) Other current assets increased during the current year, which is mainly because of the fact that the input tax of value-added tax pending to be deducted during the year has increased from the end of last year.



VII. Directors' Report

- 7) The fixed assets increased during the current year, which is mainly because the 140 oil pipe material processing project of Weihai Baolong, high-end oil equipment project and oil pipe material processing line of the Company were ready for use in the end of 2011, and were thus transferred to fixed assets.
- 8) The decrease in work in progress is mainly because the 140 oil pipe material processing project of Weihai Baolong, high-end oil equipment project and oil pipe material processing line of the Company were ready for use in the end of 2011, and were thus transferred to fixed assets.
- 9) The increase in intangible assets mainly comprises of two parts: (1) the acquisition of land use rights of the land in northern Luoyang for the Φ 180mm special oil pipes reconstruction project of the Company; (2) success in the research and development of certain of the Company's tubing and casting projects, which were transferred to intangible assets.
- 10) The decreased short-term loans is because the Company paid back some current fund loans.
- 11) The decrease in bills payable is mainly due to the fact that the Φ 180mm special oil pipes reconstruction project of the Company has been completed fundamentally, and the amount payable for projects and equipment decreased accordingly.
- 12) The accounts payable increased, which is mainly due to the increased material purchase.
- 13) The dividends payable in the current year was nil, which is because the Company paid for the unpaid dividends of the previous year.

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

Unit: RMB million

		2011	2010	Change (%)
Operation revenue	(1)	2,738.69	2,703.91	1.29
Operation costs	(2)	2,407.67	2,237.51	7.61
Selling expenses	(3)	57.59	51.36	12.12
Administrative Expenses	(4)	87.94	91.38	(3.76)
Finance Expenses	(5)	14.65	44.34	(66.96)
Asset Impairment Losses	(6)	2.89	(2.02)	242.96
Income from Investment	(7)	0.25	0.19	32.47
Non-operation revenue	(8)	34.48	50.43	(31.64)
Non-operation Expenses	(9)	0.68	2.67	(74.48)
Income tax expense	(10)	31.02	47.50	(34.69)

- 1) The operation revenue increased, which is mainly because the sales volume and amount of sales in domestic and overseas increased.
- 2) The significant increase in operation cost was mainly due to that sales revenue increased, price of steels increased and fixed cost share to unit product increased after "180mm Project" put into production.
- 3) The increase in selling expenses is mainly due to that the export port miscellaneous expenses and freight charges increased resulted from the increased sales volume.

VII. Directors' Report



- 4) The decrease administrative expenses is mainly due to that most of the line pipe and casing research project succeeded, the research and development expense for new production included in the current profits and losses decreased.
- 5) The decrease in finance costs was principally due to that long-term loans of RMB730 million was repaid back at the end of previous year, and the interest expense of the current year decreased largely result from the decreased loan amount.
- 6) The increase in asset impairment losses is mainly due to the provision on decrease in price for inventories with relatively longer ages during the year, as well as the provision for bad debts for accounts receivable with relatively long credit terms which are expected to be irrecoverable.
- 7) The income from investment is the net investment income from Kelamayi Ya Long Oil Pump Company Limited.
- 8) The decrease in non-operation revenue is mainly due to the expiry of the "Pay first, Refund later" policy for value-added tax of Shouguang Maolong Old Metals Recycle Company Limited and Wendeng Baolong Recyclable Resource Company Limited, being the subsidiaries of the Company in the end of 2010, and no concession of such policy was enjoyed during the year.
- 9) The decrease in non-operation expenses is mainly due to the relocation of industrial park and the disposal of a substantial amount of fixed assets in the first half of the year by the Company, while no disposal of a substantial amount of fixed assets was incurred during the year.
- 10) The decreased income tax expense is mainly because the total profit of the current year decreased, compared with the previous year.

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

Unit: RMB million

Item	2011	2010	Amount of increase/decrease	Percentage of increase/decrease
Net cash flow from operating activities	87.63	389.01	-301.38	-77.47
Net cash flow from investment activities	-397.30	-577.86	180.56	—
Net cash flow from financing activities	-94.23	716.77	-811.00	—

- 1) Net cash flow from operating activities decreased by RMB301.38 million year-on-year, which was mainly is primarily attributable to an increase of RMB1,345.97 million in the cost of raw materials and service payment.
- 2) Net cash flow from investment activities decreased by RMB180.56 million year-on-year, which was mainly due to the increase in other net cash flow from investment activities and the decrease in payment for fixed asset, intangible assets and other long-term assets during the period.
- 3) Net cash flow from financing activities decreased by RMB811.00 million year-on-year, which was mainly due to the decreased cash from investment and loans during the period.



VII. Directors' Report

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

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

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

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB387.89 million and the net assets amounted to RMB188.81 million, realizing operating revenue of RMB1,701.93 million, operating profit of RMB2.09 million and net profit of RMB1.82 million.

(2) MPM International Limited

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

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

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the operating revenue amounted to RMB48.01 million, operating profit amounted to RMB9.93 million and net profit amounted to RMB1.69 million.

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

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

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

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB58.74 million and the net assets amounted to RMB57.48 million, realizing net profit of RMB0.2958 million.



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

壽光墨龍機電設備有限公司 (Shouguang Molong Electro-mechanical Equipment Company Limited) was established on 6 November 2001 with a registered capital and paid-in capital of US\$1 million. The address and major production and operation site of the Company is at 99 Beihuan Road Shouguang City Shandong. The business scope is the production and sales of externally thickened oil well pipes and electrical equipment, etc. Currently, Maolong Machinery and MPM holds 75% and 25% equity interests in Maolong Electro-mechanical respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB81.86 million and the net assets amounted to RMB38.44 million, realizing operating revenue of RMB123.04 million, operating profit of RMB16.28 million and net profit of RMB12.10 million.

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

威海市寶隆石油專材有限公司 (Weihai Baolong Special Petroleum Materials Co., Ltd) was established on 26 November 2003 with a registered capital and paid-in capital of RMB10 million. The address and major production and operation site of the Company is at south of Wanjia Village, Gaocun Town of Wendeng City. The business scope is the manufacturing and sales of petroleum specialized metal material. On 22 February 2011, the Company input capital to Weihai Baolong of RMB220,000,000, including additional registered capital of RMB160,000,000 and additional capital reserve of RMB204,000,000. As at 31 December 2011, the Company, Maolong Machinery and Molong Electro-mechanical hold 61.54%, 36.54% and 1.92% of its equity interests respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB506.74 million and the net assets amounted to RMB367.04 million, realizing operating revenue of RMB690.09 million, operating profit of RMB12.27 million and net profit of RMB10.57 million.

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

壽光市懋隆廢舊金屬回收有限公司 (Shouguang Maolong Old Metals Recycle Company Limited) was established on 13 December 2002 with a registered capital and paid-in capital of RMB0.5 million. The address and major production and operation site of the Company is at eastern Xingze Road Shouguang City (southwestern corner of Shangjia Village, Gucheng Street). The business scope is the acquisition of scrap metals. Currently, the Company and Maolong Machinery hold and sales of petroleum specialized metal material. As at 31 December 2010, the Company and Maolong Machinery hold 10% and 90% of its equity interests respectively.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB14.57 million and the net assets amounted to RMB1.27 million, realizing operating revenue of RMB8.35 million.



VII. Directors' Report

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

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

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB2.53 million and the net assets amounted to RMB2.51 million.

(8) 壽光市墨龍物流有限公司 (Shouguang Molong Logistics Company Limited)

壽光市墨龍物流有限公司 (Shouguang Molong Logistics Company Limited) was established on 30 June 2011 with 100% of its equity interests held by the Company. Currently, Molong Logistics Company hold registered capital and paid-up capital of RMB3,000,000. The address of the Company is at No. 99 Beihuan Road, Shouguang City, Shandong Province. The business scope of the Company was goods storage (exclude contraband), cargo work, empty distribution and logistics information consultant.

Upon the audit of Deloitte Touche Tohmatsu Certified Public Accountant. As at 31 December 2011, the total assets amounted to RMB2.99 million and the net assets amounted to RMB2.97 million, realizing operating revenue of RMB0, operating profit of negative RMB0.029 million and net profit of negative RMB0.029 million.

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

Molong Electro-mechanical Equipment Company realized a net profit of RMB12.10 million in 2011, representing 7.19% of the Company's net profit of RMB168.33 million. Net profit of Maolong Electro-mechanical Equipment Company was mainly generated from profit on related company.

Wihai Baolong realized a net profit of RMB10.57 million in 2011, representing 6.28% of the Company's net profit of RMB168.33 million. Net profit of Weihai Baolong was mainly generated from profit on related company.



II. Prospect of the Future Developments of the Company

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

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

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

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



VII. Directors' Report

2. In line with its strategic plans, the work of the Company will focus on the following areas in 2012:

1. In respect of product research and development, the Group plans to further enhance its efforts on the research and development of high value-added products and non-API products of self propriety series. The Group will continue to place its focus on the development of new products such as high-end aluminum casing (strong and high bearable), strong anti-pressure+anti-H₂S corrosion casing, L80-9Cr anti-CO₂ corrosion casing, ultra 13Cr and anti-H₂S+CO₂ corrosion casing, ML110-9Cr anti-CO₂ corrosion casing, API acid conduit pipes, economy special thread casing, and anti-corrosion special casing to satisfy customized needs for the development of natural gas, shale gas and coalbed methane of various kinds of domestic and foreign customers.
2. In respect of new product exploration, the Group will actively research on suitable products of higher level in accordance with the special requirement and development trend of natural gas, shale gas, and coalbed methane by the market. For coalbed methane exploration equipment, the Group has already formulated its foundation and will research on appropriate low-cost product with better customization on users, thus enhancing our competitive edges in the industry.
3. In respect of production capacity, base on the operation in 2011, with the high-end equipment performance, the "180mm Special Project" combined with the research and development of high-end productions, improved the Company's production capacity, and enhance the profitability and market competitiveness of the Company.
4. In respect of domestic market, the Group will further strengthen the good cooperation relationship with CNPC Group, Sinopec Group, CNOOC, and Yanchang Petroleum, expanded the markets of shale gas and Coalbed Methane equipment, safety device for coal mining industry, and high-pressure boiler tube.
5. In respect of foreign market, the Group will thoroughly consider the trading policy of various oil producing nations and the development and demand of overseas regional market, increasing the development in markets such as South America, Middle East and Africa to diversify its market concentration. Meanwhile, long-term co-operation with foreign inventory operators with market resources, service advantages and good reputations will also be reinforced, and the market share will be improved.



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

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

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

The production of the project has put into production, the production and sale scale of the Company would expand and the related liquidity needs will be satisfied by our own funding and bank loans.



VII. Directors' Report

III. Investments During the Reporting Period

1. Use of proceeds during the reporting period

Unit: RMB'000

		Use of total proceeds during the Reporting Period	474,260.50
Total proceeds	1,196,738.30		
Total proceeds with uses changed during the Period under Review	0.00		
Accumulated total proceeds with use changed	0.00	Accumulated use of total proceeds	1,194,260.50
Ratio of accumulated total proceeds with uses changed	0.00%		

Investment project undertaken and utilization of surplus net proceeds	Project change (partly included)	Total investment out of proposed	Adjusted total investment (1)	Investment during the Period under Review	Accumulated investment as at the end of the Reporting Period (2)	Investment progress as at the end of the Reporting Period (%) (3)=(2)/(1)	Scheduled date at which the project is ready for operation	Benefits realized during the Reporting Period	Progressing as scheduled with estimated benefits	Significant change in the feasibility of the project
Investment project undertaken										
180mm Project	No	720,000.00	720,000.00	0.00	720,000.00	100.00%	—	Not calculated separately	Yes	No
Sub-total-Investment project undertaken	—	720,000.00	720,000.00	0.00	720,000.00	—	—	Not calculated separately	—	—
Utilization of surplus net proceeds										
Petroleum pipes processing project	No	220,000.00	220,000.00	217,522.20	217,522.20	98.87%	30 December 2011	—	N/A	No
Repayment of bank loans (if any)	—	—	—	—	—	—	—	—	—	—
Satisfying liquidity (if any)	—	256,738.30	256,738.30	256,738.30	256,738.30	100.00%	—	—	—	—
Sub-total-Utilization of surplus net proceeds	—	476,738.30	476,738.30	474,260.50	474,260.50	—	—	—	—	—
Total	—	1,196,738.30	1,196,738.30	474,260.50	474,260.50	—	—	—	—	—

Situation and reason of failure to progress as scheduled and estimated benefits (by project)

N/A

Explanation on significant change in the feasibility of the project

N/A

Amount, use and status of utilization of surplus net proceeds

The Company has used RMB256,738,300 for liquidity. In March 2011, the Company has paid RMB220,000,000 of investment of equity to Weihai Baolong for the petroleum pipes processing project. As at the end of the Reporting Period, total proceeds used amounted to RMB217,522,200 and the balance is RMB2,477,800.

Change of place of implementation of the proceeds-funded project

N/A

Change of way of implementation of the proceeds-funded project

N/A

Investment in advance and replacement of the proceeds-funded project

N/A

Provisional use of unutilized proceeds to satisfy liquidity

As at the end of the Reporting Period, RMB256,738,300 of proceeds was used to satisfy liquidity of the Company.

Amount and reason of unutilized proceeds in the implementation of project

N/A

Use of unutilized proceeds and their status

N/A

Issue or other situation in respect of utilization and disclosure proceeds

N/A



2. Establishment of controlling subsidiaries during the reporting period

Shouguang Molong Logistics Company, a wholly-owned subsidiary of the Company, was established during the reporting period.

3. Other investments during the reporting period

As at 31 December 2011, the accumulated investment amount for the Company's high-end petroleum equipment amounted RMB149.91 million. It is intended to invest a total of RMB179.97 million on that project, which is conducted in accordance with the local government's policy of "relocation to industrial zone" (退城進園). It is removed to different place on the foundation of production lines such as original oil pipe processing, oil well sucker, oil well machinery, and conducts technical modification via upgrading with advanced equipment partially.

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

V. Day-to-day Operation of the Board

1. Board meetings and their resolutions

During the reporting period, the Board held nine meetings.

- (1) On 9 May 2011, the first Board extraordinary meeting was held, at which, the resolution regarding to cessation of appointment of the overseas auditor for the year of 2010 were considered and approved.
- (2) On 29 March 2011, the third session of the Board held its sixth meeting, at which, 12 resolutions were considered and approved, including the report of the Board for 2010, the report of audit and performance for 2010, the profit distribution plan for 2010, and the social report for store and use the raised fund of the year 2010.
- (3) On 27 April 2011, the third session of the Board held its seventh meeting, at which, the resolution regarding 2011 first quarterly report was considered and approved.
- (4) On 20 May 2011, the third session of the Board held its eighth meeting, at which, the resolution regarding derivatives investment internal control system and information disclosure system were considered and approved.
- (5) On 26 August 2011, the third session of the Board held its ninth meeting, at which, the resolution regarding to 2011 interim report was considered and approved.
- (6) On 14 September 2011, the third session of the Board held its tenth meeting, at which, the resolution regarding found Shouguang Maolong Microfinance Company Limited (壽光懋隆小額貸款股份有限公司) was considered and approved, with eight tickets agree, one abstention.
- (7) On 28 September 2011, the third session of the Board held its eleventh meeting, at which, 2 resolutions were considered and approved, including the independent directors annual report work system (《獨立董事年報工作制度》), Annual work rules of audit committee of the Board (《董事會審計委員會年報工作規程》), and Self-examination table of internal rules implement for small and medium-sized listed enterprises (《中小企業版上市公司內部規則落實自查表》).



VII. Directors' Report

- (8) On 28 September 2011, the third session of the Board held its twelfth meeting, at which, the resolution regarding to recommend chair of Shouguang Maolong Microfinance Company Limited was considered and approved.
- (9) On 28 October 2011, the third session of the Board held its thirteen meeting, at which, the resolution regarding 2011 third quarterly report was considered and approved.

2. Implementation of resolutions of general meetings by the Board

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

- (1) The first shareholders' extraordinary meeting was held on 11 February 2011, seven resolutions. among other things, regarding use of surplus net proceeds of the A Share Issue, amendments and adoption of new procedural rules, amendments and adoption of new independent directors' rules, adoption of the implementation rules of the cumulative voting system were passed at the meeting. The related resolution announcement was published on China Securities Journal, Securities Daily, Securities Times, Shanghai Securities News, the website of CHINF (<http://www.cninfo.com.cn>) on 12 February 2011, and the website of the Hong Kong Stock Exchange (www.hkex.com) on 11 February 2011.
- (2) Implementation of the profit appropriation plan for 2010
The 2010 annual general meeting resolved the 2010 profit appropriation plan of the Company: based on the date of 10 June 2010, the total number of shares of 398,924,200 (of RMB1.00 each), dividend of RMB0.15 (before tax) per share was to be paid. RMB1.35 for every 10 shares held to be actually paid to individual shareholders, investment funds and Qualified Foreign Institutional Investors holding A shares after tax deduction. Distribution of cash bonuses under such distribution amounted to RMB59,838,630.00 (tax included). The deserved final dividend for H-shares shareholders shall be exchanged to HKD for paid, and the exchange rate is RMB83.6967 for 100 Hong Kong dollars, being the averages of foreign currency benchmark price published by Peoples Banks of China during the seven days before the date of dividend payout (from 13 May 2011 to 19 May 2011). The related resolution announcement was published on China Securities Journal, Securities Daily, Securities Times, Shanghai Securities News, the website of CHINF (<http://www.cninfo.com.cn>) on 21 May 2011, and the website of the Hong Kong Stock Exchange (www.hkex.com) on 20 May 2011, the final dividend will be paid to the shareholders of the Company before 10 July 2011.
- (3) The 2010 annual general meeting of the Company approved the resolution regarding appoint 2011 annual audit authority. The Company decided not to re-appoint its overseas auditor, Deloitte Touche Tohmatsu, whilst Deloitte Touche Tohmatsu Certified Public Accountants Ltd will be the annual auditor of the Company for 2011.



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

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

- (1) The following major tasks were completed during 2011:
 - ① It conducted pre-audit communication with auditing institution engaged by the Company in respect of the 2010 financial report auditing on pre-auditing work, reviewed the 2010 auditing report and financial report and submitted such reports to the Board of the Company;
 - ② It reviewed the first quarter financial statements for the three months ended 31 March 2011, which was passed to the Board for approval.
 - ③ It reviewed the 2011 interim financial statements for the six months ended 30 June 2011, which was passed to the Board for approval.
 - ④ It reviewed the third quarter financial statements ended 30 September 2011, which was passed to the Board for approval.
- (2) Auditing work conducted on the 2011 financial report of the Company was as follows:
 - ① It reviewed the 2011 auditing plan and the related information of the Company with the auditing certified public accountants and the finance department of the Company prior to the on site audit and negotiated and determined the schedule of an audit of the 2011 financial statements of the Company with Deloitte Touche Tohmatsu Certified Public Accountants Ltd.;
 - ② It reviewed the draft of financial statements of the Company prior to an annual on site audit performed by the certified public accountants and issued its approval to audit;
 - ③ It kept in close contact with the auditors upon the annual on site audit and issued a letter to the auditors to urge the submission of the auditors' report on schedule;
 - ④ It reviewed the financial statements of the Company again upon the issue of draft audit opinion by the certified public accountants, and considered the financial statements of the Company true, accurate and complete to reflect the overall position of the Company;
 - ⑤ At the first meeting of the audit committee in 2012, the auditors' report on the annual audit issued by the certified public accountants was approved and then was passed to the Board;
 - ⑥ It reviewed the report on internal audit and internal control of the Company for the year ended 31 December 2011.

Members of the Audit Committee	Duties	Number of meetings attended
Chau Shing Yim David	Committee Chairman and Independent non-executive Director	4/4
Wang Chun Hua	Independent non-executive Director	4/4
John Paul Cameron	Independent non-executive Director	4/4



VII. Directors' Report

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

The Nomination Committee was established on 18 January 2005 and its current members are Ms. Wang Chun Hua, Mr. Zhang Yun San, Mr. Chau Shing Yim, David and Mr. John Paul Cameron, with Ms. Wang Chun Hua as the Chairperson of the Nomination Committee. In the reporting period, the nomination committee held one meeting in total, at which, the principal matters considered included nomination of Xiao Qing Zhou as candidates for non-executive director of the Company, which then was passed to the 2010 Annual Shareholders' Meeting for consideration and approval.

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

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

The remuneration and assessment committee of the Company was established on 18 January 2005 and its current members are Mr. John Paul Cameron, Mr. Zhang Yan San, Mr. Chau Shing Yim, David and Ms. Wang Chun Hua. Mr. John Paul Cameron is the Chairman of the Remuneration and Evaluation Committee. It was primarily responsible for formulating the remuneration and assessment for the Directors and the Senior Management of the Company and formulating and examining the remuneration package of the Directors and the Senior Management of the Company, and accountable to the Board. The remuneration and assessment committee does not determine the remuneration for the Directors and the Senior Management directly, but advised its remuneration to the Board according to their job performance. In the reporting period, the remuneration and assessment committee formulated the 2011 remuneration package of the Directors and the Senior Management of the Company, which then was passed to the Board for approval, based on the production and operation conditions of 2011 and assessment of the Directors and the Senior Management of the Company.

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

VII. Directors' Report



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

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

VI. The Proposed Profit Distribution Plan and Capitalizing of Common Reserves of 2011

1. The Company plans to distribute final dividend for the year of 2011:

Based on the total share capital of 398,924,200 shares (RMB1.00 par value), a final dividend of RMB1.00 each 10 shares (inclusive of applicable tax) shall be distributed to each shareholder.

2. The Company plans to capitalize common reserves:

Based on the Company's total shares of 398,924,200 shares (RMB1.00 par share), capitalizing of common reserves will be 10 share upon each 10 shares to the whole shareholders whose names appear on the register of members of the Company. Totally 398,924,200 shares (RMB1.00 par share) are capitalized, which totally amounts to RMB398,924,200, and capital reserve of RMB849,482,000 was left.

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

Unit: RMB

Cash bonus year	Amount for profit for cash bonus (before tax)	Net profit attributable to equity holders of the Company for the cash bonus year	Ratio of cash bonus to net profit attributable to equity holders of the Company	Distributable profit of the year
2010	59,838,630	276,149,165	21.67%	824,233,008.06
2009	39,470,904	268,315,157	14.71%	575,546,933.68
2008	65,784,840	305,810,743	21.51%	386,728,243.79

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

58.25%



VII. Directors' Report

VIII. Major Suppliers and Customers

The purchase from the largest supplier of the Group for 2011 was RMB608.94 million, which accounted for 24.61% of the total purchase of the Group for the year and the total purchase from the five largest suppliers was RMB1,260.67 million, which accounted for 50.95% of the total purchases of the Group for the year. None of the Directors, Supervisors and their respective associates, or, so far as the Directors were aware, shareholders who owned more than 5% of the Company's issued share capital had any interest in any of the five largest suppliers of the Group.

The sales to the largest customer of the Group for 2011 was RMB734.66 million, which accounted for 26.83% of the total sales of the Group for the year and the total sales from the five largest customers was RMB1,567.07 million, which accounted for 57.22% of the total sales of the Group for the year. None of the Directors, Supervisors and their respective associates, or, so far as the Directors were aware, shareholders who owned more than 5% of the Company's issued share capital had any interest in any of the five largest customers of the Group.

IX. Disclosures in accordance with the Listing Rules of SEHK

1. Results

The Group's profit for the current year and the state of financial affairs of the Group and the Company at that date are set out in the consolidated financial statements on pages 75 to 82 of the annual report.

2. Financial Summary

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

Results

	2011 RMB'000	For the year ended 31 December			
		2010 RMB'000	2009 RMB'000	2008 RMB'000	2007 RMB'000
Total revenue from operation	2,738,692	2,703,907	2,075,551	2,809,629	1,813,110
Profit from operations	166,268	276,717	270,746	345,501	212,906
Total profit	200,065	324,484	324,280	353,256	238,239
Net profit	169,042	276,980	273,822	319,399	201,029
Minority interests	712	831	5,507	13,588	699
Net profit attributable to shareholders of the Company	168,330	276,149	268,315	305,811	200,330
Basic earnings share (RMB)	0.42	0.81	0.82	0.93	0.62

Assets and Liabilities

	2011 RMB'000	For the year ended 31 December			
		2010 RMB'000	2009 RMB'000	2008 RMB'000	2007 RMB'000
Total assets	4,688,931	4,586,411	3,256,607	3,335,410	2,268,811
Total liabilities	1,835,954	1,843,207	1,942,972	2,225,386	1,429,034
Net assets	2,852,978	2,743,203	1,313,634	1,110,024	839,777



3. Changes in Share Capital

Details of changes in the share capital of the Company for 2011 are set out in note V to the consolidated financial statements.

4. Reserves and Distributable Reserves

Details of changes in the reserves of the Group for 2011 are set out in note V to consolidated financial statements.

5. Property, Plant and Equipment, and Investment Properties

Details of changes in the property, plant and equipment and investment properties of the Group for 2011 are set out in note V to the consolidated financial statements.

6. Capitalised Interest

For 2011, the Group had capitalised interest amounting to RMB4.7464 million.

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

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

8. Special Committee

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

9. Continuing Related Party Transactions

For continuing related party transaction with Yalong Oil Well Pump, please refer to note V to the consolidated financial statements. This continuing related party transaction didn't consist the "Connected Transactions" or "Continuing Connected Transactions" under Charter 14A of Listing Rules from the Stock Exchange.



VII. Directors' Report

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

As at 31 December 2011, interests and short positions of the Directors, Supervisors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to the Model Code for Securities Transactions by Directors of Listed Company as set out in Appendix 10 of the Listing Rules, to be notified to the Group and to the Stock Exchange, were as follows:

Long positions in the Shares

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

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

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

As for the situation of salary of the Directors, Supervisor and Senior Management got from the Company in 2011, please refer to section IV of this annual report.

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

None of the Directors or Supervisors or their respective associates (as defined under the Rule 1.01 of the Listing Rules of the SEHK) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights in 2011.

13. Share Option Scheme

The Company does not have any share option scheme.



14. Substantial Shareholders

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

15. Directors' Interests in Contracts

There were no contracts of significance to which the Company or any of its subsidiaries was a party and in which any of the Directors had a material interest, whether directly or indirectly, subsisted at the end of 2011 or at any time in 2011.

16. Material Contracts

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

17. Purchase, Sale or Redemption of Securities

None of the Company or any of its subsidiaries has purchased, sold or redeemed any listed securities of the Company in 2011.

18. Pre-emptive Rights

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

19. Corporate Governance

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

20. Sufficiency of Public Float

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



VIII. Supervisory Committee's Report

I. Performance of Duties

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

II. Meetings of the Supervisory Committee

1. The sixth meeting of the third session of the Supervisory Committee was held on 29 March 2011. Resolutions regarding the work report of the Supervisory Committee of the Company for 2010, audited performance report of the Company for 2010, and the profit distribution plan for 2010, were considered and passed at the meeting.
2. The seventh meeting of the third session of the Supervisory Committee was held on 27 April 2011. Resolutions regarding the 2011 first quarter report of the Company was considered and passed at the meeting.
3. The eighth meeting of the third session of the Supervisory Committee was held on 26 August 2011. Resolutions regarding the interim performance report of the Company for 2011 was considered and passed at the meeting.
4. The ninth meeting of the third session of the Supervisory Committee was held on 28 September 2011. Resolution regarding the 2011 third quarter report of the Company was considered and passed at the meeting.

III. Independent Opinion of the Supervisory Committee

1. Operation according to the law

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

VIII. Supervisory Committee's Report



2. Financial position inspection

The financial statements of the Company for the year of 2011 were audited by Deloitte Touche Tohmatsu Certified Public Accountants Ltd. who issued standard auditors' reports with unqualified opinion on them upon auditing. In the opinion of the Supervisory Committee, the auditors' report gave a true and fair view of the financial conditions and operating results of the Company.

3. Use of proceeds

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

4. Material purchase or sales of assets

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

5. Connected transactions

The Company had no connected transactions during the reporting period.



IX. Material Matters

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

The Company had no entrusted loans during the reporting period.

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

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

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

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

Based on the confidence to the Company's future, as the shareholders of the Company, Lin Fu Long, Xie Xin Cang, Liu Yun Long, Cui Huan You, and Liang Yong Qiang continued to committed on 19 October 2011 that the lock-up shares of Shandong Molong they held would continue to extend the lock-up period for 24 months to 21 October 2013 after the prior lock-up period expired on 21 October 2011.

Meantime, they committed that shares held by them shall not be transferred or entrusted to others to manage, and not be purchased by the Company during the lock-up period. If matters which made the amount of shares changed happened, including capital conversion from capital reserve, dispatch stock dividend, allotment of shares, and additional shares, the amount of lock-up shares aforementioned shall be adjusted accordingly. If they breach the above promise and reduce shares during the lock-up period, all income from reducing shares will be turned over to the Company, and undertake the 10% liquidated damages.



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

At the 2010 annual general meeting of the Company, the resolutions in relation to cessation of appointment of its overseas auditor, Deloitte Touche Tohmatsu, whilst Deloitte Touche Tohmatsu Certified Public Accountants Ltd will be the annual auditor of the Company for 2011 was approved. The auditor's fees for 2011 aggregated to RMB1,100,000.

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

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

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

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

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



IX. Material Matters

In 2011, the Company's general headquarters handled more than 90 visits from individual and institutional investors surveys and studies.

Detail of reception

Time of reception	Place of reception	Manner of reception	Parties accommodated	Main topics of discussion and information provided
January 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from Northeast Securities	Matters including recent development of the industry and development trend in the future,
February 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from institutions such as TX Investment Consulting Co., Ltd; Galaxy Asset Management Co., Ltd.; GLA Assets Management Limited; Sinolink Securities; AXA SPDB Investment Management Limited; Shanghai Zexi Investment; Shanghai Elegant Investment Limited; Fortune Securities; National Trust; Capital Synergy Invest Management Limited; China Merchants Securities; Donghai Securities; China International Fund Management Limited; Aegon Industrial Fund Management Limited; Essence Securities; Xiangcai Securities; SWS Research	production and operation of the Company, as well as the condition of A Shares proceeds-funded projects
April 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from institutions such as Taiping Pension Limited; UBS AG; CITIC Securities; Changjiang Securities; Orient Securities Asset Management Co., Ltd; Huatai Asset Management; KGI	

IX. Material Matters



Time of reception	Place of reception	Manner of reception	Parties accommodated	Main topics of discussion and information provided
May 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from institutions such as Gaohua Securities; Yin Hua Fund Management Co., Ltd; Neuberger Berman Assets Management Invesco Hong Kong Limited; HSBC Jintrust Fund Management Company Limited; Hua Shang Fund Management Co., Ltd; China Asset Management Co., Ltd; China International Fund Management Co., Ltd; Chang Sheng Fund Management Co., Ltd; E Fund Management Co., Ltd; GF Securities Co., Ltd; Cape Asset Management Limited	
June 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from institutions such as China International Capital Corporation Limited; BOC International (China) Limited; CITIC-Prudential Fund Management Company Ltd.; Primasia Securities Company Limited; Shin Kong Life; UNI President Assets Management Corporation; USB Securities Co. Limited; Invesco Hong Kong Limited; Hua Xi Securities Co., Ltd; Cape Asset Management Limited	
July 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from Dong Xing Securities	



IX. Material Matters

Time of reception	Place of reception	Manner of reception	Parties accommodated	Main topics of discussion and information provided
September 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from institutions such as Jianghai Securities, Westen Securities, Guotai Junan Securities, Fubon Financial Wealth Management, Taishin Securities Investment Trust Co., Ltd, Reliance Securities Investment trust Co., Ltd, Changjiang Securities and Wanjia Asset.	
November 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from institutions such as Right Share and SWS Research Co., Ltd.	
December 2011	Shouguang, Shandong	On-site research and investigation	Research personnel and fund managers from Shandong Jiahai Investment Company.	

IX. Other Material Matters

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

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

Upon validation, the Company had provided RMB300,000,000 of external guarantee for its holding subsidiary for the period of and accrued up to 2011.

IX. Material Matters



X. Index of Information Disclosure in 2010

Date of announcement	Subject matter	Media for publication
4 January 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
19 January 2011	Suggestive Announcement in respect of IPO off-line allotment shares circulating in the market	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
2 February 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
11 February 2011	Announcement in respect of bidding OCTG from CNOOC Group in 2011	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
12 February 2011	Announcement on resolutions of 2011 first provisional extraordinary general meeting Legal opinions as witnessed by lawyers on the announcement on resolutions of the 2011 first extraordinary general meeting	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
22 February 2011	Announcement Regarding Subsidiaries Signing Proceeds of A Shares Tripartite Regulation Agreement	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
23 February 2011	Announcement in respect of bidding OCTG from CNOOC Group in 2011	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News



IX. Material Matters

Date of announcement	Subject matter	Media for publication
26 February 2011	Preliminary Financial Data for the Year 2010	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
3 March 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
10 March 2011	Proposal for the Cessation of Appointment of the overseas auditor	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
30 March 2011	Notice of 2010 Annual general meeting Special explanation on the conditions of fund occupied by controlling shareholder and other related party Special report and audit report in respect of the conditions for depositing and using the raised money Self-evaluation report on internal control Opinion of China Merchants Securities on relevant matters of the Company in the continuing supervise period Independent opinion of independent directors on further appointing the 2011 audit authority for the Company	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News

IX. Material Matters



Date of announcement	Subject matter	Media for publication
	2010 annual report	
	2010 annual report summary	
	2010 auditors' report	
	Announcement in respect of the resolutions passed at the sixth meeting of the third session of the Board	
	Announcement in respect of the resolutions passed at the sixth meeting of the third session of the Supervisory Committee	
	Special report in respect of the conditions for depositing and using the raised money	
	Independent directors' report for 2010	
	Independent opinion of independent directors on the self-evaluation report of internal control of the Company	
	Independent opinion on provision of nominating non-executive director candidate by independent directors	
	Special explanation and independent opinion on provision of the conditions of related party occupy funds and external guarantees by independent directors	
	Independent opinion on provision of external guarantee by independent directors	
30 March 2011	Clarification Announcement	http://www.hkex.com.hk
1 April 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
4 April 2011	2010 Annual Report	http://www.hkex.com.hk



IX. Material Matters

Date of announcement	Subject matter	Media for publication
5 April 2011	Circular of the AGM Reply Slip of AGM Proxy Form of AGM	http://www.hkex.com.hk
7 April 2011	Announcement in respect of holding 2010 annual results statement	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
13 April 2011	The Date of the Board	http://www.hkex.com.hk
28 April 2011	The main body of 2011 first quarterly report The full text of 2010 first quarterly report	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
5 May 2011	Monthly return of equity issuer on movements in securities	http://www.hkex.com.hk
20 May 2011	Poll results of the annual general meeting held on 20 May 2011	http://www.hkex.com.hk
21 May 2011	Announcement in respect of the resolutions passed at the eighth meeting of the third session of the Board Legal opinions as witnessed by lawyers on the announcement on resolution of the 2009 annual general meeting 2010 annual general meeting resolutions announcement Derivatives investment and internal control system and information disclosure system (May 2011)	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
2 June 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
4 June 2011	Announcement of dividend payment for A shares for 2010	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News

IX. Material Matters



Date of announcement	Subject matter	Media for publication
27 June 2011	Further Announcement on the Payment of Final Dividend	http://www.hkex.com.hk
4 July 2011	Monthly Return of Equity Issuer on Movements in Securities Announcement of Dividend Payment	http://www.hkex.com.hk
5 August 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
15 August 2011	The Date of the Board	http://www.hkex.com.hk
26 August 2011	Announcement in respect of 2011 interim performance report ended 30 June 2011	http://www.hkex.com.hk
30 August 2011	Special Opinions of Independent Directors Regarding occupying fund of related party and situation of external guarantee 2011 Interim Report 2011 Interim Financial Statement Abstract of 2011 Interim Report Annual Report Work Rules for Audit Committee of the Board Announcement in Respect of the Resolutions Passed at the Eleventh Meeting of the Third Session of the Board Annual Work System for the Independent Directors China Merchants Securities Special Verification Report Regarding Self-examination Table of Internal Rules Implement for Small and Medium-sized Listed Enterprises Corrective Actions Regarding Special Activities on Strengthen to Implement the Internal Rules for Small and Medium-sized Listed Enterprises	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News



IX. Material Matters

Date of announcement	Subject matter	Media for publication
	Self-examination Table of Internal Rules Implement for Small and Medium-sized Listed Enterprises	
5 October 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
19 October 2011	The Date of the Board	http://www.hkex.com.hk
20 October 2011	Announcement Regarding Shareholders' Additional Commitment	http://www.cninfo.com.cn http://www.hkex.com.hk
	Announcement Regarding lock-up shares circulate in the market	
	China Merchants Securities Special Verification Report Regarding the lock-up shares of the Company lifting of the ban	
30 October 2011	The Third quarter Report of the Year 2011	http://www.cninfo.com.cn http://www.hkex.com.hk Designated Newspapers for Information Disclosure: China Securities Journal, Securities Daily, Securities Times and Shanghai Securities News
3 November 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk
1 December 2011	Monthly Return of Equity Issuer on Movements in Securities	http://www.hkex.com.hk



Deloitte.

德勤

De Shi Bao (Shen) Zi (12) No. P0497

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

We have audited the accompanying financial statements of Shandong Molong Petroleum Machinery Company Limited (the "Company"), which comprise the company's and consolidated balance sheets as at 31 December 2011, the company's and consolidated income statements, the company's and consolidated statements of change in shareholders' equity and the company's and consolidated cash flow statements for the year then ended, and the notes to the financial statements.

I. Management's Responsibility for the Financial Statements

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

II. Certified Public Accountants' Responsibility

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

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

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



Auditors' Report

III. Audit Opinion

In our opinion, the financial statements of the Company present fairly, in all material respects, the Company's and consolidated financial position as of 31 December 2011, and the Company's and consolidated results of operations and cash flows for the year then ended in accordance with Accounting Standards for Business Enterprises.

Deloitte Touche Tohmatsu CPA Ltd.
Shanghai, China

Chinese Certified Public Accountant
29 March 2012

Consolidated Balance Sheets



As at 31 December 2011

Item	Note	Closing balance RMB	Opening balance RMB
Current assets:			
Cash and bank balances	V. 1	413,632,018.60	892,286,589.93
Bills receivable	V. 2	73,528,915.23	19,120,729.91
Accounts receivable	V. 3	460,164,130.15	500,867,640.05
Prepayments	V. 4	42,127,891.20	158,601,512.56
Dividends receivable	V. 5	—	150,000.00
Other receivable	V. 6	29,820,567.73	30,281,650.63
Inventory	V. 7	1,176,981,854.52	743,553,547.47
Other current assets	V. 8	72,538,796.17	41,054,637.00
Total current assets		2,268,794,173.60	2,385,916,307.55
Non-current assets:			
Long-term equity investment	V. 10	12,580,624.11	12,477,279.82
Fixed assets	V. 12	1,831,368,142.96	1,648,583,610.99
Construction in progress	V. 13	83,523,080.85	131,446,242.52
Intangible assets	V. 14	333,019,939.03	249,918,129.97
Goodwill	V. 15	142,973,383.21	142,973,383.21
Deferred income tax assets	V. 16	16,672,092.94	15,095,861.12
Total non-current assets		2,420,137,263.10	2,200,494,507.63
Total assets		4,688,931,436.70	4,586,410,815.18



Consolidated Balance Sheets

As at 31 December 2011

Item	Note	Closing balance RMB	Opening balance RMB
Current liabilities:			
Short-term borrowings	V. 18	710,502,077.23	712,866,417.20
Bills payable	V. 19	383,690,165.06	482,816,088.17
Accounts payable	V. 20	616,716,194.34	501,771,570.34
Advance receipts	V. 21	20,713,521.63	34,721,719.22
Salaries payable	V. 22	19,905,460.32	17,839,689.76
Taxes payable	V. 23	35,749,257.97	29,428,377.89
Interests payable	V. 24	5,557,955.40	955,547.63
Dividends payable	V. 25	—	23,788,680.00
Other payables	V. 26	22,561,056.57	25,991,912.66
Total current liabilities		1,815,395,688.52	1,830,180,002.87
Non-current liabilities:			
Deferred income tax liabilities	V. 16	11,518,019.83	13,027,452.38
Other non-current liabilities		9,040,000.00	—
Total non-current liabilities		20,558,019.83	13,027,452.38
Total liabilities		1,835,953,708.35	1,843,207,455.25
Shareholders' equity:			
Share capital	V. 28	398,924,200.00	398,924,200.00
Share premium	V. 29	1,248,424,858.42	1,248,406,190.92
Surplus reserve	V. 30	157,965,274.48	140,393,447.06
Retained earnings	V. 31	989,669,698.87	898,749,873.79
Foreign currency translation differences		30,361.41	(483,325.64)
Total equity attributable to owners of the Company		2,795,014,393.18	2,685,990,386.13
Minority interests	V. 32	57,963,335.17	57,212,973.80
Total shareholders' equity		2,852,977,728.35	2,743,203,359.93
Total liabilities and shareholders' equity		4,688,931,436.70	4,586,410,815.18

The notes form an integral part of the financial statements.

The financial statements as set out from pages 75 to 198 have been signed by:

Legal Representative

Chief Financial Officer

Head of the Finance Section

Balance Sheets of the Company



As at 31 December 2011

Item	Note	Closing balance RMB	Opening balance RMB
Current assets:			
Cash and bank balances	V. 1	377,139,037.54	837,167,588.76
Bills receivable	V. 2	73,528,915.23	11,570,729.91
Accounts receivable	V. 3	457,266,644.14	495,100,949.64
Prepayments	V. 4	8,735,715.10	101,572,609.15
Other receivable	V. 6	17,510,729.92	18,186,384.98
Inventory	V. 7	959,063,493.57	612,796,033.63
Other current assets	V. 8	39,474,432.06	27,836,147.66
Total current assets		1,932,718,967.56	2,104,230,443.73
Non-current assets:			
Long-term equity investment	V. 10	652,069,921.73	435,467,004.23
Investment properties	V. 11	—	6,189,666.32
Fixed assets	V. 12	1,350,869,260.71	1,305,073,564.42
Construction in progress	V. 13	84,726,317.92	44,383,482.30
Intangible assets	V. 14	246,273,322.58	170,497,485.42
Deferred income tax assets	V. 16	10,219,763.81	7,174,248.69
Total non-current assets		2,344,158,586.75	1,968,785,451.38
Total assets		4,276,877,554.31	4,073,015,895.11



Balance Sheets of the Company

As at 31 December 2011

Item	Note	Closing balance RMB	Opening balance RMB
Current liabilities:			
Short-term borrowings	V. 18	618,942,712.23	543,626,227.20
Bills payable	V. 19	380,837,165.06	446,849,308.17
Accounts payable	V. 20	462,726,552.20	324,586,612.39
Advance receipts	V. 21	26,525,840.83	80,810,957.44
Salaries payable	V. 22	12,801,416.26	11,150,221.53
Taxes payable	V. 23	19,300,276.19	14,729,859.41
Interests payable	V. 24	4,600,388.73	751,797.63
Dividends payable	V. 25	—	23,788,680.00
Other payables	V. 26	13,937,011.55	14,243,186.10
Total current liabilities		1,539,671,363.05	1,460,536,849.87
Non-current liabilities:			
Deferred income tax liabilities	V. 16	329,701.06	522,199.20
Other non-current liabilities	V. 27	9,040,000.00	—
Total non-current liabilities		9,369,701.06	522,199.20
Total liabilities		1,549,041,064.11	1,461,059,049.07
Shareholders' equity:			
share capital	V. 28	398,924,200.00	398,924,200.00
Capital reserve	V. 29	1,248,406,190.92	1,248,406,190.92
Surplus reserve	V. 30	157,965,274.48	140,393,447.06
Undistributed profit	V. 31	922,540,824.80	824,233,008.06
Total shareholders' equity		2,727,836,490.20	2,611,956,846.04
Total liabilities and shareholders' equity		4,276,877,554.31	4,073,015,895.11

Consolidated Income Statements



As at 31 December 2011

Item	Note	Amount for the current period RMB	Amount for the previous period RMB
I. Total revenue from operations	V. 33	2,738,691,830.21	2,703,906,835.19
Including: operating revenue		2,738,691,830.21	2,703,906,835.19
II. Total cost of operations		2,572,677,653.23	2,427,381,354.95
Including: Operating cost	V. 33	2,407,671,724.80	2,237,506,663.67
Business tax and surcharges	V. 34	1,931,536.70	4,812,307.46
Selling expenses	V. 35	57,586,499.79	51,360,828.52
Administrative expenses	V. 36	87,944,411.71	91,383,971.04
Finance costs	V. 37	14,649,473.96	44,341,872.74
Asset impairment losses	V. 39	2,894,006.27	(2,024,288.48)
Add: Investment income	V. 39	253,344.29	191,250.95
Including: Gains from investment in associates and joint ventures	V. 39	253,344.29	191,250.95
III. Operating profit		166,267,521.27	276,716,731.19
Add: Non-operating income	V. 40	34,476,972.35	50,431,757.52
Less: Non-operating expenses	V. 41	679,969.16	2,664,687.26
Including: Loss from disposal of non-current assets	V. 41	429,020.39	2,123,471.06
IV. Total profit		200,064,524.46	324,483,801.45
Less: Income tax expenses	V. 42	31,022,289.46	47,503,492.81
V. Net profit		169,042,235.00	276,980,308.64
Net profit attributable to shareholders of the Company		168,330,282.50	276,149,165.54
Minority interests		711,952.50	831,143.10
VI. Earnings per share:			
(1) Basic earnings per share	V. 43	0.42	0.81
(2) Diluted earnings per share	V. 43	N/A	N/A
VII. Other comprehensive income	V. 44	570,763.42	269,875.82
VIII. Total comprehensive income		169,612,998.42	277,250,184.46
Total comprehensive income attributable to owners of the Company		168,843,969.55	276,402,773.53
Total comprehensive income attributable to minority interests		769,028.87	847,410.93



Income Statements of the Company

As at 31 December 2011

Item	Note	Amount for the current period RMB	Amount for the previous period RMB
I. Operating revenue	V. 33	2,863,903,457.10	2,663,041,641.58
Less: Operating cost	V. 33	2,572,698,117.94	2,253,227,044.55
Business tax and surcharges	V. 34	3,641.15	—
Selling expenses	V. 35	57,450,067.29	50,601,134.39
Administrative expenses	V. 36	73,513,273.32	70,280,481.44
Finance costs	V. 37	8,769,296.55	33,816,054.17
Asset impairment losses	V. 38	3,289,143.71	(1,541,277.09)
Add: Investment income	V. 39	19,707,433.98	85,765,164.48
Including: Gains from investment in associates and joint ventures		—	—
II. Operating profit		167,887,351.12	342,423,368.60
Add: Non-operating income	V. 40	32,689,260.86	14,833,143.22
Less: Non-operating expense	V. 41	187,651.48	2,023,023.19
Including: Loss from disposal of non-current assets	V. 41	70,967.01	1,717,023.19
III. Total profit		200,388,960.50	355,233,488.63
Less: Income tax expenses	V. 42	24,670,686.34	35,059,068.21
IV. Net profit		175,718,274.16	320,174,420.42
V. Earnings per share:			
(1) Basic earnings per share		N/A	N/A
(2) Diluted earnings per share		N/A	N/A
VI. Other comprehensive income		—	—
VII. Total comprehensive income		175,718,274.16	320,174,420.42

Consolidated Cash Flow Statements



As at 31 December 2011

Item	Note	Amount for the current period RMB	Amount for the previous period RMB
I. Cash flows from operating activities:			
Cash received from selling goods and rendering services		3,072,075,223.47	2,209,445,846.07
Tax rebate received		133,034,729.58	127,703,832.00
Other cash received relating to operating activities	V. 45(1)	109,372,826.54	40,299,662.90
Sub-total of cash inflow from operating activities		3,314,482,779.59	2,377,449,340.97
Cash paid for purchasing goods and receiving services		2,962,042,147.34	1,616,065,575.62
Cash paid to and on behalf of employees		117,907,356.31	94,388,152.02
Taxes and surcharges paid		51,233,594.86	129,736,495.73
Other cash paid relating to operating activities	V. 45(2)	95,671,106.01	148,245,602.11
Sub-total of cash outflow from operating activities		3,226,854,204.52	1,988,435,825.48
Net cash flows from operating activities		87,628,575.07	389,013,515.49
II. Cash flows from investing activities:			
Cash received from return on investments		300,000.00	—
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		2,284,453.05	5,094,699.70
Cash inflow from other investing activities	V. 45(3)	9,040,000.00	—
Sub-total of cash inflow from investing activities		11,624,453.05	5,094,699.70
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		408,924,455.38	582,952,354.89
Sub-total of cash outflow from investing activities		408,924,455.38	582,952,354.89
Net cash flows from investing activities		(397,300,002.33)	(577,857,655.19)
III. Cash flows from financing activities:			
Cash received from equity investments		—	1,260,000,000.00
Including: Cash received by subsidiaries from minority shareholders' investment		—	—
Cash received from borrowings		959,743,537.46	1,226,069,863.92
Other cash received relating to financing activities	V. 45(4)	12,000,000.00	—
Sub-total of cash inflow from financing activities		971,743,537.46	2,486,069,863.92
Cash paid for repayment of liabilities		959,596,273.38	1,560,851,958.72
Cash paid for dividends, profits distribution or interest repayment		106,377,706.83	125,809,384.16
Including: Dividend and profit paid by subsidiaries to minority shareholders		—	4,949,462.72
Other cash paid relating to financing activities	V. 45(5)	—	82,643,150.54
Sub-total of cash outflow from financing activities		1,065,973,980.21	1,769,304,493.42
Net cash flows from financing activities		(94,230,442.75)	716,765,370.50
IV. Effect on cash and cash equivalents due to change in foreign currency exchange rate		312,859.41	182,821.83
V. Net increase (decrease) in cash and cash equivalents		(403,589,010.60)	528,104,052.63
Add: Balance of cash and cash equivalents at the beginning of the period	V. 46(2)	754,225,131.33	226,121,078.70
VI. Balance of cash and cash equivalents at the end of the period	V. 46(2)	350,636,120.73	754,225,131.33



Cash Flow Statements of the Company

As at 31 December 2011

Item	Note	Amount for the current period RMB	Amount for the previous period RMB
I. Cash flows from operating activities:			
Cash received from selling goods and rendering services		2,105,354,810.53	1,849,365,933.20
Tax rebate received		133,034,729.58	109,953,203.91
Other cash received relating to operating activities	V. 45(1)	98,546,453.69	18,760,804.03
Sub-total of cash inflow from operating activities		2,336,935,993.80	1,978,079,941.14
Cash paid for purchasing goods and receiving services		2,010,971,824.30	1,620,545,441.96
Cash paid to and on behalf of employees		80,990,888.88	59,962,600.08
Taxes and surcharges paid		28,353,741.64	43,937,397.03
Other cash paid relating to operating activities	V. 45(2)	86,912,702.70	125,600,400.00
Sub-total of cash outflow from operating activities		2,207,229,157.52	1,850,045,839.07
Net cash flows from operating activities		129,706,836.28	128,034,102.07
II. Cash flows from investing activities:			
Cash received from return on investments		3,156,000.00	85,765,164.48
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		1,773,345.40	1,960,278.04
Other cash received relating to investing activities	V. 45(3)	9,040,000.00	—
Sub-total of cash inflow from investing activities		13,969,345.40	87,725,442.52
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		304,717,441.33	473,705,110.69
Cash paid for investment		223,000,000.00	—
Sub-total of cash outflow from investing activities		527,717,441.33	473,705,110.69
Net cash flows from investing activities		(513,748,095.93)	(385,979,668.17)
III. Cash flows from financing activities:			
Cash received from equity investments		—	1,260,000,000.00
Cash received from borrowings		854,184,172.46	1,126,829,673.92
Other cash received relating to financing activities	V. 45(4)	12,000,000.00	—
Sub-total of cash inflow from financing activities		866,184,172.46	2,386,829,673.92
Cash paid for repayment of liabilities		776,356,083.38	1,432,851,958.72
Cash paid for dividends, profits distribution or interest repayment		100,539,050.96	109,994,378.16
Other cash paid relating to financing activities	V. 45(5)	—	82,643,150.54
Sub-total of cash outflow from financing activities		876,895,134.34	1,625,489,487.42
Net cash flows from financing activities		(10,710,961.88)	761,340,186.50
IV. Effect on cash and cash equivalents due to change in foreign currency exchange rate		(210,768.96)	(55,840.57)
V. Net increase (decrease) in cash and cash equivalents		(394,962,990.49)	503,338,779.83
Add: Balance of cash and cash equivalents at the beginning of the period	V. 46(2)	709,106,130.16	205,767,350.33
VI. Balance of cash and cash equivalents at the end of the period	V. 46(2)	314,143,139.67	709,106,130.16

Consolidated Statement of Change in Shareholders' Equity



For the year ended 31 December 2011

Items	Amount for the previous year							Amount for the previous year						
	Attributable to the shareholders of the Company				Total equity	Attributable to the shareholders of the Company				Total equity				
	Share capital	Capital reserve	Surplus reserve	Undistributed profit		Others	Minority interest	Share capital	Capital reserve		Surplus reserve	Undistributed profit	Others	Minority interest
RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	
I. Balance at the end of the previous year	398,924,200.00	1,248,406,190.92	140,393,447.06	888,749,873.79	2,745,203,359.93	57,212,973.80	328,924,200.00	1,211,667,859.42	108,371,005.02	694,089,054.29	(736,933.63)	61,315,025.59	1,313,635,210.69	
II. Changes in the current year														
(1) Net profit				168,330,282.50	168,042,235.00	711,952.50				276,149,165.54		831,143.10	276,980,308.64	
(2) Other comprehensive income					570,763.42	57,076.37					253,607.99	16,267.83	269,875.82	
Sub-total of (1) and (2)				168,330,282.50	169,612,998.42	769,028.87				276,149,165.54	253,607.99	847,410.93	277,250,184.46	
(3) Shareholder's capital injection and capital reduction														
1. Capital injection from shareholders							70,000,000.00	1,126,738,331.50					1,196,738,331.50	
2. Equity settled share expenses charged to equity														
3. Others		18,667.50				(18,667.50)								
(4) Profit distribution														
1. Transfer to surplus reserves			17,571,827.42						32,017,442.04					
2. Distribution to shareholders			(59,838,630.00)		(59,838,630.00)				(39,470,904.00)			(4,949,462.72)	(44,420,366.72)	
3. Others														
(5) Transfer of shareholders' equity														
1. Transfer of capital reserve to share capital														
2. Transfer of surplus reserves to share capital														
3. Surplus reserves making up of losses														
4. Others														
III. Balance at the end of the current year	398,924,200.00	1,248,424,858.42	157,965,274.48	989,689,696.87	2,852,977,728.35	57,963,335.17	398,924,200.00	1,248,406,190.92	140,393,447.06	898,749,873.79	(483,325.64)	57,212,973.80	2,743,203,359.93	



Statement of Change in Shareholders' Equity of the Company

For the year ended 31 December 2011

Items	Amount for the current year					Amount for the previous year					RMB
	Share capital	Capital reserve	Surplus reserve	Undistributed profit	Total equity	Share capital	Capital reserve	Surplus reserve	Undistributed profit	Total equity	
I. Balance at the end of the previous year	398,924,200.00	1,248,406,190.92	140,393,447.06	824,233,008.06	2,611,956,846.04	328,924,200.00	121,667,859.42	108,376,005.02	575,546,933.68	1,134,514,998.12	
II. Changes in the current year											
(1) Net profit	—	—	—	175,718,274.16	175,718,274.16	—	—	—	320,174,420.42	320,174,420.42	
(2) Other comprehensive income	—	—	—	—	—	—	—	—	—	—	
Sub-total of (1) and (2)	—	—	—	175,718,274.16	175,718,274.16	—	—	—	320,174,420.42	320,174,420.42	
(3) Shareholders' contributions and decrease in capital	—	—	—	—	—	70,000,000.00	1,126,738,331.50	—	—	1,196,738,331.50	
1. Shareholders' contributions in capital	—	—	—	—	—	—	—	—	—	—	
2. Others	—	—	—	—	—	—	—	—	—	—	
(4) Profit distribution	—	—	17,571,827.42	(17,571,827.42)	—	—	—	32,017,442.04	(32,017,442.04)	—	
1. Transfer to surplus reserves	—	—	17,571,827.42	(17,571,827.42)	—	—	—	32,017,442.04	(32,017,442.04)	—	
2. Distribution to shareholders	—	—	—	(59,838,630.00)	(59,838,630.00)	—	—	—	(39,470,904.00)	(39,470,904.00)	
3. Others	—	—	—	—	—	—	—	—	—	—	
(5) Transfer of shareholders' equity	—	—	—	—	—	—	—	—	—	—	
1. Transfer of capital reserve to share capital	—	—	—	—	—	—	—	—	—	—	
2. Transfer of surplus reserves to share capital	—	—	—	—	—	—	—	—	—	—	
3. Surplus reserves making up of losses	—	—	—	—	—	—	—	—	—	—	
4. Others	—	—	—	—	—	—	—	—	—	—	
III. Balance at the end of the current year	398,924,200.00	1,248,406,190.92	157,965,274.48	922,540,824.80	2,727,836,490.20	398,924,200.00	1,248,406,190.92	140,393,447.06	824,233,008.06	2,611,956,846.04	

Notes to the Financial Statements



For the year ended 31 December 2011

I. General Information

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

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

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

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

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

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

I. General Information (continued)

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

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

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

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

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

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

1. Basis of preparation

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

Basis of preparation and principle of measurement

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

2. Statement of compliance

The financial statements truly and completely reflect the financial position of the Group and the Company as at 31 December 2011 and the results of their operations and their cash flows for the year ended 31 December 2011.



For the year ended 31 December 2011

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

3. Financial year

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

4. Reporting currency

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

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

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

5.1 Business combinations involving entities under common control

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

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

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

5.2 Business combinations and goodwill involving entities not under common control

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

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

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

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

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

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

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

Notes to the Financial Statements



For the year ended 31 December 2011

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

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

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

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

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

6. Basis for Preparation of Consolidated Financial Statements

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

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

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

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

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

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

6. Basis for Preparation of Consolidated Financial Statements (continued)

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

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

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

7. Cash and cash equivalents

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

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

8.1 Foreign currency

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

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



For the year ended 31 December 2011

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

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

8.1 Foreign currency (continued)

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

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

8.2 Translation of Financial Statements Denominated in Foreign Currency

The financial statements denominated in foreign currency of a foreign operation are translated to RMB in comply with the following requirement: assets and liabilities on the balance sheet are translated at the spot exchange rate prevailing at the balance sheet date; all equity items except for inappropriate profits are translated at the spot exchange rates at the dates on which such items arose; income and expenses in the income statement are translated at the spot exchange rate at the date of transaction; the inappropriate profits brought forward are reported at the prior year's closing balance; the inappropriate profits carried forward are calculated, based on the translated amounts of profits and other profit appropriation items; and all exchange differences resulting from the translation are recognized separately as "translation reserve" in the shareholders' equity on the balance sheet.

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

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

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

8.2 Translation of Financial Statements Denominated in Foreign Currency (continued)

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

9. Financial instruments

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

9.1 Method of determination of the fair value

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

9.2 Effective interest method

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

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

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

9. Financial instruments (continued)

9.3 Classification, recognition and measurement of the financial assets

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

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

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

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

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

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

9.3.2 Loans and accounts receivable

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

9. Financial instruments (continued)

9.4 Impairment of financial assets

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

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

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

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

9. Financial instruments (continued)

9.4 Impairment of financial assets (continued)

- Impairment on financial assets measured at amortized cost

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

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

9.5 Transfers of financial asset

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

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

9. Financial instruments (continued)

9.5 Transfers of financial asset (continued)

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

9.6 Classification and measurement of financial liabilities

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

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

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

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

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

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

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

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

9. Financial instruments (continued)

9.6 Classification and measurement of financial liabilities (continued)

9.6.2 Other financial liabilities

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

9.7 Derecognition of financial liabilities

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

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

9.8 Offset of Financial Assets and Financial Liabilities

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

9.9 Equity instruments

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

10. Accounts receivable

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

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

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

10.2 Accounts receivable provided for bad debts by group

Basis for determining portfolio

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

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

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

Provision method for bad debts provision Individual determination method

11. Inventory

11.1 Classification and initial measure of inventories

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



For the year ended 31 December 2011

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

11. Inventory (continued)

11.2 Method for calculating value of inventories delivered

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

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

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

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

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

11.4 Inventory taking system

The inventory taking system shall be on a perpetual basis.

11.5 Amortization of low-value consumable and packaging materials

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

12. Long-term equity investments

12.1 Determination of initial investment cost

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

12. Long-term equity investments (continued)

12.2 Method for subsequent measurement and profit or loss recognition

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

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

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

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

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

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

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

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

12. Long-term equity investments (continued)

12.2 Method for subsequent measurement and profit or loss recognition (continued)

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

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

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

12.2.3 Disposal of long-term equity investments

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

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

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

12.4 Impairment test method and impairment provision

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

13. Investment Property

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

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

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

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

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

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

14. Fixed assets

14.1 Conditions for recognition of fixed assets

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

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

Notes to the Financial Statements



For the year ended 31 December 2011

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

14. Fixed assets (continued)

14.2 Method for depreciation of different fixed assets

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

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

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

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

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

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

14.4 Explanation on other matters

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

15. Construction in progress

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

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

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

16. Borrowing costs

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

Where funds are borrowed for a specific purpose, the amount of interest to be capitalized shall be the actual interest expense incurred on that borrowing for the period less any bank interest earned from depositing the borrowed funds before being used into banks or any investment income on the temporary investment of those funds. Where funds are borrowed for general purpose, the Group shall determine the amount of interest to be capitalized on such borrowings by applying a capitalization rate to the weighted average of the excess amounts of cumulative expenditures on the asset over and above the amounts of specific-purpose borrowings. The capitalization rate shall be the weighted average of the interest rates applicable to the general-purpose borrowings.

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

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

17. Intangible assets

17.1 Intangible assets

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

An intangible asset shall be initially measured at cost. An intangible asset with an infinite useful life shall be stated at cost less estimated net residual value and any accumulated impairment loss provision and amortized using the straight-line method over its useful life when the asset is available for use. No amortization is made for intangible assets without certain useful lives.

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

17.2 Research and development expenditure

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

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

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

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

17.3 Intangible assets impairment test method and their impairment provision

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

17. Intangible assets (continued)

17.3 Intangible assets impairment test method and their impairment provision (continued)

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

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

18. Long-term deferred expenses

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

19. Contingent liabilities

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

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

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

20. Revenue

20.1 Revenue from sales of goods

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

20.2 Revenue from provision of services

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

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

20. Revenue (continued)

20.2 Revenue from provision of services (continued)

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

21. Government grant

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

If a government grant is in the form of a transfer of monetary asset, the item shall be measured at the amount received or receivable. If a government grant is in the form of a transfer of non-monetary asset, the item shall be measured at fair value. If fair value is not reliably determinable, the item shall be measured at a nominal amount and recognized immediately in profit or loss for the current period.

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

For a government grant related to income, if the grant is a compensation for related expenses or losses to be incurred in subsequent periods, the grant shall be recognized as deferred income, and recognized in profit or loss over the periods in which the related costs are recognized; if the grant is a compensation for related expenses or losses already incurred, the grant shall be recognized immediately in profit or loss for the current period.

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

22. Deferred income tax assets/deferred income tax liabilities

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

22.1 Current income tax

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

22.2 Deferred income tax assets and deferred income tax liabilities

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



Notes to the Financial Statements

For the year ended 31 December 2011

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

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

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

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

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

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

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

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

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

For the year ended 31 December 2011

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

23. Lease

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

23.1 Operating lease business with the Group recorded as lessee

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

23.2 Operating lease business with the Group recorded as lessor

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

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

24.1 Employee Benefits

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

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

III. Taxation

1. Main Tax Types and Tax Rates

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

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

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

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

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

Notes to the Financial Statements



For the year ended 31 December 2011

III. Taxation (continued)

2. Tax Incentives and Approvals

Name	Type of tax	Basis of relevant regulations and policies	Approval authorities	Approval No.	Level of reduction and exemption	Valid period
The Company	Business income tax (Note)	"Enterprise Income Tax Law of the People's Republic of China"	Technology Office of Shandong Province, Finance Office of Shandong Province, State Administration of Taxation of Shandong Province, Local Taxation Bureau of Shandong Province	Lu Ke Gao Zi [2011] No. 206	Implement the income tax rate of 15%	1 January 2011 to 31 December 2013

Note: According to the "Notice Regarding the List of Shandong Province Proposed Advanced Technology Enterprise in 2011" (關於山東省2011年擬通過複審認定高新技術企業名單的通知) (Lu Ke Gao Zi[2011]206號) from Technology Office of Shandong Province, Finance Office of Shandong Province, State Administration of Taxation of Shandong Province, Local Taxation Bureau of Shandong Province on 31 October 2011, the Company's qualification of Advanced Technology Enterprise was passed the review. The Company was subject to an enterprise income tax rate of 15% during the reporting period.



Notes to the Financial Statements

For the year ended 31 December 2011

IV. Merger of Companies And Consolidated Financial Statement

1. Subsidiaries

(1) Subsidiaries acquired through establishment or investment

Full Name of Subsidiaries	Type	Registered Address	Business Nature	Registered Capital	Scope of Business	Actual capital contribution at the end of the year	Other balance items which constitute net investment in subsidiaries	Proportion of Shareholding (%)	Proportion of Voting Right (%)	Whether consolidated	Minority interests	Amount in minority interests used to write down the losses of minority interests	RMB
Shouguang Baolong (Note 1)	LLC	Shouguang City, Shandong Province	Manufacture	150,000,000.00	Manufacture and sales of petroleum equipment	105,000,000.00	—	70	70	Yes	56,643,649.13	Nil	
Molong Logistics Company (Note 2)	LLC (Legal entity wholly-owned)	Shouguang City, Shandong Province	Service	3,000,000.00	Goods storage (exclude contraband), cargo work, empty distribution and logistics information consultant	3,000,000.00	—	100	100	Yes	—	Nil	
Weihai Baolong (Note 3)	LLC	Weihai City, Shandong Province	Manufacture	26,000,000.00	Manufacture and sales of petroleum special metal materials	270,602,708.10	—	100	100	Yes	—	Nil	

Note 1: On 28 April 2007, the Company and Weifang Shengcheng Investment and Management Company Limited (hereunder "Shengcheng Investment Company") signed the "promoter agreement" to jointly invest and establish Shouguang Baolong, of which the Company contributed cash of RMB105,000,000.00, representing 70% of its equity capital, and Shengcheng Investment Company contributed cash of RMB12,600,000.00 and land use rights valued RMB32,400,000.00 (area of 120,105 sq.m), representing 30% of its equity capital. The land use rights contributed by Shengcheng Investment Company to Shouguang Baolong was transferred from Maolong Machinery Company (Maolong Machinery Company became the subsidiary of the Company since 31 December 2007), the related party of the Company to Shengcheng Investment Company on 5 January 2007 at RMB9,000,000.00. According to Shou Lu Hui Ping Zi [2007] No. 56 "Assets Valuation Report" (壽魯會評字[2007]第56號《資產評估報告書》), the land use rights were revalued on 15 September 2007 as RMB32,400,000.00. As at 25 September 2007, the above contributions have been imputed, and verified by Shouguang Ludong Accounting Firm (壽光魯東有限責任會計師事務所), which issued Shou Lu Hui Yan [2007] No. 105 Assets Examination Report (壽魯會驗[2007]第105號驗資報告).

Note 2: On 30 June 2011, the Company invested and established its wholly-owned subsidiaries Molong Logistics Company of RMB3,000,000.00. The above contributions have been imputed, and verified by Shouguang Ludong Accounting Firm (壽光魯東有限責任會計師事務所), which issued Shou Lu Hui Yan [2011] No. 222 Assets Examination Report (壽魯會驗[2011]第222號驗資報告).

Note 3: Weihai Baolong is a limited liability company, which was invested and established by four individual shareholders on 26 November 2003. According to the Equity Transfer Agreement signed by Maolong Machinery Company, Molong Electro-mechanical Equipment Company and the four individual shareholders of Weihai Baolong on 28 July 2005, Maolong Machinery Company and Molong Electro-mechanical Equipment Company purchase all the equity of Weihai Baolong, and Maolong Machinery and Molong Electro-mechanical hold 95% and 5% of its equity interests respectively. On 4 March 2011, according to the special resolution made by the first extraordinary shareholders' general meeting of 2011, the Company input capital to Weihai Baolong of RMB220,000,000, including additional share capital of RMB160,000,000 and additional capital reserve of RMB204,000,000. The above contributions have been imputed, and verified by Shouguang Shengcheng Accounting Firm (壽光聖城有限責任會計師事務所), which issued Shou Shengcheng Hui Yan Zi [2011] No. 017 Assets Examination Report (壽聖城會驗[2011]第017號驗資報告). Thus Weihai Baolong becomes a subsidiary of the Company from a subsidiary. And the Company, Maolong Machinery and Molong Electro-mechanical hold 61.54%, 36.54% and 1.92% of its equity interests respectively.

Note 4: Subsidiaries of the Company have not issued any securities during the year, and the balance of issued securities by 31 December 2011 is 0.

Notes to the Financial Statements



For the year ended 31 December 2011

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

1. Subsidiaries (continued)

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

Full Name of Subsidiaries	Type	Registered Address	Business Nature	Registered Capital	Scope of Business	Actual capital contribution at the end of the year	Other balance items which actually constitute net investment in subsidiaries	Proportion of Shareholding (%)	Proportion of Voting Right (%)	Whether consolidated	Minority interests	Amount in minority interests used to write down the losses of minority interests
Shouguang Maolong Machinery Company Limited (Note 1)	LLC (Legal entity wholly-owned)	Shouguang, Shandong Province	Manufacture	RMB12,380,000.00	Manufacture and sales of petroleum equipment and accessories; high-voltage isolating switch, voltage electrical appliances and complete equipment; processing and sales of alloy accessories	RMB306,743,691.73	—	100	100	Yes	Nil	Nil
Molong Electro-mechanical Equipment Company Limited (Note 2)	LLC (Sino-foreign joint venture)	Shouguang, Shandong Province	Manufacture	US\$1,000,000.00	Manufacture and sales of outer thickening oil well tubing and electrical complete equipment	RMB15,011,813.88	—	100	100	Yes	Nil	Nil
Shouguang Maolong Old Metals Recycle Company Limited (Note 3)	LLC	Shouguang, Shandong Province	Trade	RMB500,000.00	Trading of scrap metals	RMB500,000.00	—	100	100	Yes	Nil	Nil
Baolong Recyclable Resource Company Limited (Note 4)	LLC	Weihai, Shandong Province	Manufacture	RMB300,000.00	Trading and sales of scrap metals	RMB271,156.08	—	100	100	Yes	Nil	Nil
MPM International Limited (Note 5)	LLC	Hong Kong, PRC	Trade	US\$1,000,000.00	Acquisition and sales of petroleum extraction and chemical machinery electric equipment	RMB7,276,230.00	—	90	90	Yes	RMB1,319,686.04	Nil



Notes to the Financial Statements

For the year ended 31 December 2011

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

1. Subsidiaries (continued)

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

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

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

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

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

Note 5: On 24 May 2004, Jade Nominees Limited established Molong (Asia) Holding Limited in Hong Kong with an authorized capital of HK\$10,000, issued capital of HK\$1 and 1 share in issue.

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

On 15 May 2005, Molong (Asia) Holding Limited convened its first Board meeting and passed the following resolutions: Jade Nominees Limited would transfer its shares in Molong (Asia) Holding Limited to the Company, authorized number of shares would be increased to 7,990,000 shares of HK\$1 each and the authorized capital would be increased to HK\$8,000,000; number of shares in issue would be increased to 7,799,999 shares of HK\$1 each and share capital in issue would be increased to HK\$7,800,000. Under which, the Company subscribed for 90% of the share capital, and Maolong Machinery Company, the related party of the Company, subscribed for the remaining 10% of the share capital.

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

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

Note 6: Subsidiaries of the Company have not issued any securities during the year.

Notes to the Financial Statements



For the year ended 31 December 2011

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

2. Explanation on changes of the consolidation range

On 7 March 2011, Weifang Molong Drilling Equipment Company logged off by the Company, and will not be in the scope of combined financial statement from 7 March 2011. The book net asset of Molong Drilling Company amounted to RMB22,948,516.48 on disposal date, and net profit from 1 January 2011 to disposal date amounted to RMB0.00.

On 30 June 2011, the Company invested and established Molong Logistics Company, which be in the scope of combined financial statement of from 30 June 2011. Net loss of Molong Logistics Company from the date it established to 31 December 2011 amounted to RMB29,116.35.

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

When the Company prepared these combined financial statements, all assets and liabilities items within MPM Company's (operated overseas) balance sheet were exchanged at the rate of US\$1: RMB6.3009; all items within income statement and items that reflect the amount incurred by profit allocation were exchanged at the rate of US\$1: RMB6.4618.

V. Notes to the Financial Statements

1. Cash & cash equivalents

Consolidation

RMB

Item	Closing balance			Opening balance		
	Foreign currency amount	Exchange Rate	Amount in RMB	Foreign currency amount	Exchange Rate	Amount in RMB
Cash:						
RMB	153,603.44	1.0000	153,603.44	353,112.99	1.0000	353,112.99
Cash in Bank:						
RMB	182,144,267.32	1.0000	182,144,267.32	629,524,833.01	1.0000	629,524,833.01
USD	6,787,589.31	6.3009	42,767,930.02	813,920.62	6.6227	5,385,617.68
HKD	15,370.43	0.8107	12,460.81	17,368.05	0.8509	14,788.49
EURO	104.71	8.1625	854.70	100.32	8.8065	883.47
Other cash and cash equivalents (note):						
RMB	188,552,902.31	1.0000	188,552,902.31	257,007,354.29	1.0000	257,007,354.29
Total			413,632,018.60			892,286,589.93



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

1. Cash & cash equivalents (continued)

The Company

RMB

Item	Closing balance			Opening balance		
	Foreign currency amount	Exchange Rate	Amount in RMB	Foreign currency amount	Exchange Rate	Amount in RMB
Cash:						
RMB	54,105.00	1.0000	54,105.00	248,496.92	1.0000	248,496.92
Cash in Bank:						
RMB	161,653,147.49	1.0000	161,653,147.49	596,980,452.13	1.0000	596,980,452.13
USD	4,764,639.80	6.3009	30,021,518.88	668,180.25	6.6227	4,420,422.93
HKD	11,729.57	0.8107	9,509.16	11,727.19	0.8509	9,979.02
EURO	104.71	8.1625	854.70	100.32	8.8065	883.47
Other cash and cash equivalents (note):						
RMB	185,399,902.31	1.0000	185,399,902.31	235,507,354.29	1.0000	235,507,354.29
Total			377,139,037.54			837,167,588.76

Note: As at 31 December 2011, other monetary capital of the Group and the Company represented guarantee on bank acceptance, letter of guarantee and guarantee on loans. As at 31 December 2010, other monetary capital of the Group and the Company represented guarantee on bank's promissory notes and guarantee on loans.

As at 31 December 2011, both the Group and the Company had restricted guarantee on bank promissory notes with maturity over 3 months of RMB49,275,897.87. Both the Group and the Company had guarantee on loans with maturity over 3 months of RMB13,720,000.00. As at 31 December 2010, the Group and the Company had restricted guarantee on bank acceptance with maturity over 3 months of RMB112,341,458.60 and RMB102,341,458.60 respectively. The Group and the Company had guarantee on loans with maturity over 3 months of RMB25,720,000.00.

2. Bills receivable

(1) Classification of bills receivable

RMB

Item	Consolidated		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Bank acceptance	73,528,915.23	19,120,729.91	73,528,915.23	11,570,729.91

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

2. Bills receivable (continued)

- (2) As at 31 December 2011, the breakdown for bills endorsed to other parties but undue were as follows:

Consolidation and the Company

Name of Ticket Units	Date of draft	Due date	Amount
Shandong Xinmei Machinery Equipment Co., Ltd	2011-09-23	2012-03-23	8,000,000.00
Liulin Haobo Coke Co., Ltd	2011-08-01	2012-02-01	5,000,000.00
China Petroleum and Chemical Corporation Xi'an Petrochemical Branch	2011-09-22	2012-03-22	5,000,000.00
Dezhou Ruihua Automobile Sales and Service Co., Ltd	2011-10-25	2012-04-25	5,000,000.00
Zhejiang Chihui Trade Co., Ltd	2011-11-11	2012-05-11	5,000,000.00
Total			28,000,000.00

- (3) Balance of bills payable in the current reporting period does not have any amount due to bill of shareholders with over 5% (inclusive) voting rights in the Company.
- (4) During the current year, the Group and the Company has no discounted promissory notes (previous year: the Group have accumulatively discounted promissory notes of RMB68,244,972.00 to the bank). The Group and the Company has no discounted bills receivable derecognized (previous year: the Group have derecognized the discounted bills receivable of RMB68,244,972.00 to the bank), Discounting fees incurred amounted to RMB0.00 (previous year: discounting fees incurred by both the Group and the Company amounted to RMB1,034,174.46).



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

3. Accounts receivable

Consolidation

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

RMB

Category	Closing balance				Opening balance			
	Book balance		Bad debt provision		Book balance		Bad debt provision	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Single item with significant accounts receivable and provided for bad debt by single item	9,735,286.00	2.07	8,829,484.60	90.70	8,553,843.19	1.68	6,499,598.96	75.98
Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item	459,258,328.75	97.90	—	—	498,813,395.82	98.26	—	—
Single item with insignificant accounts receivables but provided for bad debt by single item	119,765.00	0.03	119,765.00	100.00	289,713.72	0.06	289,713.72	100.00
Total	469,113,379.75	100.00	8,949,249.60	1.91	507,656,952.73	100.00	6,789,312.68	1.34

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

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

Consolidation (continued)

Prior to the acceptance of new customers, the Group applies internal credit assessment policies to assess the credit quality of potential customers and formulates credit limit. Apart from requiring new customers to pay in advance, the Group formulates different credit policies according to different customers. The credit period is generally three months, and can be extended to six months for major customers. For domestic sales, the Group recognizes accounts receivable and operating revenue at the time point of outbound and acceptance of products, when calculation of the ages of the account begins; for export sales, the Group recognizes accounts receivable and operating revenue at the time point of customs clearance, when calculation of the ages of the account begins. Aging analysis of accounts receivable is as follows:

RMB

Aging	Closing balance				Opening balance			
	Amount	Ratio (%)	Bad debt provision	Bad debt provision	Amount	Ratio (%)	Bad debt provision	Bad debt provision
Within 1 year	444,600,302.69	94.77	—	444,600,302.69	469,500,329.21	92.48	—	469,500,329.21
1 to 2 years	8,210,585.63	1.75	—	8,210,585.63	16,100,799.42	3.17	—	16,100,799.42
2 to 3 years	5,247,762.19	1.12	1,358,702.10	3,889,060.09	20,708,830.99	4.08	6,576,638.96	14,132,192.03
Over 3 years	11,054,729.24	2.36	7,590,547.50	3,464,181.74	1,346,993.11	0.27	212,673.72	1,134,319.39
Total	469,113,379.75	100.00	8,949,249.60	460,164,130.15	507,656,952.73	100.00	6,789,312.68	500,867,640.05

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

As at 31 December 2011, single item with insignificant accounts receivable but provided for bad debt in single item is as follows:

RMB

Accounts receivable	Book balance	Bad debt balance	Provision ratio (%)	Reason
Trade receivable	119,765.00	119,765.00	100.00	Aged over three years, difficult to recover



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

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

RMB

Accounts receivable	Reason for write-back or recovery	Basis for determination of original bad debt	Accumulated amount of bad debt provision before write-back or recovery	Amount written-back or recovered
Trade receivable	Recover the amount	Relatively long aged, difficult to recover	214,574.71	214,574.71

(2) Situation of cancel after verification during the current year:

Name of Ticket Units	Accounts receivable properties	Amount of cancel after verification	Reason of cancel after verification	Whether produced by related transaction
America Bright Enterprises	Trade receivable	67,388.93	Payment can't be recovered	No

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

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

RMB

Name	Relationship with the Company	Amount	Aging	Percentage of the total balance of accounts receivable (%)
SB International Inc	customer	61,329,679.85	Within 1 year	13.07
PPC Limited	customer	58,278,808.58	Within 1 year	12.42
China National Petroleum Corporation — Qinghai Oil Field	customer	42,894,310.31	Within 1 year	9.14
Daqing Oil Field Petroleum Materials Group	customer	32,171,269.91	Within 1 year	6.86
China National Petroleum Corporation — Changqing Oil Field	customer	31,217,455.28	Within 1 year	6.65
Total		225,891,523.93		48.14

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

(5) Situation on accounts due from related parties:

RMB			
Name	Relationship with the Company	Amount	Proportion of the total accounts receivables (%)
Ya Long Oil Pump Company Limited	Related company	957,200.50	0.20

(6) Pledge on accounts receivable:

As at 31 December 2011, RMB12,853,836.00 and RMB13,971,815.15 of accounts receivable were pledged as borrowings of RMB12,853,836.00 and RMB11,177,452.23 of the Company from China Construction Bank Co., Ltd. and HSBC bank (China) Co., Ltd (outward documentary bill). These pledges will expire between 26 January 2012 and 12 January 2012 respectively.

The Company

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

Category	Closing balance				Opening balance			
	Book balance		Bad debt balance		Book balance		Bad debt balance	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Single item with significant accounts receivable and provided for bad debt by single item	9,735,286.00	2.09	8,829,484.60	90.70	8,553,843.19	1.71	6,499,598.96	75.98
Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item	456,360,842.74	97.90	—	—	493,046,705.41	98.28	—	—
Single item with insignificant accounts receivables but provided for bad debt in single item	63,065.00	0.01	63,065.00	100.00	69,255.56	0.01	69,255.56	100.00
Total	466,159,193.74	100.00	8,892,549.60	1.91	501,669,804.16	100.00	6,568,854.52	1.31



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

The Company (continued)

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

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

Prior to the acceptance of new customers, the Group applies internal credit assessment policies to assess the credit quality of potential customers and formulates credit limit. Apart from requiring new customers to pay in advance, the Group formulates different credit policies according to different customers. The credit period is generally three months, and can be extended to six months for major customers. For domestic sales, the Group recognizes accounts receivable and operating revenue at the time point of outbound and acceptance of products, when calculation of the ages of the account begins; for export sales, the Group recognizes accounts receivable and operating revenue at the time point of customs clearance, when calculation of the ages of the account begins. Aging analysis of accounts receivable is as follows:

RMB

Aging	Closing balance				Opening balance			
	Amount	Ratio (%)	Bad debt provision	Book value	Amount	Ratio (%)	Bad debt provision	Book value
Within 1 year	442,527,267.69	94.93	—	442,527,267.69	466,102,190.11	92.91	—	466,102,190.11
1 to 2 years	7,387,730.62	1.58	—	7,387,730.62	14,760,879.44	2.94	—	14,760,879.44
2 to 3 years	5,246,166.19	1.13	1,358,702.10	3,887,464.09	19,603,159.66	3.91	6,499,598.96	13,103,560.70
Over 3 years	10,998,029.24	2.36	7,533,847.50	3,464,181.74	1,203,574.95	0.24	69,255.56	1,134,319.39
Total	466,159,193.74	100.00	8,892,549.60	457,266,644.14	501,669,804.16	100.00	6,568,854.52	495,100,949.64

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

As at 31 December 2011, single item with insignificant accounts receivable but provided for bad debt in single is as follows:

RMB

Accounts receivable	Book balance	Bad debt balance	Provision ratio (%)	Reason
Trade receivable	63,065.00	63,065.00	100.00	Aged over three years, difficult to recover

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

The Company (continued)

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

RMB

Accounts receivable	Reason for write-back or recovery	Basis for determination of original bad debt Provision	Accumulated amount of bad debt provision before write-back or recovery	Amount written-back or recovered
Trade receivable	Recover the amount	Relatively long aged, difficult to recover	50,816.55	50,816.55

(3) Situation of cancel after verification are the same as notes to combined financial statements.

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

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

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

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

4. Advance payment

Consolidation

(1) Advance to suppliers stated according to aging:

RMB

Aging	Closing balance		Opening balance	
	Amount	Ratio (%)	Amount	Ratio (%)
Within 1 year	42,099,676.98	99.93	158,298,872.41	99.81
1 to 2 years	—	—	201,885.93	0.13
2 to 3 years	—	—	—	—
Over 3 years	28,214.22	0.07	100,754.22	0.06
Total	42,127,891.20	100.00	158,601,512.56	100.00



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

4. Advance payment (continued)

Consolidation (continued)

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

RMB

Name	Relationship with the Company	Amount	Aging	Reasons
Shandong Longsheng Steel Co., Ltd	Supplier	6,625,370.36	within 1 year	hasn't received material
Rushan City Yuandong Cast Co., Ltd	Supplier	5,448,307.16	within 1 year	hasn't accepted labour
Wendeng City Electric Corporation	Supplier	4,829,936.45	within 1 year	hasn't received power
Shandong Guangfu Co., Ltd	Supplier	4,311,001.16	within 1 year	hasn't received material
Shouguang Shihua Natural Gas Company Limited	Supplier	4,168,960.37	within 1 year	hasn't received material
Total		25,383,575.50		

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

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

RMB

Category	Closing balance		Opening balance	
	Amount	Ratio (%)	Amount	Ratio (%)
Single item with significant advance payment	28,949,865.84	68.72	142,156,958.18	89.63
Single item without significant advance payment but considered to be greater risks after arrived at by credit risk characteristics	28,214.22	0.07	302,640.15	0.19
Other items without significant	13,149,811.14	31.21	16,141,914.23	10.18
Total	42,127,891.20	100.00	158,601,512.56	100.00

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

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

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

4. Advance payment (continued)

Consolidation (continued)

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

The Company

(1) Advance to suppliers stated according to aging:

Aging	Closing balance		Opening balance	
	Amount	Ratio (%)	Amount	Ratio (%)
	RMB			
Within 1 year	8,725,031.49	99.88	101,360,039.61	99.79
1 to 2 years	—	—	201,885.93	0.20
2 to 3 years	—	—	—	—
Over 3 years	10,683.61	0.12	10,683.61	0.01
Total	8,735,715.10	100.00	101,572,609.15	100.00

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

Name	Relationship with the Company	Amount	Aging	Reasons
Shouguang Shihua Natural Gas Company Limited	Supplier	4,168,960.37	within 1 year	hasn't received material
Jiangyin Xingcheng Special Steel Company Limited	Supplier	2,610,940.70	within 1 year	hasn't received material
Kunlun Lubricating Oil Sales Co., Ltd. Shandong	Supplier	357,105.00	within 1 year	hasn't received material
Sinopec Corp — Weifang Oil Branch	Supplier	287,002.90	within 1 year	hasn't accepted material
Shandong Juneng Special Steel Co., Ltd	Supplier	239,448.60	within 1 year	hasn't received material
Total		7,663,457.57		

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



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

4. Advance payment (continued)

The Company (continued)

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

Category	Closing balance		Opening balance		RMB
	Amount	Ratio (%)	Amount	Ratio (%)	
Single item with significant advance payment	4,168,960.37	47.72	91,957,166.39	90.53	
Single item without significant advance payment but considered to be greater risks after arrived at by credit risk characteristics	10,683.61	0.12	212,569.54	0.21	
Other items without significant	4,556,071.12	52.16	9,402,873.22	9.26	
Total	8,735,715.10	100.00	101,572,609.15	100.00	

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

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

(5) There is no prepayment to related parties.

5. Dividends receivable

Consolidation

Item	Opening balance	Additions for the period	Deductions for the period	Closing balance	Reason for no recovery	Whether relevant amount has impaired
						RMB
Dividends receivable with aging within 1 year including: Kelamayi Ya Long Oil Pump Company Limited ("Yalong Oil Pump")	150,000.00	150,000.00	300,000.00	—		
	150,000.00	150,000.00	300,000.00	—	Nil	Nil
Total	150,000.00	150,000.00	300,000.00	—		

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

6. Other receivables

Consolidation

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

RMB

Category	Closing balance				Opening balance			
	Book balance		Bad debt balance		Book balance		Bad debt balance	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Single item with significant other receivables and provided for bad debt in single item	—	—	—	—	—	—	—	—
Single item with insignificant other receivables and single item with significant other receivables but not impaired after separate impairment test	29,820,567.73	99.60	—	—	30,281,650.63	99.61	—	—
Single item with insignificant other receivables but provided for bad debt in single item	119,119.25	0.40	119,119.25	100.00	119,119.25	0.39	119,119.25	100.00
Total	29,939,686.98	100.00	119,119.25	0.40	30,400,769.88	100.00	119,119.25	0.39

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

Aging analysis of accounts receivable is as follows:

RMB

Aging	Amount	Closing balance			Opening balance			
		Ratio (%)	Bad debt balance	Book Value	Amount	Ratio (%)	Bad debt balance	Book Value
Within 1 year	11,413,126.53	38.12	—	11,413,126.53	23,434,196.12	77.08	—	23,434,196.12
1 to 2 years	13,232,789.36	44.20	—	13,232,789.36	4,322,190.74	14.22	—	4,322,190.74
2 to 3 years	2,797,191.34	9.34	—	2,797,191.34	2,149,853.50	7.07	—	2,149,853.50
Over 3 years	2,496,579.75	8.34	119,119.25	2,377,460.50	494,529.52	1.63	119,119.25	375,410.27
Total	29,939,686.98	100.00	119,119.25	29,820,567.73	30,400,769.88	100.00	119,119.25	30,281,650.63



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

6. Other receivables (continued)

Consolidation (continued)

As at 31 December 2011, single item with insignificant other receivables but provided for bad debt in single item is the same as follows.

RMB

Other receivables	Book balance	Bad debt balance	Provision ratio (%)	Reason
Staff's personal borrowings	119,119.25	119,119.25	100.00	Aged over three years, difficult to recover

(2) During the current reporting period, there is no amount due from the balance of other receivables from shareholder units holding 5% (including 5%) or more shares in the Company.

(3) Other receivable of relatively material amount of the Group mainly comprises of rebates on value-added tax in relation to scrap metal enterprise due from Finance Bureau of Shouguang City, land removal advance due from Gucheng Street Offices, tender bond receivable from CPMC, temporary borrowing receivable from Wendeng City Gaocun Town Government, and interests receivable from China Construction Bank Shouguang Branch.

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

RMB

Name	Relationship with the Company	Amount	Aging	Percentage of the total balance of accounts receivable
Shouguang Finance Bureau	Non-related party	7,804,984.16	within 2 year	26.07
Gucheng Street Offices	Non-related party	6,891,320.00	within 4 year	23.02
China Petroleum Materials Corporation	Non-related party	6,000,000.00	within 2 year	20.04
Wendeng City Gaocun Town Government	Non-related party	3,000,000.00	within 1 year	10.02
China Construction Bank Shouguang Branch	Non-related party	612,900.56	within 1 year	2.05
Total		24,309,204.72		81.20

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

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

6. Other receivables (continued)

The Company

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

RMB

Category	Closing balance				Opening balance			
	Book balance		Bad debt balance		Book balance		Bad debt balance	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Single item with significant other receivables and provided for bad debt by single item	—	—	—	—	—	—	—	—
Single item with insignificant other receivables and single item with significant other receivables but is not impaired after separate impairment test	17,510,729.92	99.32	—	—	18,186,384.98	99.35	—	—
Single item with insignificant other receivables but provided for bad debt by single item	119,119.25	0.68	119,119.25	100.00	119,119.25	0.65	119,119.25	100.00
Total	17,629,849.17	100.00	119,119.25	0.68	18,305,504.23	100.00	119,119.25	0.65

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

Aging analysis of other receivables is as follows:

RMB

Aging	Closing balance				Opening balance			
	Amount	Ratio (%)	Bad debt balance	Book Value	Amount	Ratio (%)	Bad debt balance	Book Value
Within 1 year	7,402,640.62	41.99	—	7,402,640.62	13,082,720.87	71.46	—	13,082,720.87
1 to 2 years	5,237,873.84	29.71	—	5,237,873.84	2,851,739.34	15.58	—	2,851,739.34
2 to 3 years	2,766,093.96	15.69	—	2,766,093.96	2,148,221.50	11.74	—	2,148,221.50
Over 3 years	2,223,240.75	12.61	119,119.25	2,104,121.50	222,822.52	1.22	119,119.25	103,703.27
Total	17,629,849.17	100.00	119,119.25	17,510,729.92	18,305,504.23	100.00	119,119.25	18,186,384.98

As at 31 December 2011, single item with insignificant other receivables but provided for bad debt in single item is the same as noted to financial statements.

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



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

6. Other receivables (continued)

The Company (continued)

- (3) Other receivable of relatively material amount of the Company mainly comprises of land removal advances due from Gucheng Street Offices, tendering guarantee due from China Petroleum Materials Corporation, and interests receivable from China Construction Bank Shouguang Branch, Beijing Bank Jinan Branch and Bank of China Shouguang Branch.
- (4) Top 5 other receivables are set out as follows:

Name	Relationship with the Company	Amount	Aging	RMB
				Percentage of the total balance of Accounts receivable (%)
Gucheng Street Offices	Non-related party	6,891,320.00	within 4 year	39.09
China Petroleum Materials Corporation	Non-related party	6,000,000.00	within 2 year	34.03
China Construction Bank Shouguang Branch	Non-related party	612,900.56	within 1 year	3.48
Beijing Bank Jinan Branch	Non-related party	494,928.50	within 1 year	2.81
Bank of China Shouguang Branch	Non-related party	441,368.98	within 1 year	2.50
Total		14,440,518.04		81.91

- (5) Payment receivables from related parties:

Name	Relationship with the Company	Amount	Percentage of the total balance of Accounts receivable (%)
			(%)
Molong Logistics Company	Subsidiary	20,000.00	0.11

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

7. Inventory

Consolidation

(1) Inventory categories:

RMB

Item	Closing balance			Opening balance		
	Book balance	Allowance for inventories	Book value	Book balance	Allowance for inventories	Book value
Raw materials	317,932,966.06	1,347,882.94	316,585,083.12	244,146,298.70	916,732.12	243,229,566.58
Work-in-progress	444,056,692.70	632,526.25	443,424,166.45	265,326,710.41	872,825.06	264,453,885.35
Consigned processing materials	56,203,898.79	—	56,203,898.79	15,619,636.34	—	15,619,636.34
Finished product	362,249,067.17	1,480,361.01	360,768,706.16	221,921,817.72	1,671,358.52	220,250,459.20
Total	1,180,442,624.72	3,460,770.20	1,176,981,854.52	747,014,463.17	3,460,915.70	743,553,547.47

(2) Allowance for inventories is as follows:

RMB

Inventory categories	Opening book balance	Provision for the current period	Decrease for the period		Closing book balance
			Reversals	Write-offs	
Raw materials	916,732.12	932,945.28	158,772.31	343,022.15	1,347,882.94
Work-in-progress	872,825.06	102,388.26	175,896.36	166,790.71	632,526.25
Finished product	1,671,358.52	563,457.46	597,441.91	157,013.06	1,480,361.01
Total	3,460,915.70	1,598,791.00	932,110.58	666,825.92	3,460,770.20

(3) Allowance for inventories:

RMB

Item	Basis of allowance for inventories	Reason of reversal of allowance for inventories for the current period	Percentage of the reversal in the current period to the closing balance of such inventory (%)
Raw materials	Relatively long inventory age	Value has rebounded and is higher than cost	0.05
Work-in-progress	Cost is higher than net realizable value	Value has rebounded and is higher than cost	0.04
Finished product	Cost is higher than net realizable value	Value has rebounded and is higher than cost	0.16



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

7. Inventory (continued)

The Company

(1) Inventory categories:

RMB

Item	Closing balance		Opening balance			
	Book balance	Allowance for inventories	Book balance	Book balance	Allowance for inventories	Book balance
Raw materials	210,638,707.71	1,202,576.97	209,436,130.74	181,513,472.81	478,729.14	181,034,743.67
Work-in-progress	405,680,962.15	565,531.52	405,115,430.63	256,072,176.42	650,512.06	255,421,664.36
Consigned processing materials	56,169,021.96	—	56,169,021.96	15,083,226.29	—	15,083,226.29
Finished product	289,712,192.05	1,369,281.81	288,342,910.24	162,641,708.88	1,385,309.57	161,256,399.31
Total	962,200,883.87	3,137,390.30	959,063,493.57	615,310,584.40	2,514,550.77	612,796,033.63

(2) Allowance for inventories:

RMB

Inventory categories	Opening book balance	Provision for the current period	Decrease for the period		Closing book balance
			Reversals	Write-offs	
Raw materials	478,729.14	932,945.28	115,428.99	93,668.46	1,202,576.97
Work-in-progress	650,512.06	102,388.26	126,572.05	60,796.75	565,531.52
Finished product	1,385,309.57	563,457.46	458,730.26	120,754.96	1,369,281.81
Total	2,514,550.77	1,598,791.00	700,731.30	275,220.17	3,137,390.30

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

Item	Basis of allowance for inventories	Reason of reversal of allowance for inventories for the current period	Percentage of the reversal in the current period to the closing balance of such inventory (%)
Raw materials	Relatively long inventory age	Value has rebounded and is higher than cost	0.05
Work-in-progress	Cost is higher than net realizable value	Value has rebounded and is higher than cost	0.03
Finished product	Cost is higher than net realizable value	Value has rebounded and is higher than cost	0.16

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

8. Other current assets

RMB

Item	Consolidation		the Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Input tax pending deduction	71,148,262.69	36,978,684.73	38,931,374.18	25,599,842.89
Prepaid land usage tax	543,057.88	2,185,679.28	543,057.88	2,185,679.28
Prepaid income tax	539,301.51	995,000.00	—	—
Other prepaid tax	308,174.09	895,272.99	—	50,625.49
Total	72,538,796.17	41,054,637.00	39,474,432.06	27,836,147.66

9. Investment in equity joint ventures and investment in associates

Consolidation

RMB

Name of investee entity	Percentage of the shareholding of the investee entity (%)	Percentage of voting rights of the investee entity (%)	Total assets at the end of period	Total liabilities at the end of period	Total net asset value at the end of period	Operating income for the current period	Net profit from the current period
<i>Consortium</i>							
Yalong Oil Pump	30.00	30.00	16,329,268.74	7,962,511.08	8,366,757.66	16,455,520.39	844,480.96



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

10. Long-term equity investment

Consolidation

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

RMB

Investee entity (non-listed company)	Accounting method	Investment	Opening balance	Change	Closing balance	Percentage of shareholding in the investee entity (%)	Percentage of voting right in the investee entity (%)	Explanation of the inconsistence of shareholding percentage and voting right in the investee entity	Impairment provision	Provision of impairment for the current period	Cash bonuses for the current period
Yalong Oil Pump Shouguang Mihe Water Company Limited ("Mihe Water")	Equity method	1,888,500.00	2,477,279.82	103,344.29	2,580,624.11	30.00	30.00	N/A	—	—	150,000.00
	Cost method	10,000,000.00	10,000,000.00	—	10,000,000.00	9.73	9.73	N/A	—	—	—
Total		11,888,500.00	12,477,279.82	103,344.29	12,580,624.11	—	—	—	—	—	150,000.00

(2) There is no restriction on the ability of the investee in which the long-term equity investments are held by the Group and the Company as at 31 December 2011 to transfer capital to the Group.

The Company

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

RMB

Investee entity	Accounting method	Investment cost	Opening balance	Change	Closing balance	Percentage of shareholding in the investee entity (%)	Percentage of voting right in the investee entity (%)	Explanation of the inconsistence of shareholding percentage and voting right in the investee entity	Impairment provision	Provision of impairment for the current period	Cash bonuses for the current period
Molong Drilling Equipment	Cost method	6,397,082.50	6,397,082.50	(6,397,082.50)	—	N/A	N/A	N/A	—	—	—
Molong Logistics Company	Cost method	3,000,000.00	—	3,000,000.00	3,000,000.00	100.00	100.00	—	—	—	—
MPM International Limited	Cost method	7,276,230.00	7,276,230.00	—	7,276,230.00	90.00	90.00	N/A	—	—	—
Shouguang Baolong Company Limited	Cost method	105,000,000.00	105,000,000.00	—	105,000,000.00	70.00	70.00	N/A	—	—	—
Shouguang Maolong Machinery Company Limited	Cost method	306,743,691.73	306,743,691.73	—	306,743,691.73	100.00	100.00	N/A	—	—	3,156,000.00
Shouguang Maolong Old Metals Recycle Company Limited	Cost method	50,000.00	50,000.00	—	50,000.00	10.00	10.00	N/A	—	—	—
Weihai Baolong Company Limited	Cost method	220,000,000.00	—	220,000,000.00	220,000,000.00	61.54	61.54	—	—	—	—
Mihe Water	Cost method	10,000,000.00	10,000,000.00	—	10,000,000.00	9.73	9.73	N/A	—	—	—
Total		658,467,004.23	435,467,004.23	216,602,917.50	652,069,921.73	—	—	—	—	—	3,156,000.00

(2) There is no restriction on the ability of the investee in which the long-term equity investments are held by the Group and the Company as at 31 December 2011 to transfer capital to the Group.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

11. Investment Properties

The Company

Item	Opening carrying amount	Increase in the current year	Decrease in the current year	RMB
				Closing carrying amount
I. Total original carrying amount:	8,069,389.56	—	8,069,389.56	—
Buildings	8,069,389.56	—	8,069,389.56	—
II. Total accumulated depreciation:	1,879,723.24	91,235.10	1,970,958.34	—
Buildings	1,879,723.24	91,235.10	1,970,958.34	—
III. Total net book value of investment properties	6,189,666.32	—	—	—
Buildings	6,189,666.32	—	—	—
IV. Total accumulated provision for impairment losses of investment properties	—	—	—	—
Buildings	—	—	—	—
V. Total net book value of investment properties	6,189,666.32	—	—	—
Buildings	6,189,666.32	—	—	—

The depreciation for the current period amounted to RMB91,235.10.

The original book value over the current year decreased by RMB8,069,389.56 as investment properties transferred to real estate for private use, including the transferred original value of fixed assets of RMB7,431,471.53, and the transferred original value of intangible assets of RMB637,918.03.

The accumulated depreciation decreased by RMB1,970,958.34 in the current year as investment properties transferred to real estate for private use, including the transferred original value of fixed assets of RMB1,890,987.24, and the transferred original value of intangible assets of RMB79,971.10.



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

12. Fixed Assets

Consolidation

(1) Overview of fixed assets:

Item	RMB				
	Opening book balance	Additions for the current year	Deductions for the current year	Closing book balance	
I. Total original book value:	2,013,174,926.54	341,211,962.30	31,169,842.15	2,323,217,046.69	
Of which: Buildings	336,581,660.30	60,671,313.99	1,312,305.70	395,940,668.59	
Machinery and equipment	1,605,185,073.35	263,916,413.59	28,935,840.29	1,840,165,646.65	
Electronic equipment and others	60,915,096.81	12,537,019.74	636,733.16	72,815,383.39	
Vehicles	10,493,096.08	4,087,214.98	284,963.00	14,295,348.06	
II. Total accumulated depreciation:	345,357,993.89	Additions for the current year	Provision for the current year	16,705,772.34	475,642,567.92
Of which: Buildings	43,124,491.62	—	15,577,827.02	235,850.84	58,466,467.80
Machinery and equipment	271,009,846.57	—	118,025,712.01	15,595,835.75	373,439,722.83
Electronic equipment and others	25,748,550.35	—	11,141,866.55	631,245.14	36,259,171.76
Vehicles	5,475,105.35	—	2,244,940.79	242,840.61	7,477,205.53
III. Total fixed assets — net book value	1,667,816,932.65				1,847,574,478.77
Of which: Buildings	293,457,168.68				337,474,200.79
Machinery and equipment	1,334,175,226.78				1,466,725,923.82
Electronic equipment and others	35,166,546.46				36,556,211.63
Vehicles	5,017,990.73				6,818,142.53
IV. Total Impairment provision	19,233,321.66		—	3,026,985.85	16,206,335.81
Of which: Buildings	4,986,478.28		—	—	4,986,478.28
Machinery and equipment	14,246,843.38		—	3,026,985.85	11,219,857.53
Electronic equipment and others	—		—	—	—
Vehicles	—		—	—	—
V. Total fixed assets — net book value	1,648,583,610.99				1,831,368,142.96
Of which: Buildings	288,470,690.40				332,487,722.51
Machinery and equipment	1,319,928,383.40				1,455,506,066.29
Electronic equipment and others	35,166,546.46				36,556,211.63
Vehicles	5,017,990.73				6,818,142.53

Note 1: The original book value over the current year increased as acquisition increased by RMB38,219,857.86, while the transfer in of construction in progress increased by RMB302,992,104.44.

Note 2: The original book value over the current year decreased as the disposal led to a decrease of RMB9,516,693.52, decreased of RMB21,015,230.60 as the transfer in of construction in progress and inventory, while the transfer of intangible assets increased by RMB637,918.03.

Note 3: The accumulated depreciation increased over the current year as the provision over the current year amounted to RMB146,990,346.37.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

12. Fixed Assets (continued)

Consolidation (continued)

Note 4: The accumulated depreciation decreased over the current year as the disposal led to decrease of RMB4,657,848.13 and the transfer to construction in progress and inventory led to decrease of RMB79,971.10.

Note 5: The impairment provision decreased over the current year as the disposal led to decrease of RMB1,672,245.85 and the transfer to construction in progress led to decrease of RMB1,354,740.00.

Note 6: The surplus amortized deadlines of land-use right of the above buildings were 39.75 years to 49.5 years.

(2) Fixed assets without duly prepared title certificates

Item	Original value	Reason for title certificate not duly prepared	RMB
			Estimate time for preparing title certificates
Steel structure major plant zone	74,812,100.42	Is still in the process	2012
Office Building	1,231,239.29	Is still in the process	2012
180 electric rooms	2,345,130.32	Is still in the process	2012
Major electricity room	3,311,410.87	Is still in the process	2012
Steel pipes storage	2,982,953.13	Is still in the process	2012
Workshop for pumping unit and sucker rod	19,441,974.91	New Construction	2013
Finish machining plant	11,833,530.03	New Construction	2012
Casing and tubing storage	13,234,817.30	New Construction	2012
Dormitory building	6,095,893.00	New Construction	2012
Road surface and country yard wall	1,738,000.00	New Construction	2012
140 Plant	10,548,959.62	New Construction	2013
Bathroom, Gatehouse, washroom, and so on	1,407,361.48	New Construction	2012
Total	148,983,370.37		



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

12. Fixed Assets (continued)

The Company

(1) Overview of fixed assets:

Item					RMB
	Opening book balance		Additions for the current year	Deductions for the current year	Closing book balance
I. Total original book value:	1,518,888,759.74		170,592,769.74	25,952,739.15	1,663,528,790.33
Of which: Buildings	236,499,787.76		56,702,802.60	—	293,202,590.36
Machinery and equipment	1,251,623,376.61		100,666,104.91	25,187,238.07	1,327,102,243.45
Electronic equipment and others	23,043,980.63		9,301,889.73	552,538.08	31,793,332.28
Vehicles	7,721,614.74		3,921,972.50	212,963.00	11,430,624.24
II. Total accumulated depreciation:	213,815,195.32	Additions for the current year	Provision for the current year	15,988,572.46	312,659,529.62
Of which: Buildings	28,216,957.35	1,890,987.24	11,209,941.03	—	41,317,885.62
Machinery and equipment	172,886,703.03	8,721,956.19	87,163,451.51	15,287,025.66	253,485,085.07
Electronic equipment and others	8,619,717.71	182,374.74	3,900,080.28	523,506.19	12,178,666.54
Vehicles	4,091,817.23	—	1,764,115.77	178,040.61	5,677,892.39
III. Total fixed assets — net book value	1,305,073,564.42		—	—	1,350,869,260.71
Of which: Buildings	208,282,830.41		—	—	251,884,704.74
Machinery and equipment	1,078,736,673.58		—	—	1,073,617,158.38
Electronic equipment and others	14,424,262.92		—	—	19,614,665.74
Vehicles	3,629,797.51		—	—	5,752,731.85
IV. Total Impairment provision	—		—	—	—
Of which: Buildings	—		—	—	—
Machinery and equipment	—		—	—	—
Electronic equipment and others	—		—	—	—
Vehicles	—		—	—	—
V. Total fixed assets — net book value	1,305,073,564.42		—	—	1,350,869,260.71
Of which: Buildings	208,282,830.41		—	—	251,884,704.74
Machinery and equipment	1,078,736,673.58		—	—	1,073,617,158.38
Electronic equipment and others	14,424,262.92		—	—	19,614,665.74
Vehicles	3,629,797.51		—	—	5,752,731.85

Note 1: Original book value for the year increased, an increase of RMB29,803,076.45 was due to acquisition, an increase of RMB120,874,162.52 was due to construction in progress transferred to fixed assets, an increase of RMB7,431,471.53 was due to investment properties transferred to fixed assets, an increase of RMB12,484,059.24 was due to acquisition of the assets of Molong Drilling Company.

Note 2: Original book value for the year decreased, a decrease of RMB6,388,248.55 was due to disposal of fixed assets, a decrease of RMB19,564,490.60 was due to the transfer in of construction in progress and inventory.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

12. Fixed Assets (continued)

The Company (continued)

Note 3: Accumulated depreciation for the period increased, an amount of RMB104,037,588.59 was provided for during the period, an increase of RMB1,890,987.24 was due to investment properties transferred to fixed assets, an increase of RMB8,904,330.93 was due to combined the assets of Molong Drilling Company.

Note 4: Accumulated depreciation for the period decreased, a decrease of RMB4,657,848.13 was due to disposal, a decreased of RMB11,330,724.33 was due to the transfer to of construction in progress and inventory.

Note 5: The surplus amortized deadlines of land-use right of above buildings were 39.75 years to 49.5 years.

(2) Fixed assets without duly prepared title certificates

Item	Original value	Reason for title certificate not duly prepared	RMB
			Estimate time for preparing title certificates
Steel structure major plant zone	74,812,100.42	Is still in the process	2012
Office Building	1,231,239.29	Is still in the process	2012
180 electric rooms	2,345,130.32	Is still in the process	2012
Major electricity room	3,311,410.87	Is still in the process	2012
Steel pipes warehouse	2,982,953.13	Is still in the process	2012
Workshop for pumping unit and sucker rod	19,441,974.91	New Building	2013
Finish machining plant	11,833,530.03	New Building	2012
Casing and tubing storage	13,234,817.30	New Building	2012
Road surface and country yard wall	1,738,000.00	New Building	2012
Bathroom, Gatehouse, washroom, etc.	1,288,361.49	New Building	2012
Total	132,219,517.76		



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

13. Construction in progress

Consolidation

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

Items	Closing balance			Opening balance			RMB
	Book balance	Impairment provision	Net book value	Book balance	Impairment provision	Net book value	
	180mm heat treatment machining project	40,665,467.84	—	40,665,467.84	—	—	—
OCTG finish machining line	24,353,797.05	—	24,353,797.05	31,328,238.46	—	31,328,238.46	
High-end petroleum equipment project	503,219.19	—	503,219.19	2,885,000.00	—	2,885,000.00	
1200 mm forging expansion project	81,339.21	—	81,339.21	—	—	—	
140mm Petroleum pipes processing project	—	—	—	84,332,699.43	—	84,332,699.43	
Others	17,919,257.56	—	17,919,257.56	12,900,304.63	—	12,900,304.63	
Total	83,523,080.85	—	83,523,080.85	131,446,242.52	—	131,446,242.52	

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

13. Construction in progress (continued)

Consolidation (continued)

(2) Change in material constructions in progress projects:

Project name	Budget amount	Opening balance	Additions for the current period	Transfer to fixed assets	Transfer to intangible assets	Investment to budgeted costs (%)	Progress (%)	Accumulated capitalized interest amount	Of which: capitalized interest amount for current year	Sources of Fund	Closing balance
180mm heat treatment machining project	71,950,000.00	—	40,665,467.84	—	57	57	871,073.41	871,073.41	5.73%	Loan from financial institution and Self-raised	40,665,467.84
1200 mm forging expansion project	180,320,000.00	—	81,339.21	—	—	—	2,814.93	2,814.93	5.73%	Loan from financial institution and Self-raised	81,339.21
140mm Petroleum pipes processing project	170,000,000.00	84,332,699.43	91,632,595.52	175,965,294.95	104	100	831,179.98	—	—	Loan from financial institution and Self-raised	—
High-end petroleum equipment project	60,000,000.00	2,885,000.00	47,952,400.00	50,334,180.81	85	85	322,411.05	322,411.05	5.73%	Loan from financial institution and Self-raised	503,219.19
OCTG finish machining line	108,510,000.00	31,328,238.46	60,727,260.35	67,701,701.76	85	85	4,523,775.04	3,041,246.37	5.73%	Loan from financial institution and Self-raised	24,353,797.05
Others	—	12,900,304.63	14,009,879.85	8,990,926.92	—	—	508,828.17	508,828.17	5.73%	Loan from financial institution and Self-raised	17,919,257.56
Total	—	131,446,242.52	255,068,942.77	302,992,104.44	—	—	7,060,082.58	4,746,373.93	—	—	83,523,080.85



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

13. Construction in progress (continued)

The Company

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

Items	Closing balance			Opening balance			RMB
	Book balance	Impairment		Book balance	Impairment		Net book value
		provision	Net book value		provision	Net book value	
180mm heat treatment machining project	40,665,467.84	—	40,665,467.84	—	—	—	
OCTG finish machining line	26,374,341.84	—	26,374,341.84	31,328,238.46	—	31,328,238.46	
High-end petroleum equipment project	503,219.19	—	503,219.19	2,885,000.00	—	2,885,000.00	
Φ 1200 mm forging expansion project	81,339.21	—	81,339.21	—	—	—	
Others	17,101,949.84	—	17,101,949.84	10,170,243.84	—	10,170,243.84	
Total	84,726,317.92	—	84,726,317.92	44,383,482.30	—	44,383,482.30	

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

13. Construction in progress (continued)

The Company (continued)

(2) Change in material constructions in progress projects:

Project name	Budget amount	Opening balance	Additions for current year	Transfer to fixed assets	Investment to budgeted costs (%)	Progress (%)	Accumulated capitalized interest amount	Of which: capitalized interest amount for the current year	Capitalized interest amount for the current year (%)	Sources of fund	Closing balance	RMB
180mm heat treatment machining project	71,950,000.00	—	40,665,467.84	—	57	57	871,073.41	871,073.41	5.73%	Loan from financial institution and Self-raised	40,665,467.84	
High-end petroleum equipment project	60,000,000.00	2,885,000.00	47,952,400.00	50,334,180.81	85	85	322,411.05	322,411.05	5.73%	Loan from financial institution and Self-raised	503,219.19	
OCTG finish machining line	108,510,000.00	31,328,238.46	62,747,805.14	67,701,701.76	87	87	4,523,775.04	3,041,246.37	5.73%	Loan from financial institution and Self-raised	26,374,341.84	
1200 mm forging expansion project	180,320,000.00	—	81,339.21	—	—	—	2,814.93	2,814.93	5.73%	Loan from financial institution and Self-raised	81,339.21	
Others	—	10,170,243.84	9,769,985.95	2,838,279.95	—	—	508,828.17	508,828.17	5.73%	Loan from financial institution and Self-raised	17,101,949.84	
Total	44,383,482.30	161,216,998.14	120,874,162.52	6,228,902.60	4,746,373.93	84,726,317.92						



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

14. Intangible assets

Consolidation

(1) Intangible assets

RMB

Items	Opening book balance	Additions for the current period	Deductions for the current period	Closing book balance
I. Total original book value:	276,712,246.88	109,117,433.96	—	385,829,680.84
Land use rights	187,536,595.46	36,749,893.03	—	224,286,488.49
Software	702,088.00	67,948.72	—	770,036.72
Non-patent technology	88,454,913.42	71,266,492.21	—	159,721,405.63
Patent technology	18,650.00	1,033,100.00	—	1,051,750.00
II. Total accumulated amortization	26,794,116.91	26,015,624.90	—	52,809,741.81
Land use rights	9,398,378.23	4,105,065.15	—	13,503,443.38
Software	702,088.00	8,333.32	—	710,421.32
Non-patent technology	16,688,497.41	21,823,400.91	—	38,511,898.32
Patent technology	5,153.27	78,825.52	—	83,978.79
III. Total intangible assets net book value	249,918,129.97	—	—	333,019,939.03
Land use rights	178,138,217.23	—	—	210,783,045.11
Software	—	—	—	59,615.40
Non-patent technology	71,766,416.01	—	—	121,209,507.31
Patent technology	13,496.73	—	—	967,771.21
IV. Total impairment provision	—	—	—	—
Land use rights	—	—	—	—
Software	—	—	—	—
Non-patent technology	—	—	—	—
Patent technology	—	—	—	—
V. Total intangible assets book value	249,918,129.97	—	—	333,019,939.03
Land use rights	178,138,217.23	—	—	210,783,045.11
Software	—	—	—	59,615.40
Non-patent technology	71,766,416.01	—	—	121,209,507.31
Patent technology	13,496.73	—	—	967,771.21

The land-use rights owned by the Company were located in the mainland of China, which were leased land under the medium term lease.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

14. Intangible assets (continued)

Consolidation (continued)

(1) Intangible assets (continued)

The land-use rights by liquidity:

	Closing book balance	Opening book balance
Current assets	4,485,729.77	4,105,065.15
Non-current assets	206,297,315.34	174,033,152.08
Total	210,783,045.11	178,138,217.23

Note 1: Of the increase of original carrying amount during the year, the acquisition of land use right certificates led to an increase of RMB36,111,975.00, an increase of RMB637,918.03 was due to investment properties transferred to building for private use, Independent development led to an increase of RMB71,266,492.21, the purchase of patent technology led to an increase of RMB1,033,100.00, the purchase of software led to an increase of RMB67,948.72.

Note 2: Accumulated amortization for the period increased, an amount of RMB25,935,653.80, an increase of RMB79,971.10 was due to investment properties transferred to building for private use.

(2) Research project expenditure of the Company

Item	Opening book balance	Additions for the current period	Deductions for the current period		Closing book balance
			Recognized as expense	Recognized as intangible assets	
Research expenditure	—	7,978,653.38	7,978,653.38	—	—
Development expenditure	—	71,266,492.21	—	71,266,492.21	—
Total	—	79,245,145.59	7,978,653.38	71,266,492.21	—

Note: During the year, the development expenditure represented 89.93% of the total research and development expenditure.

Intangible assets generated from research and development expenditure of the Company represented 36.40% of the carrying amount of intangible assets at the end of the year.



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

14. Intangible assets (continued)

The Company

(1) Intangible assets

RMB

Items	Opening book balance	Additions for the current period	Deductions for the current period	Closing book balance
I. Total original book value:	191,479,256.67	99,602,751.36	—	291,082,008.03
Land use rights	102,303,605.25	36,749,893.03	—	139,053,498.28
Software	702,088.00	67,948.72	—	770,036.72
Non-patent technology	88,454,913.42	61,751,809.61	—	150,206,723.03
Patent technology	18,650.00	1,033,100.00	—	1,051,750.00
II. Total accumulated amortization	20,981,771.25	23,826,914.20	—	44,808,685.45
Land use rights	3,586,032.57	2,351,512.87	—	5,937,545.44
Software	702,088.00	8,333.32	—	710,421.32
Non-patent technology	16,688,497.41	21,388,242.49	—	38,076,739.90
Patent technology	5,153.27	78,825.52	—	83,978.79
III. Total intangible assets net book value	170,497,485.42	—	—	246,273,322.58
Land use rights	98,717,572.68	—	—	133,115,952.84
Software	—	—	—	59,615.40
Non-patent technology	71,766,416.01	—	—	112,129,983.13
Patent technology	13,496.73	—	—	967,771.21
IV. Total impairment provision	—	—	—	—
Land use rights	—	—	—	—
Software	—	—	—	—
Non-patent technology	—	—	—	—
Patent technology	—	—	—	—
V. Total intangible assets book value	170,497,485.42	—	—	246,273,322.58
Land use rights	98,717,572.68	—	—	133,115,952.84
Software	—	—	—	59,615.40
Non-patent technology	71,766,416.01	—	—	112,129,983.13
Patent technology	13,496.73	—	—	967,771.21

The land-use rights owned by the Company were located in the mainland of China, which were leased land under the medium term lease.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

14. Intangible assets (continued)

The Company (continued)

(1) Intangible assets (continued)

The land-use rights by liquidity:

	Closing book balance	Opening book balance
Current assets	2,781,069.97	2,351,512.87
Non-current assets	130,334,882.87	96,366,059.81
Total	133,115,952.84	98,717,572.68

RMB

Note 1 : Of the increase of original carrying amount during the year, the acquisition of land use right certificates led to an increase of RMB36,111,975.00, an increase of RMB637,918.03 was due to investment properties transferred to building for private use, independent development led to an increase of RMB61,751,809.61, the purchase of patent technology led to an increase of RMB1,033,100.00, the purchase of software led to an increase of RMB67,948.72.

Note 2 : Accumulated amortization for the period increased, an amount of RMB23,746,943.10, an increase of RMB79,971.10 was due to investment properties transferred to building for private use.

(2) Research project expenditure of the Company

Item	Opening balance	Additions for the current period	Deductions for the current period		Closing balance
			Recognized as expense	Recognized as intangible assets	
Research expenditure	—	6,235,180.58	6,235,180.58	—	—
Development expenditure	—	61,751,809.61	—	61,751,809.61	—
Total	—	67,986,990.19	6,235,180.58	61,751,809.61	—

RMB

Note: During the year, the development expenditure represented 90.83% of the total research and development expenditure.

Intangible assets generated from research and development expenditure of the Company represented 45.53% of the carrying amount of intangible assets at the end of the year.



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

15. Goodwill

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

Consolidation

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

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

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

16. Deferred income tax assets and deferred income tax liabilities

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

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Deferred income tax assets:				
Bad debt balance	1,365,925.33	1,727,107.98	1,351,750.33	1,671,993.44
Including: Accounts receivable	1,348,057.44	1,697,328.17	1,333,882.44	1,642,213.63
Other receivables	17,867.89	29,779.81	17,867.89	29,779.81
Allowance for inventories	551,453.53	865,228.92	470,608.55	628,637.69
Salaries payable	3,696,223.46	4,459,922.44	1,920,212.44	2,787,555.38
Intangible assets amortization	4,817,635.02	2,086,062.18	4,759,592.49	2,086,062.18
Fixed assets Impairment provision	2,141,584.71	3,240,420.59	—	—
Deductible losses	1,834,039.02	2,717,119.01	—	—
Unrealized profit of intragroup transaction	547,631.87	—	—	—
Deferred income	1,717,600.00	—	1,717,600.00	—
Total	16,672,092.94	15,095,861.12	10,219,763.81	7,174,248.69
Deferred income tax liabilities:				
Adjustment of fair value (Note 1)	9,237,072.73	9,668,877.75	—	—
Including: inventory	—	—	—	—
long-term equity investments	3,809.38	3,809.38	—	—
Fixed assets	1,161,091.77	1,406,955.76	—	—
Intangible assets	8,072,171.58	8,258,112.61	—	—
Balance of value-added tax rebates due from government	1,951,246.04	2,359,336.73	—	—
Interest receivable	329,701.06	522,199.20	329,701.06	522,199.20
Unrealized loss of intragroup transaction	—	477,038.70	—	—
Total	11,518,019.83	13,027,452.38	329,701.06	522,199.20

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

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



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

16. Deferred income tax assets and deferred income tax liabilities (continued)

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

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Deferred income tax assets:				
Bad debt balance	9,068,368.85	6,908,431.93	9,011,668.85	6,687,973.77
Including: Accounts receivable	8,949,249.60	6,789,312.68	8,892,549.60	6,568,854.52
Other receivables	119,119.25	119,119.25	119,119.25	119,119.25
Allowance for inventories	3,460,770.20	3,460,915.70	3,137,390.30	2,514,550.77
Salaries payable	19,905,460.32	17,839,689.76	12,801,416.26	11,150,221.53
Intangible assets amortization	19,270,540.03	8,344,248.71	19,038,369.95	8,344,248.71
Fixed assets Impairment provision	8,566,338.84	12,961,682.35	—	—
Deductible losses	7,336,156.08	10,868,476.02	—	—
Unrealized profit of intragroup transaction	3,650,879.15	—	—	—
Deferred income	9,040,000.00	—	9,040,000.00	—
Total	80,298,513.47	60,383,444.47	53,028,845.36	28,696,994.78
Deferred income tax liabilities:				
Adjustment of fair value	36,948,290.92	38,675,510.96	—	—
Including: long-term equity investments	15,237.51	15,237.51	—	—
Fixed assets	4,644,367.09	5,627,823.02	—	—
Intangible assets	32,288,686.32	33,032,450.43	—	—
Balance of value-added tax rebates due from government	7,804,984.16	9,437,346.91	—	—
Interest receivable	2,198,007.08	2,088,796.81	2,198,007.08	2,088,796.81
Unrealized loss of intragroup transaction	—	3,180,257.98	—	—
Total	46,951,282.16	53,381,912.66	2,198,007.08	2,088,796.81

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

17. Provision for impairment of assets

Consolidation

Items	Opening balance	Additions for the current period	Deductions		Closing balance
			Reversals	Write-offs	
			RMB		
I. Provisions for bad debts	6,908,431.93	2,441,900.56	214,574.71	67,388.93	9,068,368.85
Of which: trade receivables	6,789,312.68	2,441,900.56	214,574.71	67,388.93	8,949,249.60
Other receivables	119,119.25	—	—	—	119,119.25
Provisions for inventory impairment	3,460,915.70	1,598,791.00	932,110.58	666,825.92	3,460,770.20
Including:					
Raw materials	916,732.12	932,945.28	158,772.31	343,022.15	1,347,882.94
Work-in-progress	872,825.06	102,388.26	175,896.36	166,790.71	632,526.25
Finished product	1,671,358.52	563,457.46	597,441.91	157,013.06	1,480,361.01
Fixed assets					
Impairment provision	19,233,321.66	—	—	3,026,985.85	16,206,335.81
Including:					
Building	4,986,478.28	—	—	—	4,986,478.28
Machinery and equipment	14,246,843.38	—	—	3,026,985.85	11,219,857.53
Provisions for goodwill impairments	—	—	—	—	—
Total	29,602,669.29	4,040,691.56	1,146,685.29	3,761,200.70	28,735,474.86



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

17. Provision for impairment of assets (continued)

The Company

RMB

Items	Opening balance	Additions for the current period	Deductions		Closing balance
			Reversals	Write-offs	
Provisions for bad debts	6,687,973.77	2,441,900.56	50,816.55	67,388.93	9,011,668.85
Of which: trade receivables	6,568,854.52	2,441,900.56	50,816.55	67,388.93	8,892,549.60
Other receivables	119,119.25	—	—	—	119,119.25
Provisions for inventory impairment	2,514,550.77	1,598,791.00	700,731.30	275,220.17	3,137,390.30
Including:					
Raw materials	478,729.14	932,945.28	115,428.99	93,668.46	1,202,576.97
Work-in-progress	650,512.06	102,388.26	126,572.05	60,796.75	565,531.52
Finished product	1,385,309.57	563,457.46	458,730.26	120,754.96	1,369,281.81
Total	9,202,524.54	4,040,691.56	751,547.85	342,609.10	12,149,059.15

18. Short-term borrowings

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Credit loans	680,888,976.90	559,240,190.00	589,329,611.90	390,000,000.00
Guarantee loans	5,581,812.10	17,455,000.00	5,581,812.10	17,455,000.00
Secured borrowings	24,031,288.23	136,171,227.20	24,031,288.23	136,171,227.20
Total	710,502,077.23	712,866,417.20	618,942,712.23	543,626,227.20

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

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

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

19. Bills payable

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

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Bank acceptance	383,690,165.06	482,816,088.17	380,837,165.06	446,849,308.17

- (1) Payable of the Group and the Company as at 31 December 2011 will be fully due by 14 June 2012.
- (2) Balance of bills payable in the current reporting period does not have any amount due to bill of shareholder unit with over 5% (inclusive) voting rights in the Company.
- (3) The Group does not have bills payable to related parties.

The Company has bills payable to other related parties in its bills payable as follows:

RMB

Items	Closing balance	Opening balance
Molong Electro-mechanical Equipment Company Limited	9,885,396.97	18,805,654.37
Weihai Baolong	22,000,000.00	13,830,000.00
Shouguang Baolong	233,973,085.56	257,400,000.00
Molong Drilling Equipment	—	1,048,000.00
Total	265,858,482.53	291,083,654.37

20. Accounts payable

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

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Trade payable	509,741,645.18	390,316,585.54	385,727,717.16	222,340,794.46
Payment for equipment and construction in progress	106,974,549.16	111,454,984.80	76,998,835.04	102,245,817.93
Total	616,716,194.34	501,771,570.34	462,726,552.20	324,586,612.39



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

20. Accounts payable (continued)

(2) Aging analysis of accounts payable is as follows:

Age	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Within 1 year	554,887,296.45	464,598,177.18	423,147,481.00	310,628,796.75
1 to 2 year	41,850,903.42	16,068,602.25	32,884,199.70	8,623,173.45
2 to 3 year	5,317,135.68	10,926,875.98	2,833,068.73	2,932,613.80
Over 3 years	14,660,858.79	10,177,914.93	3,861,802.77	2,402,028.39
Total	616,716,194.34	501,771,570.34	462,726,552.20	324,586,612.39

The Group and the Company confirm accounts payable and calculate its age when the purchase goods was put in storage, and the average credit period for purchase is two months. As at 31 December 2011, significant accounts payable of the Group and the Company aged over 1 year amounting to over RMB2,000,000.00 in a single amount was RMB21,279,160.12 and RMB18,775,860.12, respectively. This represented the acquisition fees for equipment, which such amounts are not paid as the credit period is over 1 year.

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

Name	Closing balance	Opening balance
Molong Drilling Equipment	—	20,194,138.58
Shouguang Baolong	16,701,218.40	—
Weihai Baolong	64,209,376.84	—
Molong Electro-mechanical Equipment Company Limited	30,473,480.99	7,415,268.46
Maolong Old Metals Recycle Company Limited	—	360,215.00
Total	111,384,076.23	27,969,622.04

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

21. Advance receipts

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

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Advance received from customers	20,713,521.63	34,721,719.22	26,525,840.83	80,810,957.44

RMB

As at 31 December 2011, the Group and the Company do not have any single material advance receipt of over RMB2,000,000.00 aged over 1 year.

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

The Company has advance receipts from related parties as follows:

Name	Closing balance	Opening balance
MPM International Limited	13,784,097.22	58,889,120.06

RMB

22. Employee benefits payable

Consolidation

Items	Opening balance	Accrued during the period	Paid during the period	Closing balance
Salaries, bonuses, allowance and subsidies	17,485,969.50	95,750,705.42	93,679,872.86	19,556,802.06
Staff welfare	101,235.82	5,939,116.04	5,939,116.04	101,235.82
Social insurance premiums	—	14,572,411.75	14,572,411.75	—
Housing provident funds	—	2,127,277.00	2,127,277.00	—
Others	252,484.44	1,583,616.66	1,588,678.66	247,422.44
Total	17,839,689.76	119,973,126.87	117,907,356.31	19,905,460.32

RMB



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

22. Employee benefits payable (continued)

The Company

Items	RMB			
	Opening balance	Accrued during the period	Paid during the period	Closing balance
Salaries, bonuses, allowance and subsidies	11,150,221.53	66,778,493.23	65,127,298.50	12,801,416.26
Staff welfare	—	3,986,699.45	3,986,699.45	—
Social insurance premiums	—	10,067,181.11	10,067,181.11	—
Housing provident funds	—	1,473,951.92	1,473,951.92	—
Others	—	335,757.90	335,757.90	—
Total	11,150,221.53	82,642,083.61	80,990,888.88	12,801,416.26

23. Tax payables

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Income tax	26,687,827.54	24,042,381.60	14,804,663.13	14,139,491.74
Value added tax	3,030,940.82	3,134,259.26	—	—
Business tax	—	413,200.00	—	—
Personal income tax	4,028,147.55	132,074.96	4,023,213.13	66,662.06
Others	2,002,342.06	1,706,462.07	472,399.93	523,705.61
Total	35,749,257.97	29,428,377.89	19,300,276.19	14,729,859.41

24. Interest payables

Item	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Interest of Bank loan	4,600,388.73	751,797.63	4,600,388.73	751,797.63
Interest of loan from Finance Bureau	957,566.67	203,750.00	—	—
Total	5,557,955.40	955,547.63	4,600,388.73	751,797.63

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

25. Dividends payable

Consolidation and the Company

Name	RMB	
	Closing balance	Opening balance
Domestic Natural person	—	23,788,680.00

26. Other payables

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

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Accrued in electricity fees and delivery expenses	14,833,788.59	10,640,796.42	7,078,230.94	4,826,422.70
A Shares listing expenses	—	2,680,000.00	—	2,680,000.00
Deposit	4,703,106.23	5,876,238.62	3,727,271.23	4,664,738.62
Others	3,024,161.75	6,794,877.62	3,131,509.38	2,072,024.78
Total	22,561,056.57	25,991,912.66	13,937,011.55	14,243,186.10

(2) The other payables of the Group and the Company at the end of the year were not due to any shareholders who holding over 5% (5% inclusive) of the Company's shares.

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

Items	RMB	
	Closing balance	Opening balance
Maolong Old Metals Recycle Company Limited	622,553.06	622,553.06
Shouguang Baolong Company	3,723,785.85	—
Total	4,346,338.91	622,553.06



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

27. Other non-current liabilities

Consolidation and the Company

RMB

Items	Consolidation	
	Closing balance	Opening balance
Deferred income	9,040,000.00	—

According to the notice of Shandong Province Development and Reform Committee Lu Fa Gai Invest [2011] No.1354 (魯發改投資[2011]1354號), the Company received the central budget investment of RMB9,040,000.00 for the construction of the high-end petroleum equipment project. The government grant was recognized as deferred income when received by the Company.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

28. Share capital

Consolidation and the Company

RMB

	Opening balance	Change for the period				Sub-total	Closing balance
		New Issue	Bonus shares	Shares transfer from reserve	Others		
2011:							
I. Restricted shares outstanding							
1. Other domestic shares	2,622,000.00	—	—	—	(2,622,000.00)	(2,622,000.00)	—
2. Natural person shares	198,239,000.00	—	—	—	—	—	198,239,000.00
3. RMB ordinary shares	14,000,000.00	—	—	—	(14,000,000.00)	(14,000,000.00)	—
Total number of restricted shares outstanding	214,861,000.00	—	—	—	(16,622,000.00)	(16,622,000.00)	198,239,000.00
II. Non-restricted shares							
1. RMB ordinary shares	56,000,000.00	—	—	—	16,622,000.00	16,622,000.00	72,622,000.00
2. Overseas listed foreign shares	128,063,200.00	—	—	—	—	—	128,063,200.00
Total number of non-restricted shares	184,063,200.00	—	—	—	16,622,000.00	16,622,000.00	200,685,200.00
Total shares	398,924,200.00	—	—	—	—	—	398,924,200.00
2010:							
I. Restricted shares							
1. Other domestic shares	2,622,000.00	—	—	—	—	—	2,622,000.00
2. Natural person shares	198,239,000.00	—	—	—	—	—	198,239,000.00
3. RMB ordinary shares	—	14,000,000.00	—	—	—	14,000,000.00	14,000,000.00
Total number of restricted shares outstanding	200,861,000.00	14,000,000.00	—	—	—	14,000,000.00	214,861,000.00
II. Non-restricted shares							
1. RMB ordinary shares	—	56,000,000.00	—	—	—	56,000,000.00	56,000,000.00
2. Overseas listed foreign shares	128,063,200.00	—	—	—	—	—	128,063,200.00
Total number of non-restricted shares	128,063,200.00	56,000,000.00	—	—	—	56,000,000.00	184,063,200.00
Total shares	328,924,200.00	70,000,000.00	—	—	—	70,000,000.00	398,924,200.00



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

28. Share capital (continued)

Consolidation and the Company (continued)

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

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

On 21 January 2011, the off-line allotment started to circular in the market. On 21 October 2011, the 2,622,000 shares of Shengli Oil Field Kaiyuan Petroleum Development Company was lifted and circular in the market.

The Company has no buyback of shares in Hong Kong Stock Exchange during the reporting year.

29. Share premium

Consolidation

Items	Opening balance	Increase for the period	Decrease for the period	RMB
				Closing balance
2011:				
Share premium	1,248,406,190.92	18,667.50	—	1,248,424,858.42
Of which:				
Capital contribution from investors	1,248,406,190.92	—	—	1,248,406,190.92
Non-controlling interest of subsidiary	—	18,667.50	—	18,667.50
		(Note)		
Total	1,248,406,190.92	18,667.50	—	1,248,424,858.42
2010:				
Share premium	121,667,859.42	1,126,738,331.50	—	1,248,406,190.92
Of which:				
Capital contribution from shareholder	121,667,859.42	1,126,738,331.50	—	1,248,406,190.92
Total	121,667,859.42	1,126,738,331.50	—	1,248,406,190.92

Note: The new share premium during the year was due to the fact that the Company invests in Weihai Baolong Company and diluted the non-controlling shareholder equity.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

29. Share premium (continued)

The Company

	RMB			
Items	Opening balance	Increase for the period	Decrease for the period	Closing balance
2011:				
Share premium	1,248,406,190.92	—	—	1,248,406,190.92
Of which:				
Capital contribution from shareholder	1,248,406,190.92	—	—	1,248,406,190.92
Total	1,248,406,190.92	—	—	1,248,406,190.92
2010:				
Share premium	121,667,859.42	1,126,738,331.50	—	1,248,406,190.92
Of which:				
Capital contribution from shareholder	121,667,859.42	1,126,738,331.50	—	1,248,406,190.92
Total	121,667,859.42	1,126,738,331.50	—	1,248,406,190.92

30. Surplus reserve

Consolidation and the Company

	RMB			
Items	Opening balance	Increase for the period	Decrease for the period	Closing balance
2011:				
Statutory surplus reserve	140,393,447.06	17,571,827.42	—	157,965,274.48
2010:				
Statutory surplus reserve	108,376,005.02	32,017,442.04	—	140,393,447.06

Statutory surplus reserve is detailed in note V. 31.



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

31. Retained earnings

Consolidation

Items	Amount	RMB Proportion of appropriation or allocation
2011:		
Retained earnings at the beginning of the year	898,749,873.79	—
Add: Net profits attribute to the shareholders of the Company of the year	168,330,282.50	—
Less: Appropriation of statutory surplus reserves	17,571,827.42	Note 1
Dividends recognized as distribution	59,838,630.00	Note 2
Ordinary shares dividend transfer as share capital	—	—
Retained earnings at the end of the year	989,669,698.87	—
2010:		
Retained earnings at the beginning of the year	694,089,054.29	—
Add: Net profits attribute to the shareholders of the Company of the year	276,149,165.54	—
Less: Appropriation of statutory surplus reserves	32,017,442.04	Note 1
Dividends recognized as distribution	39,470,904.00	Note 2
Ordinary shares dividend transfer as share capital	—	—
Retained earnings at the end of the year	898,749,873.79	—

The Company

Items	Amount	RMB Proportion of appropriation or allocation
2011:		
Retained earnings at the beginning of the year	824,233,008.06	—
Add: Net profits of the year	175,718,274.16	—
Less: Appropriation of statutory surplus reserves	17,571,827.42	Note 1
Dividends recognized as distribution	59,838,630.00	Note 2
Ordinary shares dividend transfer as share capital	—	—
Retained earnings at the end of the year	922,540,824.80	—
2010:		
Retained earnings at the beginning of the year	575,546,933.68	—
Add: Net profits of the year	320,174,420.42	—
Less: Appropriation of statutory surplus reserves	32,017,442.04	Note 1
Dividends recognized as distribution	39,470,904.00	Note 2
Ordinary shares dividend transfer as share capital	—	—
Retained earnings at the end of the year	824,233,008.06	—

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

31. Retained earnings (continued)

The Company (continued)

As at 31 December 2011, the statutory surplus reserve provided for each subsidiary as calculated by the shareholding proportion of the undistributed profit of the Group amounted to RMB47,608,420.85 (31 December 2010: RMB30,036,593.43). As at 31 December 2011, the profit distributed to shareholders of the Company was RMB922,540,824.80 (31 December 2010: RMB824,233,008.06).

Note 1: Withdrawal of statutory surplus reserve

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

Note 2: Cash dividends of the first half of the year as approved in 2009–2010 General Meeting

According to the resolution of the Board meeting of the Company convened on 5 February 2011, with 28 March 2010 as the base date of dividend distribution and a total of 328,924,200 shares (with a nominal value of RMB1 per share) as the basis, as well as a cash dividend of RMB0.12 per share distributed to all shareholders. Such resolution has been passed in the 2009 General Meeting.

According to the Board resolution of the Company convened on 29 March 2011, with 10 June 2010 as the base date of dividend distribution and a total of 398,924,200 shares (with a nominal value of RMB1 per share) as the basis, a cash dividend of RMB0.15 per share distributed to all shareholders. Such resolution has been passed in the 2010 General Meeting.

Note 3: Retained earnings after Balance Sheet

The proposed profit distribution plan of 2011 was passed in the sixteenth Board meeting of the third session which hold on 29 March 2012, based on the total share capital of 398,924,200 shares as at 31 December 2011, a final dividend of RMB0.10 per share shall be distributed to the whole shareholders; and based on the total shares of 398,924,200 shares, capitalizing of common reserves will be one share upon one share to the whole shareholders whose names appear on the register of member of the Company as at 24 April 2012. The above proposal will be approved by Shareholders' Meeting.

32. Minority shareholders' interest

Minority shareholders' interest is as follows:

Name	Closing balance	RMB
		Opening balance
MPM International Limited	1,319,686.04	1,113,902.05
Shouguang Baolong	56,643,649.13	56,099,071.75
Total	57,963,335.17	57,212,973.80



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

33. Operating Revenue and Cost of operations

Consolidation

(1) Operating Revenue

RMB

Items	Incurred during the current period	Incurred during the previous period
Principal operating revenue	2,684,115,540.14	2,652,746,555.56
Other business revenue	54,576,290.07	51,160,279.63
Cost of operations	2,407,671,724.80	2,237,506,663.67

(2) Principal operations (by product)

RMB

Products	Incurred during the current period		Incurred during the previous period	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
Casing and Tubing	2,334,253,537.27	2,055,296,640.95	2,126,589,473.71	1,722,881,977.14
Three kinds of pumping units	78,296,157.27	65,384,600.08	111,655,198.06	88,484,979.52
Petroleum machinery	165,947,013.60	138,060,140.84	148,493,859.41	125,039,346.09
Others	105,618,832.00	105,777,961.11	266,008,024.38	253,518,564.08
Total	2,684,115,540.14	2,364,519,342.98	2,652,746,555.56	2,189,924,866.83

(3) Principal operations (by Geographical segment)

RMB

Regions	Incurred during the current period		Incurred during the previous period	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
PRC	1,653,957,527.10	1,498,457,075.50	1,703,047,344.22	1,424,007,536.39
Overseas	1,030,158,013.04	866,062,267.48	949,699,211.34	765,917,330.44
Total	2,684,115,540.14	2,364,519,342.98	2,652,746,555.56	2,189,924,866.83

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

33. Operating Revenue and Cost of operations (continued)

Consolidation (continued)

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

Name of customer	Operating Revenue	RMB
		the percentage of the total sales revenue (%)
China National Petroleum Corporation	734,659,226.28	26.83
PPC Limited	255,297,067.19	9.32
SB International Inc	223,975,783.39	8.18
Campex Inc	177,046,959.80	6.46
Shandong Luxin Steel Pipes Co., Ltd	176,088,154.46	6.43
Total	1,567,067,191.12	57.22

The Company

(1) Operating Revenue

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Principal operating Revenue	2,657,191,558.57	2,474,408,308.66
Other operating Revenue (Note)	206,711,898.53	188,633,332.92
Cost of operations	2,572,698,117.94	2,253,227,044.55

Note: The income from investment real estate included in other operation income of 2011 was RMB20,000.00 (2010: of RMB690,000.00).

(2) Principal operations (by product)

Products	Incurred during the current period		Incurred during the previous period	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
	RMB			
Casing and Tubing	2,399,352,089.95	2,164,033,335.58	2,126,589,473.71	1,763,881,977.14
Three kinds of pumping units	78,296,157.27	65,384,600.08	111,655,198.06	93,484,979.52
Petroleum machinery	165,947,013.60	138,060,140.84	148,493,859.41	125,380,683.43
Others	13,596,297.75	8,724,007.33	87,669,777.48	85,297,570.28
Total	2,657,191,558.57	2,376,202,083.83	2,474,408,308.66	2,068,045,210.37



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

33. Operating Revenue and Cost of operations (continued)

The Company (continued)

(3) Principal operations (by Geographical segment)

RMB

Regions	Incurred during the current period		Incurred during the previous period	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
PRC	1,627,033,545.53	1,510,139,816.35	1,524,709,097.32	1,302,127,879.93
Overseas	1,030,158,013.04	866,062,267.48	949,699,211.34	765,917,330.44
Total	2,657,191,558.57	2,376,202,083.83	2,474,408,308.66	2,068,045,210.37

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

RMB

Name of customer	Operating Revenue	the percentage of the total sales revenue (%)
China National Petroleum Corporation	734,659,226.28	25.65
PPC Limited	255,297,067.19	8.91
SB International Inc	223,975,783.39	7.82
Campex Inc	177,046,959.80	6.18
Shandong Luxin Steel Pipes Co., Ltd	176,088,154.46	6.15
Total	1,567,067,191.12	54.71

34. Tax and levies on operations

Consolidation

RMB

Items	Incurred during the current period	Incurred during the previous period
Business tax	—	100.00
Urban maintenances and construction tax	1,064,181.19	3,062,313.86
Educational surcharges	783,373.20	1,504,236.04
Others	83,982.31	245,657.56
Total	1,931,536.70	4,812,307.46

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

34. Tax and levies on operations (continued)

The Company

RMB

Items	Incurring during the current period	Incurring during the previous period
Urban maintenances and construction tax	3,641.15	—

35. Selling Expenses

Consolidation

RMB

Items	Incurring during the current period	Incurring during the previous period
Delivery expenses	48,094,190.29	40,861,583.20
Agency fees	2,062,726.28	392,833.43
Salary	1,752,893.62	1,313,289.67
Travelling expenses	1,214,644.85	1,722,858.54
Business reception fees	550,452.04	1,697,598.20
Transportation fees	396,865.80	274,414.95
Office expenses	329,943.63	507,632.80
Intermediate fees	280,000.00	2,182,935.78
Depreciation charge	177,462.19	177,752.87
Other	2,727,321.09	2,229,929.08
Total	57,586,499.79	51,360,828.52

The Company

RMB

Items	Incurring during the current period	Incurring during the previous period
Delivery expenses	48,094,190.29	40,777,883.31
Agency fees	2,034,047.28	392,833.43
Salary	1,700,095.02	1,117,076.03
Travelling expenses	1,205,026.55	1,560,071.14
Business reception fees	526,934.00	1,485,494.00
Transportation fees	396,865.80	274,414.95
Office expenses	329,004.73	451,265.80
Intermediate fees	280,000.00	2,182,935.78
Depreciation charge	177,462.19	177,752.87
Other	2,706,441.43	2,181,407.08
Total	57,450,067.29	50,601,134.39



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

36. Management fees

Consolidation

RMB

Item	Incurred during the current period	Incurred during the previous period
Amortization of intangible assets	25,935,653.80	12,078,058.98
Research and development fees of new products	15,057,324.94	25,522,276.35
Salary and Staff welfare expenses	10,487,686.97	9,682,607.82
Depreciation charges	8,965,906.75	8,634,192.67
Taxes	8,065,329.90	7,426,098.83
Machinery material consumption	7,770,147.71	7,198,839.15
Repair fees	1,643,337.08	8,574,919.85
Intermediate fees	1,489,266.29	731,650.28
The Board fees	1,209,562.50	2,690,648.50
Environmental protection expenses	1,208,663.48	531,842.14
Electricity fees	1,161,829.12	1,258,328.67
Delivery expenses	864,993.45	307,926.85
Travelling expenses	685,457.13	572,643.42
Business reception fees	586,747.00	881,678.00
Transportation fees	488,266.42	485,824.60
Property insurance fees	454,931.35	795,582.84
Water fees	182,540.06	220,170.82
Promotion expenses	165,256.71	482,411.48
Other	1,521,511.05	3,308,269.79
Total	87,944,411.71	91,383,971.04

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

36. Management fees (continued)

The Company

RMB

Item	Incurred during the current period	Incurred during the previous period
Amortization of intangible assets	23,746,943.10	10,546,033.07
Research and development fees of new products	13,313,852.14	25,392,276.35
Salary and Staff welfare expenses	8,406,196.18	6,818,458.53
Machinery material consumption	7,362,986.36	7,146,708.74
Depreciation charges	7,306,230.20	5,747,945.14
Taxes	5,073,763.77	4,668,507.68
Intermediate fees	1,436,266.29	680,642.30
The Board fees	1,209,562.50	2,690,648.50
Electricity fees	1,119,450.61	1,251,528.67
Delivery expenses	860,357.45	304,020.85
Travelling expenses	562,373.78	416,621.05
Transportation fees	467,832.42	467,693.64
Repair fees	362,589.10	321,029.08
Property insurance fees	353,266.72	368,568.62
Environmental protection expenses	296,423.48	372,662.14
Business reception fees	276,837.60	596,565.96
Promotion expenses	165,112.71	482,411.48
Water fees	129,440.06	175,852.82
Other	1,063,788.85	1,832,306.82
Total	73,513,273.32	70,280,481.44

37. Finance fees

Consolidation

RMB

Item	Incurred during the current period	Incurred during the previous period
Interest expenses (Bank loans within 1 year)	28,496,324.62	65,978,204.21
Less: Capitalized interest expenses	4,746,373.93	26,583,267.92
Less: Interest income	11,521,908.44	5,112,478.99
Foreign exchange difference	(1,394,006.70)	6,584,539.78
Other	3,815,438.41	3,474,875.66
Total	14,649,473.96	44,341,872.74



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

37. Finance fees (continued)

The Company

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Interest expenses (Bank loans within 1 year)	21,903,852.08	55,472,225.93
Less: Capitalized interest expenses	4,746,373.93	25,752,087.94
Less: Interest income	10,597,526.28	4,791,051.40
Foreign exchange difference	(1,394,006.70)	6,584,539.78
Other	3,603,351.38	2,302,427.80
Total	8,769,296.55	33,816,054.17

38. Loss on impairment of assets

Consolidation

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Provision of bad debt	2,227,325.85	(513,766.81)
Including: accounts receivable	2,227,325.85	(513,766.81)
Other accounts receivable	—	—
Provision of allowance for inventory	666,680.42	(1,510,521.67)
Including: Raw materials	774,172.97	(1,395,116.85)
Work-in-progress	(33,984.45)	41,242.13
Finished product	(73,508.10)	(156,646.95)
Total	2,894,006.27	(2,024,288.48)

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

38. Loss on impairment of assets (continued)

The Company

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Provision of bad debt	2,391,084.01	(513,766.81)
Including: accounts receivable	2,391,084.01	(513,766.81)
Other accounts receivable	—	—
Provision of allowance for inventory	898,059.70	(1,027,510.28)
Including: Raw materials	817,516.29	(878,259.08)
Finished product	104,727.20	105,306.61
Work-in-progress	(24,183.79)	(254,557.81)
Total	3,289,143.71	(1,541,277.09)

39. Investment income

Consolidation

(1) Breakdown of investment income

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Gain from long-term equity investments accounted for using the equity method	253,344.29	191,250.95

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

Investee	RMB		
	Incurred during the current period	Incurred during the previous period	Reason of change from the previous period to the current period
Yalong Oil Pump	253,344.29	191,250.95	The net profit of the investee achieved in the current year changed



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

39. Investment income (continued)

Consolidation (continued)

- (3) There are no significant restrictions on remittance of investment gains back to the Company, and the above investment gains are from the investment to the non-listing company.

The Company

- (1) Breakdown of investment income

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Gain from long-term equity investments accounted for using the equity method	3,156,000.00	85,765,164.48
Investment gain received from the disposal of long-term equity investments	16,551,433.98	—
Total	19,707,433.98	85,765,164.48

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

Investee	RMB		
	Incurred during the current period	Incurred during the previous period	Reason of change from the previous period to the current period
Maolong Machinery Company Limited	3,156,000.00	41,220,000.00	Dividend distribution of investee in current year
MPM International Limited	—	44,545,164.48	Dividend distribution of investee in current year
Total	3,156,000.00	85,765,164.48	

- (3) There are no significant restrictions on remittance of investment gains back to the Company, and the above investment gains are from the investment to the non-listing company.

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

40. Non-operating income

Consolidation

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

Items	Incurred during the current period	Incurred during the previous period	RMB
			Amounts credited to non-recurring profit or loss during the current year
Total income on disposal of non-current assets	152,697.88	1,624,848.11	152,697.88
Of which: Income on disposal of fixed assets	152,697.88	1,624,848.11	152,697.88
Government grants	31,474,069.50	47,330,650.51	31,474,069.50
Income from penalty	1,562,707.27	261,980.70	1,562,707.27
Others	1,287,497.70	1,214,278.20	1,287,497.70
Total	34,476,972.35	50,431,757.52	34,476,972.35

(2) Breakdown of Government grants

Items	Incurred during the current period	Incurred during the previous period	RMB
Financial subsidies (Note)	31,474,069.50	29,580,022.42	
Tax rebate from value-added tax	—	17,750,628.09	
Total	31,474,069.50	47,330,650.51	

Note: On 30 June 2011, the Company received the financial subsidies of RMB14,000,000.00 given by Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2011] No. 282 "Notice Regarding the Allocation of Research Award Fund for Shandong Molong Petroleum Machinery Company Limited" (壽財預指字[2011]3號文《關於撥付山東墨龍石油機械股份有限公司科研獎勵資金的通知》). From August to November in 2011, the Company received the financial subsidies of RMB1,994,069.50 from Gucheng Finance Bureau. On 24 October 2011, the Company received the subsidies of RMB200,000.00 given by Weifang Finance Bureau pursuant to Wei Ke Gui Zi [2011] No. 48 "Notice Regarding Transmitting the Development of Science and Technology Plan of Shandong Province in 2011 (First Batch) and the Development of Science and Technology Plan of Shandong Province in 2011 (Carry Forward Part)" (壽財預指字[2010]280號文《關於轉發2011年山東省科學技術發展計劃(第一批)和2011年山東省科學技術發展計劃(結轉部分)的通知》). On 15 November 2011, the Company received the financial subsidies of RMB116,000.00 from Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2011] No. 714 "Notice Regarding the Allocation of Support Foreign Trade Development Fund of 2010" (壽財預指字[2011]714號文《關於撥付2010年度扶持外經貿發展資金的通知》). On 7 December 2011, the Company received the subsidies of RMB104,000.00 from Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2011] No. 1012 "Notice Regarding the Allocation of Special Fund for Export Credit Insurance Premium in 2011" (壽財預指字[2011]1012號文《關於撥付2011年度出口信用保險保費補貼專項資金的通知》). On 13 December 2011, the Company received the subsidies of RMB15,000,000.00 from Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi Zi [2011] No. 480 "Notice Regarding the Allocation of Special Fund" (壽財預指字[2011]480號文《關於撥付專項資金的通知》).



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

40. Non-operating income (continued)

Consolidation (continued)

(2) Breakdown of government grants: (continued)

In 2011, Weihai Baolong received science and technology innovation fund of RMB50,000.00 from Wendeng Finance Bureau. Shouguang Baolong received award funded of RMB10,000.00 from Shouguang Gucheng district office.

The Company

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

Items	Incurred during the current period	Incurred during the previous period	RMB
			Amounts credited to non-recurring profit or loss during the current year
Total loss on disposal of non-current assets	113,911.99	1,879,329.93	113,911.99
Of which: Loss on disposal of fixed assets	113,911.99	1,879,329.93	113,911.99
Government grants	31,414,069.50	12,237,500.00	31,414,069.50
Income from penalty	1,161,279.37	—	1,161,279.37
Others	—	716,313.29	—
Total	32,689,260.86	14,833,143.22	32,689,260.86

(2) Breakdown of Government grants

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Financial subsidies	31,414,069.50	12,237,500.00

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

41. Non-operating expenses

Consolidation

Items	RMB		
	Incurring during the current period	Incurring during the previous period	Amounts credited to non-recurring profit or loss for the current year
Total loss on disposal of non-current assets	429,020.39	2,123,471.06	429,020.39
Of which: Loss on disposal of fixed assets	429,020.39	2,123,471.06	429,020.39
Donation expenses	200,000.00	437,078.00	200,000.00
Other	50,948.77	104,138.20	50,948.77
Total	679,969.16	2,664,687.26	679,969.16

The Company

Items	RMB		
	Incurring during the current period	Incurring during the previous period	Amounts credited to non-recurring equity for the current year
Total loss on disposal of non-current assets	70,967.01	1,717,023.19	70,967.01
Of which: Loss on disposal of fixed assets	70,967.01	1,717,023.19	70,967.01
Donation expenses	114,000.00	306,000.00	114,000.00
Other	2,684.47	—	2,684.47
Total	187,651.48	2,023,023.19	187,651.48

42. Income tax expenses

Items	Consolidation		The Company	
	Incurring during the current period	Incurring during the previous period	Incurring during the current period	Incurring during the previous period
Income tax for the current period calculated according to tax laws and relevant rules	34,107,953.83	42,950,274.04	27,908,699.60	37,838,088.74
— Hong Kong	120,470.56	—	—	—
— Chinese mainland	33,987,483.27	42,950,274.04	27,908,699.60	37,838,088.74
Adjustment on deferred income tax	(3,085,664.37)	4,553,218.77	(3,238,013.26)	(2,779,020.53)
Total	31,022,289.46	47,503,492.81	24,670,686.34	35,059,068.21



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

42. Income tax expenses (continued)

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

	RMB			
Consolidation	The Company Incurred during the current period	Incurred during the previous period	Incurred during the current period	Incurred during the previous period
Accounting profit	200,064,524.46	324,483,801.45	200,388,960.50	355,233,488.63
Income tax calculated at tax rate of 15% on the Company	30,009,678.67	48,672,570.21	30,058,344.08	53,285,023.29
Effect of non-deductible expenses	288,320.00	524,061.58	49,830.55	125,614.35
Effect of non-taxable income	(550,873.84)	(99,241.34)	(3,729,061.89)	(12,935,328.37)
Unrecognized tax effect of deductible losses and deductible temporary differences	44,674.79	—	—	—
Additional charge on research and development expenses	(1,947,676.90)	(2,351,549.34)	(1,800,598.00)	(2,351,549.34)
Additional charge on disabled staff salary	—	(158,187.20)	—	—
Effect of non-consistent tax rates among branch companies of subsidiaries	3,085,995.14	3,980,530.62	—	—
Difference between applicable income tax rate for previous year and applicable tax rate for deferred income tax assets/ liabilities recognized	(1,431,012.13)	(285,335.03)	(1,431,012.13)	(285,335.03)
Changes on balance of deferred income tax assets at the beginning of the year caused by adjustment of tax rate	1,523,183.73	(2,779,356.69)	1,523,183.73	(2,779,356.69)
Income tax expense	31,022,289.46	47,503,492.81	24,670,686.34	35,059,068.21

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

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

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

	RMB	
	Incurred during the current period	Incurred during the previous period
Net profits for the period attributable to ordinary shareholders	168,330,282.50	276,149,165.54
Of which: net profits attributable to going concern	168,330,282.50	276,149,165.54

- (2) For the purpose of calculating earnings per share, the denominator is the weighted average of outstanding ordinary shares. The calculation is as follows:

	Unit: share	
	Incurred during the current period	Incurred during the previous period
Number of outstanding ordinary shares at the beginning of the year	398,924,200.00	328,924,200.00
Add: number of weighted ordinary shares issued during the period	—	11,666,667.00
Number of outstanding weighted ordinary shares at the end of the year	398,924,200.00	340,590,867.00

The Group does not have any dilutive potential ordinary shares.

- (3) Earnings per share

	RMB	
	Incurred during the current period	Incurred during the previous period
Calculated based on net profits attributable to the equity holders of the Company:		
Basic earnings per share	0.42	0.81
Diluted earnings per share	N/A	N/A
Calculated based on net profits attributable to equity holders of the Company on the going concern basis:		
Basic earnings per share	0.42	0.81
Diluted earnings per share	N/A	N/A



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

44. Other comprehensive income

Consolidation

RMB

	Incurred during the current period	Incurred during the previous period
Translation difference of financial statements denominated in foreign currency	570,763.42	269,875.82

45. Notes to cash flow statements

(1) Receipt of cash related to other operating activities

RMB

Item	Consolidation		The Company	
	Incurred during the current period	Incurred during the previous period	Incurred during the current period	Incurred during the previous period
Decrease in guarantees of promissory notes	63,065,560.73	—	53,065,560.73	—
Government grants	31,474,069.50	29,580,022.42	31,414,069.50	12,237,500.00
Interest income	11,521,908.44	5,112,478.99	10,597,526.28	4,791,051.40
Other	3,311,287.87	5,607,161.49	3,469,297.18	1,732,252.63
Total	109,372,826.54	40,299,662.90	98,546,453.69	18,760,804.03

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

45. Notes to cash flow statements (continued)

(2) Payment of cash related to other operating activities

RMB

	Consolidation		The Company	
	Incurring during the current period	Incurring during the previous period	Incurring during the current period	Incurring during the previous period
Transportation expense	48,959,183.74	41,169,510.05	48,954,547.74	41,081,904.16
Development fees for new products	13,469,334.15	24,299,332.74	11,794,658.95	24,299,332.74
Consumable	7,770,147.71	7,198,839.15	7,362,986.36	7,146,708.74
Agency fees	2,062,726.28	392,833.43	2,034,047.28	392,833.43
Travel expense	1,900,101.98	2,295,501.96	1,767,400.33	1,976,692.19
Expense Intermediary service	1,769,266.29	2,914,586.06	1,716,266.29	2,863,578.08
Repair expense	1,643,337.08	8,574,919.85	362,589.10	321,029.08
Electricity expense	1,161,829.12	1,258,328.67	1,119,450.61	1,251,528.67
Business reception fees	1,137,199.04	2,579,276.20	803,771.60	2,082,059.96
Increase in guarantees of promissory notes	—	32,953,041.76	—	22,953,041.76
Other	15,797,980.62	24,609,432.24	10,996,984.44	21,231,691.19
Total	95,671,106.01	148,245,602.11	86,912,702.70	125,600,400.00

(3) Receipt of cash related to other investment activities

RMB

	Consolidation		The Company	
	Incurring during the current period	Incurring during the previous period	Incurring during the current period	Incurring during the previous period
Deferred income	9,040,000.00	—	9,040,000.00	—

(4) Receipt of cash related to other financing activities

RMB

	Consolidation		The Company	
	Incurring during the current period	Incurring during the previous period	Incurring during the current period	Incurring during the previous period
Guarantees for borrowing	12,000,000.00	—	12,000,000.00	—



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

45. Notes to cash flow statements (continued)

(5) Payment of cash related to other financing activities

RMB

Item	Consolidation		The Company	
	Incurring during the current period	Incurring during the previous period	Incurring during the current period	Incurring during the previous period
Guarantees for borrowings	—	25,720,000.00	—	25,720,000.00
Intermediate fees for listing	—	56,923,150.54	—	56,923,150.54
Total	—	82,643,150.54	—	82,643,150.54

Notes to the Financial Statements



For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

46. Supplementary information on cash flow statements

(1) Supplementary information on cash flow statements

RMB

Supplementing Information	Consolidation		The Company	
	Incurring during the current period	Incurring during the previous period	Incurring during the current period	Incurring during the previous period
(1) Reconciliation of net profits as cash flows from operating activities:				
Net profits	169,042,235.00	276,980,308.64	175,718,274.16	320,174,420.42
Add: Provision of impaired assets	2,894,006.27	(2,024,288.48)	3,289,143.71	(1,541,277.09)
Depreciation of fixed assets	146,990,346.37	98,682,327.10	104,037,588.59	57,237,838.02
Depreciation of real estate held for investment	—	—	91,235.10	364,940.40
Intangible assets amortized	25,935,653.80	12,078,058.98	23,746,943.10	10,546,033.07
Amortization of long-term deferred expenses	—	—	—	—
Losses (Gains) on disposal of fixed assets, intangible assets and other long-term assets	276,322.51	498,622.95	(42,944.98)	(162,306.74)
Financial expenses (gains)	20,925,487.23	39,212,114.46	14,856,643.06	29,775,978.56
Investment losses (gains)	(253,344.29)	(191,250.95)	(19,707,433.98)	(85,765,164.48)
Decrease (Increase) in deferred income tax assets	(1,576,231.82)	1,995,768.03	(3,045,515.12)	(3,301,219.73)
Decrease (Increase) in deferred income liabilities	(1,509,432.55)	2,557,450.74	(192,498.14)	522,199.20
Decrease (Increase) in stock	(433,428,161.55)	(27,515,030.04)	(346,890,299.47)	(21,455,200.04)
Decrease (Increase) in operating receivables	164,307,318.25	(182,538,977.11)	142,687,196.09	(152,187,649.76)
Increase (Decrease) in operating payables	(5,975,624.15)	169,278,411.17	35,158,504.16	(26,174,489.76)
Net cash flows from operating activities	87,628,575.07	389,013,515.49	129,706,836.28	128,034,102.07
(2) Net change in cash and cash equivalents:				
Cash balance at the end of the year	350,636,120.73	754,225,131.33	314,143,139.67	709,106,130.16
Less: cash balance at the beginning of the year	754,225,131.33	226,121,078.70	709,106,130.16	205,767,350.33
Net increase in cash and cash equivalents	(403,589,010.60)	528,104,052.63	(394,962,990.49)	503,338,779.83



Notes to the Financial Statements

For the year ended 31 December 2011

V. Notes to the Financial Statements (continued)

46. Supplementary information on cash flow statements (continued)

(2) Components of cash and cash equivalents

	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
1. Cash				
Consist of: treasury cash	153,603.44	353,112.99	54,105.00	248,496.92
Bank deposits readily available for payment	224,925,512.85	634,926,122.65	191,685,030.23	601,411,737.55
Other currency capital readily available for payment	125,557,004.44	118,945,895.69	122,404,004.44	107,445,895.69
2. Cash and cash equivalent balance at the end of year	350,636,120.73	754,225,131.33	314,143,139.67	709,106,130.16
Other restricted currency capital	62,995,897.87	138,061,458.60	62,995,897.87	128,061,458.60
3. Currency capital at the end of the year	413,632,018.60	892,286,589.93	377,139,037.54	837,167,588.76

VI. Related Party and Transactions

1. Situation on Controlling Shareholders of the Group

As at 31 December 2011, Mr. Zhang En Rong owns 35.03% of voting shares in the Company, and is the controlling shareholder of the Company.

2. Situation on Subsidiaries of the Group is detailed in Note IV.

3. Situation on Associates of the Group is detailed in Note V. 9.

Notes to the Financial Statements



For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction

(1) Purchase and Sales of Commodities. Supplement and Acceptance of Service

Table on situation on commodities purchasement:

The Company

Related party	Subject of connected transaction	Pricing method and decision procedures of connected transaction	Incurred during the current period		Incurred during the previous period	
			Amount	As a proportion to same type of transaction amount (%)	Amount	As a proportion to same type of transaction amount (%)
Molong Drilling Equipment	Three kinds of pumping equipment	Agreed price	—	—	18,264,024.05	0.78
Shouguang Baolong	Casting	Agreed price (Note 1)	1,684,924,524.83	62.55	1,616,539,241.27	68.82
Molong Electro-mechanical Equipment Company Limited	Casting, accessories, cold bed and electrical cabinet	Agreed price (Note 2)	97,096,637.29	3.61	105,170,847.10	4.48
Molong Electro-mechanical Equipment Company Limited	Accessories and cold bed	Agreed price (Note 2)	3,104,306.15	0.12	—	—
Weihai Baolong	Oil well pipes, casing and tubing	Agreed price (Note 3)	587,696,671.40	21.82	244,957,892.32	10.43
Maolong Old Metals Recycle Company Limited	Scrap steel	Agreed price	—	—	307,876.07	0.01
Total			2,372,822,139.67	88.10	1,985,239,880.81	84.52

Note 1: The purchase of raw materials by the Company from Shouguang Baolong was settled by the transaction price determined by the contract signed by both parties.

Note 2: The purchase of raw materials by the Company from Molong Electro-mechanical Equipment Company was settled by the fixed price prescribed by China's relevant government authorities. If there is no limitation of any prescribed price, the price would be negotiated and agreed by both parties with reference to market price (subject to adjustment). The machining expense paid by the Company to Molong Drilling Company was settled at a discounted price of 5% more of cost price.

Note 3: The purchase of raw materials by the Company from Weihai Baolong Company was determined by the market price less the discounted price of less than RMB100 per ton. Meanwhile, Weihai Baolong Company promised to provide the Company with a commodity price of less than that provided to independent third party for the same commodity at the same time.



Notes to the Financial Statements

For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(1) Purchase and Sales of Commodities. Supplement and Acceptance of Service (continued)

Table on situation of commodities sales:

Consolidation

RMB

Related party	Subject of connected transaction	Pricing method and decision procedures of connected transaction	Incurred during the current period		Incurred during the previous period	
			Amount	As a proportion to same type of transaction amount (%)	Amount	As a proportion to same type of transaction amount (%)
Yalong Oil Pump	Oil Well pumpings and accessories	Agreed price (Note 4)	12,259,827.00	0.45	8,022,376.45	0.30

The Company

RMB

Related party	Subject of connected transaction	Pricing method and decision procedures of connected transaction	Incurred during the current period		Incurred during the previous period	
			Amount	As a proportion to same type of transaction amount (%)	Amount	As a proportion to same type of transaction amount (%)
Molong Drilling Equipment	Scrap steel and oil machinery parts	Agreed price (Note 4)	—	—	5,446,821.38	0.20
Shouguang Baolong	Scrap steel	Agreed price (Note 4)	58,962,797.04	2.06	64,616,120.84	2.43
Molong Electro-mechanical Equipment Company Limited	Scrap steel metal	Agreed price (Note 4)	42,143,387.97	1.47	32,386,756.91	1.22
Weihai Baolong	Scrap steel and cylindric steel, etc	Agreed price (Note 4)	70,685,838.45	2.47	58,102,318.68	2.18
Yalong Oil Pump	Oil well pumping sand accessories	Agreed price (Note 4)	12,259,827.00	0.43	8,022,376.45	0.30
Total			184,051,850.46	6.43	168,574,394.26	6.33

Note 4: The purchase of raw materials by the Company from related parties was settled by the fixed price prescribed by China's relevant government authorities. If there is no limitation of any prescribed price, the price would be negotiated and agreed by both parties with reference to market price (subject to adjustment).

Notes to the Financial Statements



For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(2) Situation on connected tenancy

Table on situation of tenancy:

The Company

							RMB
Name of Leasor	Name of Lessee	Type of leased asset	Initial date of lease	Expiry date of lease	Basis of lease gains determination	Lease gains recognized during the year	
The Company	Molong Logistics Company Limited	Housing and construction	30 June 2011	30 June 2021	Agreement price	20,000.00	

(3) Assets assignment of related party:

The Company

								RMB
Related party	Subject of connected transaction	Type of connected transaction	Pricing principles for connected transaction	Incurred during the current period		Incurred during the previous period		
				Amount	As a proportion to same type of transaction amount (%)	Amount	As a proportion to same type of transaction amount (%)	
Weihai Baolong	Fixed Asset	Sales	Net carrying value	899,866.46	50.74	5,561,188.67	75.57	
Molong Drilling Equipment	Fixed Asset	Purchase	Net carrying value	—	—	14,499.62	—	
Shouguang Baolong	Fixed Asset	Purchase	Net carrying value	833,615.02	0.42	—	—	
Molong Electro-mechanical Equipment Company Limited	Fixed Asset	Purchase	Net carrying value	21,222,426.86	10.73	20,149,227.42	2.45	
Total				22,056,041.88	11.15	20,163,727.04	2.45	



Notes to the Financial Statements

For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(4) Remuneration of Key Management

Consolidation and the Company

The remuneration of key management of the Company in 2011 amounted to RMB3,092,369.02 (2010: RMB3,090,090.68).

The emoluments paid or payable on each of the 13 (2010: 12) directors and supervisors were as follows:

	Executive directors					Independent non-executive directors					Supervisors			Total		
	Zhang En Rong	Zhang Yun San	Lin Fu Long	Xie Xin Gang	Wang Ping (Note 1)	Chen Jian Xiang (Note 1)/(Note 2)	Qing Zhou (Note 3)	Xiao Hua	Wang Chun Hua	John Paul Cameron	Chau Shing Yim, David	Liu Huai Duo	Liu Wan Fu		Fan Ren Yi	
2011:																
Fees	—	—	—	—	—	—	22,200.00	36,000.00	90,600.00	90,600.00	90,600.00	—	—	—	—	239,400.00
Basic salaries and allowances	701,933.27	590,496.73	314,342.35	376,627.65	—	—	—	—	—	—	—	61,414.38	24,000.00	12,000.00	—	2,080,814.38
Retirement scheme	—	9,359.40	9,359.40	9,359.40	—	—	—	—	—	—	—	6,240.36	—	—	—	34,318.56
Other	—	6,291.24	6,291.24	6,291.24	—	—	—	—	—	—	—	5,475.66	—	—	—	24,349.38
Total	701,933.27	606,147.37	329,992.99	392,278.29	—	—	22,200.00	36,000.00	90,600.00	90,600.00	90,600.00	73,130.40	24,000.00	12,000.00	—	2,378,882.32
2010:																
Fees	—	—	—	—	—	—	—	36,000.00	94,800.00	94,800.00	—	—	—	—	—	225,600.00
Basic salaries and allowances	710,463.67	561,238.89	297,332.46	378,809.57	—	—	—	—	—	—	—	55,800.00	24,000.00	12,000.00	—	2,039,644.59
Retirement scheme	—	3,060.72	3,007.20	3,007.20	—	—	—	—	—	—	—	3,500.00	—	—	—	12,575.12
Other	—	5,304.73	5,244.38	5,244.38	—	—	—	—	—	—	—	—	—	—	—	15,793.49
Total	710,463.67	569,604.34	305,584.04	387,061.15	—	—	—	36,000.00	94,800.00	94,800.00	59,300.00	24,000.00	12,000.00	—	—	2,293,613.20

Notes to the Financial Statements



For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(4) Remuneration of Key Management (continued)

Consolidation and the Company (continued)

Note 1: The personnel has not received remuneration of any form from the Group.

Note 2: The personnel has resigned on 20 May 2011.

Note 3: The personnel has been in office on 20 May 2011.

Note 4: Payment of remuneration for key management are all made in the form of monetary currency.

Note 5: In 2011 and 2010, no director has waived any remuneration.

Note 6: During the current year, no amount is paid or payable for procuring any director to join or upon joining the Group; and no amount is paid or payable to them as the compensation for any director or resigned director for his/her loss of position as the director of the members of the Group.

Note 7: The Group has formulated the remuneration of directors and supervisors according to the remuneration management system of the Group, which has been approved by the Board.

Three (2010: 4) of the five top remuneration persons are directors of the Company, whose remuneration was shown in Note (VI)4(4). The other 2 (2010: 2) persons' remuneration is as follows:

Name of item	RMB	
	Occurred in the current year	Occurred in the previous year
Salaries	778,078.60	794,526.60
Retirement scheme contribution	18,718.80	6,014.40
Other	12,582.48	12,836.00
Total	809,379.88	813,377.00

Remuneration Range:

	RMB	
	Number of the current year	Number of the previous year
Below HK\$1,000,000	5	5



Notes to the Financial Statements

For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

5. Account receivable and payable of related parties :

(1) Account receivable of related party:

Consolidation

RMB

Item	Related party	Closing balance		Opening balance	
		Book balance	Bad debt balance	Book balance	Bad debt balance
Accounts receivable	Yalong Oil Pump	957,200.50	—	2,576,611.00	—

The Company

RMB

Item	Name	Closing balance		Opening balance	
		Book balance	Bad debt balance	Book balance	Bad debt balance
Accounts receivable	Yalong Oil Pump	957,200.50	—	2,576,611.00	—
Other receivables	Molong Electro-mechanical Equipment Company Limited	—	—	690,000.00	—
	Molong Logistics Company	20,000.00	—	—	—
	Total	20,000.00	—	690,000.00	—
Advance Payment	Weihai Baolong	—	—	42,880,150.69	—
	Shouguang Baolong	—	—	49,077,015.70	—
	Total	—	—	91,957,166.39	—

Notes to the Financial Statements



For the year ended 31 December 2011

VI. Related Party and Transactions (continued)

5. Account receivable and payable of related parties: (continued)

(2) Account payable of related party:

The Company

		RMB	
Item	Name	Closing balance	Opening balance
Accounts receivable	Molong Drilling Equipment	—	20,194,138.58
	Shouguang Baolong	16,701,218.40	—
	Weihai Baolong	64,209,376.84	—
	Molong Electro-mechanical Equipment Company Limited	30,473,480.99	7,415,268.46
	Maolong Old Metals Recycle Company Limited	—	360,215.00
Total		111,384,076.23	27,969,622.04
Other receivables	Maolong Old Metals Recycle Company Limited	622,553.06	622,553.06
	Shouguang Baolong	3,723,785.85	—
Total		4,346,338.91	622,553.06
Advance Payment	MPM Internal Company Limited	13,784,097.22	58,889,120.06
Bills payable	Molong Electro-mechanical Equipment Company Limited	9,885,396.97	18,805,654.37
	Weihai Baolong	22,000,000.00	13,830,000.00
	Shouguang Baolong	233,973,085.56	257,400,000.00
	Molong Drilling Equipment	—	1,048,000.00
Total		265,858,482.53	291,083,654.37



Notes to the Financial Statements

For the year ended 31 December 2011

VII. Commitments

1. Capital Commitment

	Closing balance	Opening balance
Contracted but not recognized in financial statements		RMB
— Commitment on acquisition and construction of long-term assets	45,726,786.00	75,560,023.34

VIII. Non-adjustment subsequent to balance sheet date

1. Distribution of profits after Balance Sheet

Item	Amount
Profit or dividend which would distribute (Note)	39,892,420.00
Capitalizing of common reserves	398,924,200 shares

Note: For details, please refer to Note (v.) 31.

IX. Other Significant Items

1. Segment Reporting

According to the internal organization structure, management requirements and internal reporting system of the Group, the Group's operating segments are divided into 4 reportable segments. The Group's management regularly evaluates the operating results of these reportable segments to determine the resources to be allocated and evaluates its results. Each of the Group's reportable segments includes casing, tubing, three kinds of pumping units, petroleum machinery and others.

Segment reporting information is disclosed in accordance to the accounting policies and measurement standards adopted for reporting to the management by each segment, which are consistent with the accounting policies and measurement basis for preparing financial statements.

Transfer and transaction among segments are measured on the basis of actual transaction price. Segment income and segment expenses are recognized on the basis of actual income and expense of each segment. Segment assets or liabilities are allocated in accordance with assets attributable to such operating segment used or liabilities attributable to such operating segment incurred during normal course of operation of the operating segment.

Notes to the Financial Statements



For the year ended 31 December 2011

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(1) Segment Reporting Information

Combined segment reporting — 2011

	Casing and Tubing	Three kinds of pumping units	Petroleum machinery	Other	Unallocated Items	Intersegment elimination	RMB Total
Operation Revenue							
External transaction income	2,334,253,537.27	78,296,157.27	165,947,013.60	160,195,122.07	—	—	2,738,691,830.21
Income for inter-segment transaction	—	—	—	—	—	—	—
Total Segment Operation Revenue	2,334,253,537.27	78,296,157.27	165,947,013.60	160,195,122.07	—	—	2,738,691,830.21
Total operation revenue presented	2,334,253,537.27	78,296,157.27	165,947,013.60	160,195,122.07	—	—	2,738,691,830.21
Segment Costs	2,111,666,214.36	67,047,080.77	141,583,732.74	149,947,779.69	(161,040.00)	—	2,470,083,767.56
Segment operating profit	222,587,322.91	11,249,076.50	24,363,280.86	10,247,342.38	161,040.00	—	268,608,062.65
Adjustment items:							
Administrative Expenses	—	—	—	—	87,944,411.71	—	87,944,411.71
Finance expenses	—	—	—	—	14,649,473.96	—	14,649,473.96
Investment income	—	—	—	—	253,344.29	—	253,344.29
Operation Profit	222,587,322.91	11,249,076.50	24,363,280.86	10,247,342.38	(102,179,501.38)	—	166,267,521.27
Non-operation income	—	—	—	—	34,476,972.35	—	34,476,972.35
Non-operation expenditure	—	—	—	—	679,969.16	—	679,969.16
Total Profit	222,587,322.91	11,249,076.50	24,363,280.86	10,247,342.38	(68,382,498.19)	—	200,064,524.46
Income tax	—	—	—	—	31,022,289.46	—	31,022,289.46
Net profit	222,587,322.91	11,249,076.50	24,363,280.86	10,247,342.38	(99,404,787.65)	—	169,042,235.00
Total segment assets	3,704,280,140.19	119,942,369.19	254,215,259.92	167,608,931.75	442,884,735.65	—	4,688,931,436.70
Total segment liabilities	978,297,235.93	25,998,192.73	59,814,850.84	44,265,376.39	727,578,052.46	—	1,835,953,708.35
Supplementary Information:							
Depreciation	127,351,622.79	3,421,346.61	7,251,470.22	—	8,965,906.75	—	146,990,346.37
Amortize	21,446,606.22	—	—	376,794.69	4,112,252.89	—	25,935,653.80
Interest Income	—	—	—	—	(11,521,908.44)	—	(11,521,908.44)
Interest cost	—	—	—	—	28,496,324.62	—	28,496,324.62
Impairment losses recognized in current year:	3,289,143.71	—	—	(234,097.44)	(161,040.00)	—	2,894,006.27
Non-current assets other than long-term equity investment	2,120,244,420.03	66,547,725.59	141,046,466.49	63,045,933.94	16,672,092.94	—	2,407,556,638.99
Capital expenditure	324,648,269.44	3,072,365.76	7,431,471.53	—	66,616,209.83	—	401,768,316.56
Consist of:							
Expenses on construction in progress	241,059,062.92	—	—	—	14,009,879.85	—	255,068,942.77
Expenses on purchase of fixed assets	18,335,572.93	3,072,365.76	7,431,471.53	—	9,380,447.64	—	38,219,857.86
Expenses on purchase of intangible assets	65,253,633.59	—	—	—	43,225,882.34	—	108,479,515.93
Non-cash expenses other than depreciation and amortization	—	—	—	—	—	—	—



Notes to the Financial Statements

For the year ended 31 December 2011

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(1) Segment Reporting Information (continued)

Combined segment reporting — 2010

	RMB						
	Casing and Tubing	Three kinds of pumping units	Petroleum machinery	Other	Unallocated items	Intersegment elimination	Total
Operation Revenue							
External transaction income	2,126,589,473.71	111,655,198.06	148,493,859.41	317,168,304.01	—	—	2,703,906,835.19
Income for inter-segment transaction	—	—	—	—	—	—	—
Total Segment Operation Revenue	2,126,589,473.71	111,655,198.06	148,493,859.41	317,168,304.01	—	—	2,703,906,835.19
Total operation revenue presented	2,126,589,473.71	111,655,198.06	148,493,859.41	317,168,304.01	—	—	2,703,906,835.19
Segment costs	1,765,924,819.79	90,804,594.44	128,124,277.00	307,689,470.44	(887,650.50)	—	2,291,655,511.17
Segment operating profit	360,664,653.92	20,850,603.62	20,369,582.41	9,478,833.57	887,650.50	—	412,251,324.02
Adjustment items:							
Administrative expenses	—	—	—	—	91,383,971.04	—	91,383,971.04
Finance expenses	—	—	—	—	44,341,872.74	—	44,341,872.74
Investment income	—	—	—	—	191,250.95	—	191,250.95
Operation Profit presented	360,664,653.92	20,850,603.62	20,369,582.41	9,478,833.57	(134,646,942.33)	—	276,716,731.19
Non-operation income	—	—	—	—	50,431,757.52	—	50,431,757.52
Non-operation expenditure	—	—	—	—	2,664,687.26	—	2,664,687.26
Total Profit	360,664,653.92	20,850,603.62	20,369,582.41	9,478,833.57	(86,879,872.07)	—	324,483,801.45
Income tax	—	—	—	—	47,503,492.81	—	47,503,492.81
Net profit	360,664,653.92	20,850,603.62	20,369,582.41	9,478,833.57	(134,383,364.88)	—	276,980,308.64
Total segment assets	2,879,744,594.66	105,967,422.92	590,841,404.05	89,847,662.69	920,009,730.86	—	4,586,410,815.18
Total segment liabilities	974,692,381.05	25,778,108.93	54,523,677.02	37,575,191.04	750,638,097.21	—	1,843,207,455.25
Supplementary Information:							
Depreciation	83,113,141.70	2,415,819.56	4,718,452.52	—	8,434,913.32	—	98,682,327.10
Amortization	11,051,502.34	—	1,026,556.64	—	—	—	12,078,058.98
Interest Income	—	—	—	—	5,112,478.99	—	5,112,478.99
Interest cost	—	—	—	—	65,978,204.21	—	65,978,204.21
Impairment losses recognized in previous year:	(1,136,637.98)	—	—	—	(887,650.50)	—	(2,024,288.48)
Non-current assets other than long term equity investment	2,064,014,359.04	41,443,738.55	18,487,846.47	48,975,422.63	15,095,861.12	—	2,188,017,227.81
Capital expenditure	634,988,815.03	489,529.51	40,232,058.22	—	16,890,017.19	—	692,600,419.95
Consist of:							
Expenses on construction in progress	558,871,719.53	476,572.51	8,099,611.62	—	—	—	567,447,903.66
Expenses on purchase of fixed assets	22,100,646.12	12,957.00	3,042,453.43	—	2,194,380.64	—	27,350,437.19
Expenses on purchase of intangible assets	54,016,449.38	—	29,089,993.17	—	14,695,636.55	—	97,802,079.10
Non-cash expenses other than depreciation and amortization	—	—	—	—	—	—	—



For the year ended 31 December 2011

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(2) External transaction income by location of income source and non-current assets by location of assets

In 2011 and 2010, all of the Group's external transaction income were from China and overseas, while all assets were located in China, hence the external transaction income by location of income source is disclosed as follows:

	Incurred during the current period	Incurred during the previous period
Domestic external transaction income	1,708,533,817.17	1,754,207,623.85
Foreign external transaction income	1,030,158,013.04	949,699,211.34
Total	2,738,691,830.21	2,703,906,835.19

RMB

(3) Reliability on major customers

The Group's major customers are PetroChina Company Limited, PPC Limited, SB International Inc, Campex Inc and Shandong Luxing Steel Co., Ltd. Specific details could be referred to Note V. 33.

2. Financial instruments and risk management

Major financial instruments of the Group include bills receivable, accounts receivables, equity investment, borrowings, bills payables, accounts payables, financial assets held for trading, financial liabilities held for trading, etc. Detailed descriptions of these financial instruments are set out in related note. Below are the risks associated with such financial instruments and the risk management policies adopted by the Group to mitigate such risks. The management of the Group manages and monitors such risk exposures to ensure such risks are contained within a prescribed scope.

2.1. Objective and policies of risk management

The Group engages in risk management with the aim of achieving an appropriate balance between risk and return, where the negative effects of risks against the Group's operating results are minimized, in order to maximize the benefits of shareholders and other stakeholders. Based on such objective in risk management, the underlying strategy of the Group's risk management is to ascertain and analyze all types of risks exposures of the Group, establish appropriate risk tolerance thresholds, carry out risk management procedures and perform risk monitoring on all kinds of risks in a timely and reliable manner, thus containing risk exposures within a prescribed scope.



Notes to the Financial Statements

For the year ended 31 December 2011

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.1. Objective and policies of risk management (continued)

2.1.1 Market risks

2.1.1.1 Foreign exchange risk

Foreign exchange risk represents risks of loss incurred as a result of changes in exchange rate. The Group is mainly exposed to foreign exchange risks in connection with USD; except for the Company and its subsidiaries MPM of which effect purchases and sales in USD, all the business activities of the remaining principal operations of the Group are settled with RMB. On 31 December 2011, except for the USD balances in assets and liabilities, odd monies in EUR and balances in HKD and Yen as set out below, all the balances of assets and liabilities of the Group were denominated in RMB. The foreign exchange risk arising from assets and liabilities in such USD balances may affect the operating results of the Group.

	RMB	
	Closing balance	Opening balance
Cash and cash equivalents — USD	42,767,930.02	5,385,617.68
Cash and cash equivalents — HKD	12,460.81	14,788.49
Cash and cash equivalents — EUR	854.70	883.47
Accounts receivable — USD	153,878,561.49	216,735,933.07
Accounts receivable — EUR	1,863,200.41	2,593,713.72
Other receivables — USD	—	1,326,354.02
Other payables — USD	282,533.87	241,257.61
Short-term borrowings — USD	373,920,265.13	117,866,417.20
Short-term borrowings — Yen	5,581,812.10	—

For foreign exchange risk, the Group has always placed its concern on the research of foreign exchange risk management policies and strategies, and maintain close co-operation with financial institutions engaging in foreign exchange business, while arranging favorable settlement terms via contracts. Meanwhile, with the continuous increase in the proportion of international market, if risks beyond the control of the Group, such as the appreciation of Renminbi, incurs, the Group will mitigate such risk via suitable adjustment of sales strategies. Apart from entering into fixed-rate bank borrowing contracts, most of the Group's borrowing contracts are in variable rates. The Group has not adopted other measures, including entering into interest swap contract, to avoid the fair value risk arising from the change in interest rate.

2.1.1.2 Interest rate risk — risk in change in cash flow

The risk that changes in interest rate lead to changes in cash flow of the financial instruments of the Group is mainly associated with floating-rate bank borrowings. The Group's goal is to maintain these borrowings in floating rates.



For the year ended 31 December 2011

IX. Other Significant Items *(continued)*

2. Financial instruments and risk management *(continued)*

2.1. Objective and policies of risk management *(continued)*

2.1.2. Credit risk

On 31 December 2011, the most significant credit risk exposure that might incur financial losses on the Group was mainly attributable to a contractual counterparty's failure to perform its obligations, the effects of which could lead to losses in financial assets of the Group, specific details are set out as follows:

The carrying amount of financial assets recognized in the combined balance sheet: in respect of financial instruments carried at fair value, the carrying amount reflects the risk exposure; however, such amount does not represent the maximum credit exposure which changes in line with future changes in fair value.

In order to mitigate credit risk, the Group reassesses the collectability of each amount receivable on an individual basis at each balance sheet date, in order to ensure sufficient provision is allocated for amounts that are not recoverable. As such, the management of the Group believes the credit risk assumed by the Group has been significantly reduced.

The Group has adopted necessary policies to ensure that all sales customers have good credit records. Apart from the top five accounts receivables, the Group has no other significant concentration risk.

	RMB
	Closing balance
Accounts receivable	225,891,523.93



Notes to the Financial Statements

For the year ended 31 December 2011

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.1. Objective and policies of risk management (continued)

2.1.3. Liquidity risk

In managing liquidity risk, the Group maintains cash and cash equivalent at a level deemed sufficient by the management and carry out monitoring, in order to satisfy the operating needs of the Group and lower the effects of fluctuations in cash flows. The management of the Group monitors the utilization of bank borrowings and makes sure the related borrowing agreements are complied with.

The primary source of funding for the Group is bank borrowings. On 31 December 2011, the Group unutilized bank facilities of RMB4,466,290,596.71 (On 31 December 2010, the Group unutilized bank facilities of RMB2,549,893,081.28), including outstanding short-term bank facilities of RMB4,466,290,596.71 (On 31 December 2010, the Group had unutilized bank facilities of RMB2,549,893,081.28).

Maturity analysis of financial assets and financial liabilities of the Group at undiscounted remaining contractual obligations are set out as follows:

Item	Closing balance		Total
	within 1 year	Over 1 year	
Monetary capital	413,632,018.60	—	413,632,018.60
Bills receivable	73,528,915.23	—	73,528,915.23
Account receivables	469,113,379.75	—	469,113,379.75
Other receivables	29,939,686.98	—	29,939,686.98
Short-term borrowings	710,502,077.23	—	727,334,271.06
Bills payables	383,690,165.06	—	383,690,165.06
Account payables	616,716,194.34	—	616,716,194.34
Interests payables	5,557,955.40	—	5,557,955.40
Other payables	22,561,056.57	—	22,561,056.57

Notes to the Financial Statements



For the year ended 31 December 2011

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.2. Fair value

The value of financial assets and financial liabilities are determined using the following method:

The fair values of financial assets and financial liabilities with standard terms and conditions and active markets shall be determined with reference to the prevailing bid prices and the prevailing put prices in the corresponding active markets respectively;

The fair values of other financial assets and financial liabilities (excluding derivatives) shall be determined by the general pricing model based on the future cash flow discounting method or confirmed by adopting observable prevailing trading prices in the market;

The fair values of derivative instrument are determined based on the publicly quoted price in an active market. If public quotation does not exist, the fair value of derivatives without options is estimated on the basis of appropriate revenue curve using future cash flow discounting method; fair value of derivatives with options is measured using fixed price option model (eg. binomial model).

In the opinion of the Group's management, the carrying values for financial assets and financial liabilities measured at amortized costs in financial statements are approximate to the fair value of those assets and liabilities.

2.3. Sensitivity analysis

The Group adopts sensitivity analysis techniques to analyze the possible effects of rational and probable changes in risk variables to profit and loss for the current period or to the beneficial interests. Since risk variables seldom change on a stand-alone basis, while the correlation between variables has significant influence to the ultimate amount of change effected by the change in a single risk variable; therefore, the below analysis is based on the assumption that the changes in each variable occurred separately.

2.3.1. Foreign exchange risk

Assumption of foreign exchange risk sensitivity analysis: all overseas operating net investment hedging and cash flow hedging are highly efficient.

Based on the above basis, holding all other variables constant the effects of probable and rational changes in exchange rate to the profit and loss for the current period and after-tax consequences of interests are set out below:

Item	Change in exchange rate	Current year		Previous year	
		Effects on profit	Effects on shareholder's equity	Effects on profit	Effects on shareholder's equity
All foreign currency	Appreciate 5% relative to RMB	(9,063,080.61)	(9,063,080.61)	5,331,163.08	5,331,163.08
All foreign currency	Depreciate 5% relative to RMB	9,063,080.61	9,063,080.61	(5,331,163.08)	(5,331,163.08)

RMB



Notes to the Financial Statements

For the year ended 31 December 2011

IX. Other Significant Items (continued)

2. Financial instruments and risk management (continued)

2.3. Sensitivity analysis (continued)

2.3.2. Sensitivity analysis of interest rate risk

Sensitivity analysis of interest rate risk is based on the below assumptions:

- Changes in market rate affects the interest income or expense of floating-rate financial instruments;
- For fixed rate financial instruments measured at fair value, the change in market rates only affect its interest income or expenses;
- For derivative financial instruments designated as hedging instruments, the change in market rates affects its fair value, and all interest rate hedging are anticipated to be highly effective;
- The changes in fair value of derivative financial instrument and other financial assets and liabilities were calculated by Discounted Cash Flow (DCF) with the market rate at the balance sheet date.

Based on the above assumptions, holding all other variables constant, the effect of possible occurrence of rational changes in interest rate to the profit and loss for the period and after tax consequences of interests are set out below:

RMB

Item	Change in exchange rate	Current year		Previous year	
		Effects on profit	Effects on shareholder's equity	Effects on profit	Effects on shareholder's equity
Floating-rate borrowings	Decreased by 1%	5,432,610.29	5,432,610.29	4,378,664.17	4,378,664.17
Floating-rate borrowings	Increased by 1%	(5,432,610.29)	(5,432,610.29)	(4,378,664.17)	(4,378,664.17)

Notes to the Financial Statements



For the year ended 31 December 2011

IX. Other Significant Items (continued)

3. Retirement/Pension Scheme Benefits

RMB

Item	Consolidation	
	Amount for the current period	Amount for the current period
Retirement and Pension Scheme Benefits	9,970,146.29	6,041,392.54
Less: capitalised amount	34,314.36	470,642.37
Total	9,935,831.93	5,570,750.17

The Group is required to make contributions to the retirement plans at a rate of 20% of the salaries, a member of the plan is entitled to a pension, to be paid by the municipal governments. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. When the staff leaves the positions, the Group is not entitled to recover the contributions paid in respect of their pension.

4. Other financial information

RMB

Item	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Net current assets	453,398,485.08	555,736,304.68	393,047,604.51	643,693,593.86
Total assets reducing current assets	2,873,535,748.18	2,756,230,812.31	2,737,206,191.26	2,612,479,045.24

Item	Consolidation		The Company	
	Amount for the current period			
Depreciation	146,990,346.37	98,682,327.10	104,128,823.69	57,602,778.42
Amortization	25,935,653.80	12,078,058.98	23,746,943.10	10,546,033.07
Annual audit fee	1,100,000.00	800,000.00	1,100,000.00	800,000.00

X. Approval of the Financial Statements

These financial statements had been approved by the Board of Directors of the Company on 29 March 2012.



Supplementary Information

I. Breakdown of Extraordinary Gains and Losses

RMB

Item	Amount	Remarks
Profit or loss from disposal of non-current assets non-current assets	(276,322.51)	
Government grants accounted for in profit and loss account of the current period (except for government grants closely related to the corporate business that were given under at a fixed standard amount or quantity as stipulated by the State)	31,474,069.50	
Reversal of impairment provision on receivables tested for impairment on individual basis	50,816.55	
Non-operating gains and losses other than the above items	2,599,256.20	
Effect of income tax	(5,229,933.99)	
Effect of minority interests (after tax)	(9,627.46)	
Total	28,608,258.29	

II. Yielding on Net Assets and Earnings Per Share

This calculation of return on net assets and earnings per was prepared by Shandong Molong in accordance with the relevant requirements of the spare "Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 09) — Calculations and disclosures for the return on net assets and earnings per share" (as amended in 2011) issued by the China Securities Regulatory Commission.

Profit during the reporting	Weighted aver age return period on assets (%)	Earnings per share	
		Basic	Diluted
Net profit attributable to holders of ordinary shares of the Company	6.14	0.42	N/A
Net profit attributable to holders of ordinary shares of the Company, after deducting extraordinary gains and losses	5.10	0.35	N/A

III. Irregular Movements in Major Items of the Accounting Statements of the Company and Explanation on their Reasons

This movements in items of the accounting statements of the Company was prepared by Shandong Molong in accordance with the relevant requirements of the spare "Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 15) — general regulation of financial statement" (as amended in 2011) issued by the China Securities Regulatory Commission.



III. Irregular Movements in Major Items of the Accounting Statements of the Company and Explanation on their Reasons (CONTINUED)

1. Items of combined balance sheet as at 31 December 2011 with relatively material changes as compared with that as at 31 December 2010 are set forth below:

RMB'000

Item		31 December 2011	31 December 2010	Increase/decrease from the last year (%)
Cash and bank balances	(1)	413,632	892,287	(53.64)
Bills receivable	(2)	73,529	19,121	284.55
Accounts receivable	(3)	460,164	500,868	(8.13)
Prepayments	(4)	42,128	158,602	(73.44)
Inventory	(5)	1,176,982	743,554	58.29
Other current assets	(6)	72,539	41,055	76.69
Fixed assets	(7)	1,831,368	1,648,584	11.09
Construction in progress	(8)	83,523	131,446	(36.46)
Intangible assets	(9)	333,020	249,918	33.25
Short-term borrowings	(10)	710,502	712,866	(0.33)
Bills payable	(11)	383,690	482,816	(20.53)
Accounts payable	(12)	616,716	501,722	22.91
Dividends payable	(13)	—	23,789	(100.00)

- (1) The increase in currency fund was mainly due to the acquisition and construction of fixed assets and intangible assets as well as the payment of dividends and interests during the year.
- (2) The decrease in bills receivables was mainly due to the fact that most of the Company's receivables in the year were in the form of bills of exchange of banks, which together with the concentrated collection of the accounts receivables in the year, resulted in an increase of the balance of bills receivables as compared with the end of last year.
- (3) The accounts receivable decreased in the current year, which is mainly because the Company strengthen the collection efforts of accounts receivable, and the cash collection improved.
- (4) The prepayments in the current year decreased, which is mainly because the prepaid money of RMB200 million accordance with the contract signed by Shouguang Baolong Petroleum Material Company Limited ("Shouguang Baolong Company") and Shandong Luli Steel Co., Ltd has been settled during the current year.
- (5) The inventory increased during the current year, which is mainly because (1) the Company expanded its production and reserved more raw materials; (2) the unit cost of production increased resulted from the high fixed cost of "180mm Project", which put into production at the end of 2010; and (3) the semi-finished casing and tubing of the Company haven't been processed to finished product and sold out at the end of 2011.



III. Irregular Movements in Major Items of the Accounting Statements of the Company and Explanation on their Reasons *(CONTINUED)*

1. Items of combined balance sheet as at 31 December 2011 with relatively material changes as compared with that as at 31 December 2010 are set forth below: *(continued)*

- (6) Other current assets increased during the current year, which is mainly because of the fact that the input tax of value-added tax pending to be deducted during the year has increased from the end of last year.
- (7) The fixed assets increased during the current year, which is mainly because the 140 oil pipe material processing project of Weihai Baolong, high-end oil equipment project and oil pipe material processing line of the Company were ready for use in the end of 2011, and were thus transferred to fixed assets.
- (8) The decrease in work in progress is mainly because the 140 oil pipe material processing project of Weihai Baolong, high-end oil equipment project and oil pipe material processing line of the Company were ready for use in the end of 2011, and were thus transferred to fixed assets.
- (9) The increase in intangible assets mainly comprises of two parts: (1) the acquisition of land use rights of the land in northern Luoyang for the Φ 180mm special oil pipes reconstruction project of the Company; (2) success in the research and development of certain of the Company's tubing and casting projects, which were transferred to intangible assets.
- (10) The decreased short-term loans is because the Company paid back some current fund loans.
- (11) The decrease in bills payable is mainly due to the fact that the Φ 180mm special oil pipes reconstruction project of the Company has been completed fundamentally, and the amount payable for projects and equipment decreased accordingly.
- (12) The accounts payable increased, which is mainly due to the increased material purchase.
- (13) The dividends payable in the current year was nil, which is because the Company paid for the unpaid dividends of the previous year.

2. Items of combined income statement as at 31 December 2011 with relatively material changes as compared with that as at 31 December 2010 are set forth below:

		RMB'000		
		2011	2010	Change (%)
Operation revenue	(1)	2,738,692	2,703,907	1.29
Operation costs	(2)	2,407,672	2,237,507	7.61
Selling expenses	(3)	57,586	51,361	12.12
Administrative Expenses	(4)	87,944	91,384	(3.76)
Finance Expenses	(5)	14,649	44,342	(66.96)
Asset Impairment Losses	(6)	2,894	(2,024)	242.96
Income from Investment	(7)	253	191	32.47
Non-operation revenue	(8)	34,477	50,432	(31.64)
Non-operation Expenses	(9)	680	2,665	(74.48)
Income tax expense	(10)	31,022	47,503	(34.69)



III. Irregular Movements in Major Items of the Accounting Statements of the Company and Explanation on their Reasons *(CONTINUED)*

2. Items of combined income statement as at 31 December 2011 with relatively material changes as compared with that as at 31 December 2010 are set forth below: *(continued)*

- (1) The operation revenue increased, which is mainly because with the steady economic situation, the sales in domestic and overseas increased.
- (2) The significant increase in operation cost was mainly due to that sales revenue increased, price of steels increased and fixed cost share to unit product increased after "180mm Project" put into production.
- (3) The increase in selling expenses is mainly due to that the export port miscellaneous expenses and freight charges increased resulted from the increased sales volume.
- (4) The decrease administrative expenses is mainly due to that most of the line pipe and casing research project succeeded, the research and development expense for new production included in the current profits and losses decreased.
- (5) The decrease in finance costs was principally due to that long-term loans of RMB730 million was repaid back at the end of previous year, and the interest expense of the current year decreased largely result from the decreased loan amount.
- (6) The increase in asset impairment losses is mainly due to the provision on decrease in price for inventories with relatively longer ages during the year, as well as the provision for bad debts for accounts receivable with relatively long credit terms which are expected to be irrecoverable.
- (7) The income from investment is the net investment income from Kelamayi Ya Long Oil Pump Company Limited.
- (8) The decrease in non-operation revenue is mainly due to the expiry of the "Pay first, Refund later" policy for value-added tax of Shouguang Maolong Old Metals Recycle Company Limited and Wendeng Baolong Recyclable Resource Company Limited, being the subsidiaries of the Company in the end of 2010, and no concession of such policy was enjoyed during the year.
- (9) The decrease in non-operation expenses is mainly due to the relocation of industrial park and the disposal of a substantial amount of fixed assets in the first half of the year by the Company, while no disposal of a substantial amount of fixed assets was incurred during the year.
- (10) The decreased income tax expense is mainly because the total profit of the current year decreased, compared with the previous year.



XI. Documents Available for Inspection

1. The financial statements which were signed and sealed by the legal representative, financial controller and head of the financial department of the Company.
2. The original copy of the auditors' report which was sealed by the accounting firm and signed by a certified public accountant.
3. Original copies of all of the documents and announcements of the Company which have been disclosed in the designated newspaper and website as approved by China Securities Regulatory Commission during the reporting period.

Shandong Molong Petroleum Machinery Company Limited

29 March 2012