



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)



2012
Annual
Report

I. Important, Contents and Definitions



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.

All Directors, Supervisors and the Senior Management are able to guarantee the truthfulness, accuracy and completeness of the annual report or disagree with the content of the annual report.

All directors attended the Board meeting for considering this report.

The Company's profit distribution plan considered and approved by the Board is: based on the total share capital of the Company as at 31 December 2012, a cash bonus of RMB0.5 (tax included) for every 10 shares will be distributed to all shareholders, no bonus share will be issued, and no reserve will be transferred to the share capital of the Company.

Contents

I.	Important, Content and Definitions	1
II.	Company Profile	3
III.	Summary of Financial and Operating Results	5
IV.	Directors' Report	7
V.	Material Matters	27
VI.	Changes in Share Capital and Shareholders	29
VII.	Directors, Supervisors, Senior Management and Employees	35
VIII.	Corporate Governance Report	44
IX.	Internal Control	60
X.	Financial Report	62
XI.	Documents Available for Inspection	194



I. Important, Contents and Definitions

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.

Major Risk Alerts

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.

II. Company Profile



I. Company Information

Stock Abbreviation	山東墨龍
Stock Code	A shares: 002490 H shares: 00568
Stock Exchange of Listed Securities	A shares: Shenzhen Stock Exchange H shares: The Stock Exchange of Hong Kong Limited
Legal Chinese name of the Company	山東墨龍石油機械股份有限公司
Abbreviation of the Chinese name	山東墨龍
Legal English name of the Company	Shandong Molong Petroleum Machinery Co.,Ltd
Abbreviation of the English name	Shandong Molong
Legal Representative of the Company	Zhang En Rong
Registered Address of the Company	No. 999 WenSheng Street, Shouguang City, Shandong Province
Postal Code of Registered Address	262700
Office Address	No. 999 WenSheng Street, Shouguang City, Shandong Province
Postal Code of office address	262700
Website of the Company	http://www.molonggroup.com / http://www.hkex.com.hk
Email Address	sdml@molonggroup.com

II. Contact Information

	The Secretary of the Board	Securities Affairs Representative
Name	Zhao Hong Feng	Wang Peng Hua
Office Address	No. 999 WenSheng Street, Shouguang City, Shandong Province	No. 999 WenSheng Street, Shouguang City, Shandong Province
Telephone	(86)-0536-5100890	(86)-0536-5789083
Facsimile	(86)-0536-5100888	(86)-0536-5100888
Email Address	zhf@molonggroup.com	wph@molonggroup.com

Principal place of business in Hong Kong

Suite A, 11th Floor
Ho Lee Commercial Building
38-44 D' Aguilar Street
Central
Hong Kong

III. Information Disclosure and Places for Inspection of the Company's Annual Report

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
Places for Inspection of the Company's Annual Report	Board of Directors Office of the Company



II. Company Profile

IV. Registry Changes

	Date of Registration	Registered Address	Legal Person Business License	Registration Number with tax bureau	Organization No.
First Registration	30 December, 2001	No. 99 Beihuan Road, Shouguang City, Shandong Province	3700001807083	370783734705456	73470545-6
Report the Final Registration	28 August, 2012	No. 999 WenSheng Street, Shouguang City, Shandong Province	370000400000030	370783734705456	73470545-6
Changes in principal operations (if any) since the Company's listing			No change		
All changes in controlling shareholders (if any)			No change		

V. Other Relevant Information of the Company

Auditor Retained by the Company

Auditor	Deloitte Touche Tohmatsu Certified Public Accountants Ltd. (Special General Partner)
Office Address	30th Floor, Bund Center, No. 222 Yanan Road, Huangpu District, Shanghai
Name of Signature certified public accountants	Yang Yu Min, Huang Yue

Sponsors engaged by the Company to continuously perform its supervisory function during the reporting period

The Sponsor Institution	Office Address of Sponsor	Name of the Sponsor	The period of continuous supervision and guidance
China Merchants Securities Co.	41th Floor, Block A, Jiangsu Building, Yitian Road, Futian District, Shenzhen	Xu Zhong Zhe, Hong Jin Yong	21 October 2010–31 December 2012

III. Summary of Financial and Operating Results



I. Major Financial Data and Indicators for the Year of the Group

	Unit: RMB			
	2012	2011	Year-on-year Increase/Decrease (%)	2010
Operating Revenue	2,952,063,832.16	2,738,691,830.21	7.79%	2,703,906,835.19
Net profit attributable to equity holders of Listed Company	134,263,035.30	168,330,282.50	-20.24%	276,149,465.54
Net profit after extraordinary gains or losses attributable to equity holders of Listed Company	88,497,742.61	139,722,024.21	-36.66%	251,864,739.11
Net cash flows from operating activities	445,930,901.29	87,628,575.07	408.89%	389,013,515.49
Basic earning per Share (RMB)	0.17	0.21	-19.05%	0.41
Diluted earning per Share (RMB)	0.17	0.21	-19.05%	0.41
Net Assets Income Rate (%)	4.73%	6.14%	-1.41%	17.7%
			Year-on-year Increase/Decrease (%)	
	2012	2011		2010
Total assets	5,285,750,978.82	4,688,931,436.70	12.73%	4,586,410,815.18
Net assets attributable to shareholders of Listed Company (owners' interests attributable to shareholders of List Company)	2,889,416,712.61	2,795,014,393.18	3.38%	2,685,990,386.13



III. Summary of Financial and Operating Results

II. Extraordinary Gains or Losses Items

Item	Unit: RMB			Instruction
	2012	2011	2010	
Gains or losses arising from the disposal of non-current assets (including the written-offs that have been provided for impairment of assets)	-187,450.15	-276,322.51	-498,622.95	—
Government grant recognised in current profit and loss (excluding those grants that are closely related to the Company's business and that were granted in accordance with the standard amount or volume prescribed by the State)	49,141,000.00	31,474,069.50	29,580,022.42	—
Reversal of bad debt provision for accounts receivable provided for impairment separately	4,650,513.63	50,816.55	513,766.81	—
Non-operating gain or loss other than the above	185,257.13	2,599,256.20	935,042.70	—
Effect of extraordinary gains or losses on income tax	8,011,893.61	5,229,933.99	6,200,727.22	—
Effect of extraordinary gains or losses on minority shareholders interest (after tax)	12,134.31	9,627.46	44,755.33	—
Total	45,765,292.69	28,608,258.29	24,284,726.43	—

IV. Directors' Report



I. Overview

With the promulgation of “The Twelfth Five-Year Development Plan on Petrochemical and Chemical Industry”, “The Twelfth Five-Year Plan for the Development of Natural Gas” and “The Twelfth Five-Year Development Plan on Shale Gas”, the Company was facing new opportunities and challenges and entered to a new period of development during 2012. With the continuously increasing production capacity of its original projects and the continuous improvement of its product series, the Company has equipped with the ability to cope with the changes in the market. Amidst the frequent fluctuation in global oil price, prolonged low level of steel price, weak demand of overseas markets and slowdown of the growth of domestic economy, the energy equipment industry has presented a trend of higher professional level and increasing market competition. During 2012, facing the new challenges from shales gas and offshore petroleum, the Company has organized and planned for project construction, continuously increased the investment in technology and research and development of new products, steadily expanded its market coverage, integrally enhanced the management, proactively overcame the influence from internal and external difficulties, and basically accomplished its planned objectives.

II. Principal Operations of the Company and Analysis on Their Operations

1. Overview of Principal operations

The Company reported RMB2,952,063,832.16 in operating revenue for the year 2012, representing a 7.79% growth compared with the previous year. Total profit in 2012 of RMB165,854,479.55 representing a 17.10% decrease compared with the previous year. The net profit attributable to shareholders of the Company in 2012 decreased by 20.24% as compared with the previous year to RMB134,263,035.30. The net profit of the Company after non-recurring profit and loss was RMB88,497,742.61, decreased by 36.66% compared with last year.

Company's review of the development strategy disclosed before and the progress of the operating plan during the reporting period.

1. In terms of domestic market expansion, the Group's main customers are major oil fields in the PRC, including Daqing Oil Field (大慶油田), Changqing Oil Field (長慶油田), Xinjiang Oil Field (新疆油田), Liaohe Oil Field (遼河油田), Qinghai Oil Field (青海油田), Talimu Oil Field (塔里木油田), Huabei Oil Field (華北油田), Jidong Oil Field (冀東油田) and Jilin Oil Field (吉林油田), all of which are oil fields of PetroChina Company Limited and its subsidiaries (collectively, “PetroChina Group”), as well as Shengli Oil Field (勝利油田), Zhongyuan Oil Field (中原油田), Jiangsu Oil Field (江蘇油田) and Jiangnan Oil Field (江漢油田), all of which are oil fields of China Petroleum & Chemical Corporation and its subsidiaries (collectively, “Sinopec Group”). During the period under review, the Group increased its efforts to cooperate with existing oil field customers, and gained wide market evaluation, Sales to the above oil fields under the PetroChina Group and the Sinopec Group accounted for approximately 26.73% of the Group's sales revenue.



IV. Directors' Report

After the oil well pipes fully entering into PetroChina Group, during the reporting period the non-API pipe in the oil market was further promoted, the mass production order of Xinjiang Oil Field (新疆油田) and PetroChina Southwest Oil & Gasfield Company (西南油气). The large inner diameter tubing, simple and special buckle casing, anti-twist release buckle tubing, internal coupling tubing and other new products were tested downhole successfully in the Xinjiang Oil Field, Changqing Oil Field, Huabei Oil Field, Jidong Oil Field, Daqing Oil Field and other oilfields. The thermal recovery well tubing has also been supplied for downhole testing.

In addition, the Company's products such as oil well pipes, oil well pumps and oil well pumping machines successfully enter the Northeast coal market for coalbed methane development. Meanwhile, the sales of the non-oil well tubes and seamless tubes increased largely, suspension single hydraulic prop pipe, pipe for automobile cylinder and other products began to occupy the domestic major markets.

2. In terms of overseas market, during the reporting period, the Group further strengthened the existing markets and customers while the Group continued to step up its efforts in developing its business to regions such as the Middle East, South America, North Africa, and Australia and had achieved good performance. The Group has developed new customers which are major in casing and tubing sales, line pipe, subsea line pipe, and sucker rod products. In addition, during the reporting period, the casing and tubing and line pipe products of the Group got the product certification from many well-known international oil company. With the development of new customers and the production certification of international oil companies, the Group further expanded occupation ratio of the overseas market, and promote its popularity in the international oil drilling equipment market. The Group continued to establish and maintain good and long-term cooperative relationships with many overseas stock companies and oil field service companies, which in turn boosted the sales of its products in the overseas markets. During the reporting period, the Group's revenue generated from exports accounted for approximately 39.59% of the Group's total sales revenue.
3. In terms of the 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 increase its efforts to develop high-end products and strengthened technological cooperation with research institutes such as Xi'an Jiaotong University, Northeastern University, and Xi'an Pipe Material Research Institute of PetroChina Group. With the advantages, the Company increased its efforts to develop new products, expand product mix and enrich product categories, and has successfully developed products including large inner diameter tube, thermal recovery well casing, anti-twisting and galling tube, and Anti-H₂S tube, extra-long and thick tube, suspension pillar tube, thin-walled high-pressure alloy tube, nickel plating anticorrosion sucker rod and acidic line pipe, all of which have been complete trial producing and sold domestic and overseas. In particular, the research and development of the following four products including the economic gas seal threaded sleeve, ultra-high strength anti-torque sucker rod, ML140V high strength and toughness casing, large inner diameter tubing was classified as the province-level technology innovation projects of the Shandong Province, and related research and development work have been carried out. Moreover, the Company's patent protection of its new research and development achievements are as follows. The Company has achieved national patents in seven new product's researches including "rod anti-tripping connected device and manufacturing method", "subsequent guidance devices for seamless steel pipes and mills", "adjustable fixture for the use in three-way valves", "Bearing lubricating device for input shaft of decelerator", "tooling for metal parts quenching treatment", "two-roll cross piercing roll" and "2-7/8 large internal diameter tubing"; and the Company's three patent applications including "Cross-Roll puncher roll", "pumping unit brakes", "anti-twisting sucker rod" have officially been accepted by the State Intellectual Property Office of the PRC.

IV. Directors' Report



2. Income

By industry	Items	2012	2011	Unit: '0000 tons
				Year-on-year Increase/decrease (%)
Special equipment manufacturing	Sales volume	47.62	39.59	20.28%
	Production volume	49.53	43.47	1.39%
	Inventories	15.94	14.03	13.61%

The main customer sales situation of company:

Total sales to top 5 customers (RMB)	1,307,285,528.82
The percentage of the total sales for the year attributable to the total sales to top 5 customers (%)	44.28%

Information on top 5 customers:

Serial number	Name of customer	Saleroom (Unit: RMB)	Percentage of total sales of the year (%)
1	PetroChina Company Limited	720,370,069.42	24.40%
2	Campex Inc. Offshore Engineering & Marketing Ltd. (OEML) in the Middle East	172,147,618.00	5.83%
3	Shandong Luxing Steel Pipe Co., Ltd	158,084,340.07	5.35%
4	Hebei Zhongtai Steel Pipe Manufacture Co., Ltd	149,907,140.51	5.08%
5		106,776,360.82	3.62%
Total		1,307,285,528.82	44.28%



IV. Directors' Report

3. Cost

By product

Unit: RMB

By product	Item	2012		2011		Year-on-year Increase/Decrease (%)
		Amount	Attributable to the percentage of the operating costs (%)	Amount	Attributable to the percentage of the operating costs (%)	
Tubings & Casings	Materials	1,910,388,972.23	82.11%	1,698,086,084.75	82.62%	-0.51%
Tubings & Casings	Depreciation	156,116,307.44	6.71%	128,661,569.72	6.26%	0.45%
Tubings & Casings	Labour Cost	47,695,742.21	2.05%	28,774,152.97	1.40%	0.65%
Tubings & Casings	Expenses	212,420,549.46	9.13%	199,774,833.50	9.72%	-0.59%
Three kinds of pumping units	Materials	53,514,484.10	78.41%	50,941,141.92	77.91%	0.50%
Three kinds of pumping units	Depreciation	3,398,828.35	4.98%	3,373,845.36	5.16%	-0.18%
Three kinds of pumping units	Labour Cost	4,634,145.48	6.79%	4,452,691.27	6.81%	-0.02%
Three kinds of pumping units	Expenses	6,702,107.31	9.82%	6,616,921.53	10.12%	-0.30%
Petroleum machinery	Materials	120,052,543.17	85.92%	119,601,500.01	86.63%	-0.71%
Petroleum machinery	Depreciation	4,429,312.87	3.17%	4,500,760.59	3.26%	-0.09%
Petroleum machinery	Labour Cost	6,650,955.60	4.76%	5,701,883.82	4.13%	0.63%
Petroleum machinery	Expenses	8,593,146.42	6.15%	8,255,996.42	5.98%	0.17%
Others	Materials	41,851,137.86	82.38%	87,393,751.47	82.62%	-0.24%
Others	Depreciation	2,900,825.41	5.71%	6,621,700.37	6.26%	-0.55%
Others	Labour Cost	1,585,039.45	3.12%	1,480,891.46	1.40%	1.72%
Others	Expenses	4,465,543.84	8.79%	10,281,617.82	9.72%	-0.93%

Explanations

Raw materials accounted for the most significant part of the Company's cost of product, and the major raw material of the Company is pipe billet.

Overview of the Company's major suppliers

Total purchase amount of the top 5 suppliers (RMB)	1,253,885,438.83
Percentage of the total purchase amount of the top 5 suppliers to the total purchase amount of the year (%)	28.05%

IV. Directors' Report



Information of the Company's top 5 suppliers

Serial number	Name of the suppliers	Purchases (Unit: RMB)	Percentage of the total purchases for the year (%)
1	Lin Qu Tian Tai De Long Casting Co. Ltd (臨朐天泰德隆鑄造有限公司)	385,330,898.79	8.62%
2	Shandong Longsheng Steel Co., Ltd (山東隆盛鋼鐵有限公司)	342,532,780.56	7.66%
3	Qingzhou Tian Tai De Long Casting Co. Ltd (青州市天泰德隆鑄造有限公司)	190,027,923.07	4.25%
4	Weihai Steel Research Institute (威海鋼鐵研究所)	181,851,863.39	4.07%
5	Shandong Luli Steel Co., Ltd (山東魯麗鋼鐵有限公司)	154,141,973.02	3.45%
Total		1,253,885,438.83	28.05%

4. Expenses

Finance costs year-on-year increased 153.42%, mainly because of the increase in the Company's short-term borrowings which resulted in the increase in borrowing interest expenses.

Impairment loss of assets year-on-year increased 246.86%, mainly as a result of the Group's provisions made on goodwill impairment loss and the Company's provisions made on decrease in price of inventories with longer aging during the year.

5. R&D expenditures

Item	2012	2011	Change (%)
R&D expenses	100,222,770.67	86,323,817.15	16.10%
Net assets	2,889,416,712.61	2,795,014,393.18	3.38%
Revenue from operations	2,952,063,832.16	2,738,691,830.21	7.79%
Percentage of net assets (%)	3.47%	3.09%	0.38%
Percentage of revenue from operations (%)	3.40%	3.15%	0.24%



IV. Directors' Report

6. Cash flow

Item	2012	2011	Unit: RMB
			Year-on-year increase/ decrease (%)
Cash inflow subtotals from operating activities	2,605,219,787.13	3,314,482,779.59	-21.40%
Cash outflow subtotals from operating activities	2,159,288,885.84	3,226,854,204.52	-33.08%
Net cash flow from operating activities	445,930,901.29	87,628,575.07	408.89%
Cash inflow subtotals from investment activities	1,035,777.38	11,624,453.05	-91.09%
Cash outflow subtotals from investment activities	649,837,780.57	408,924,455.38	58.91%
Net cash flow from investment activities	-648,802,003.19	-397,300,002.33	63.30%
Cash inflow subtotals from financing activities	2,211,613,329.80	971,743,537.46	127.59%
Cash outflow subtotals from financing activities	1,990,216,146.89	1,065,973,980.21	86.70%
Net cash flow from financing activities	221,397,182.91	-94,230,442.75	
Net increase in cash and cash equivalents	18,456,785.73	-403,589,010.60	

Explanation on why the related data was varied by more than 30%:

1. During the reporting period, operating activities cash outflow was RMB2,159,288,885.84, a decrease of 33.08% when compared with same period of last year. The decrease was mainly because the Company increased the use of bills of acceptance for settlement during the year.
2. Net cash flow generated from operating activities during the reporting period was RMB445,930,901.29, an increase of 408.89% when compared with same period of last year. The increase was mainly because more bills were used during the year which resulted in increase in net cash flow.
3. During the reporting period, investment activities cash outflow was RMB1,035,777.38, a decrease of 91.09% when compared with same period of last year. The decrease was mainly because we received government grant for specific projects during last year which was non-recurring in the year.
4. During the reporting period, investment activities cash outflow was RMB649,837,780.57, an increase of 58.91% when compared with same period of last year. The increase was mainly because (i) Shouguang Baolong Company contributed to set up Shouguang Maolong Micofinance; (ii) the Company invested in the 90 tons electric furnace and 1200 tubes expansion projects.
5. During the reporting period, net cash flow generated from investment activities was RMB648,802,003.19, a decrease of 63.30% when compared with same period of last year. The decrease was mainly because increase in expenses as a result of new project investment during the year.
6. During the reporting period, financing activities cash inflow was RMB2,211,613,329.80, an increase of 127.59% when compared with same period of last year. The increase was mainly because the Group's amount of expenses on construction work increased during the year, and at the same time the Group needed to increase our external borrowings to meet the working capital needs in daily operation.
7. During the reporting period, financing activities cash outflow was RMB1,990,216,146.89, an increase of 86.70% when compared with same period of last year. The increase was mainly because increase in repayment of loans due during the year.

IV. Directors' Report



8. During the reporting period, net cash flow generated from financing activities was RMB221,397,182.91, an increase of RMB315,627,600 when compared with same period of last year. The increase was mainly because increase in the Group's expenses on construction work during the year, and the Group needed to increase our external borrowings to meet the working capital needs in daily operation.
9. During the reporting period, net increase in cash and cash equivalents was RMB18,456,785.73, an increase of RMB422,045,796.33 when compared with same period of last year. The increase was mainly because more bills were used during the year, and we have increased borrowings from banks.

III. Principal Operations by Industry and by Product

Unit: RMB

	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 (%)
By industry						
Special equipment manufacturing	2,905,348,601.16	2,585,399,641.20	11.01%	8.24%	9.34%	-0.89%
By product						
Tubings & Casings	2,598,091,671.18	2,326,621,571.34	10.45%	11.30%	13.20%	-1.50%
Three kinds of pumping units	83,240,409.14	68,249,565.23	18.01%	6.31%	4.38%	1.52%
Petroleum machinery	173,068,574.45	139,725,958.06	19.27%	4.29%	1.21%	2.46%
Others	50,947,946.39	50,802,546.57	0.29%	-51.76%	-51.97%	0.44%
Geographical segment						
PRC	1,755,204,212.99	1,599,362,657.11	8.88%	6.12%	6.73%	-0.52%
Abroad	1,150,144,388.17	986,036,984.09	14.27%	11.65%	13.85%	-1.66%



IV. Directors' Report

IV. Analysis of Assets, liabilities condition

1. Significant changes in assets

Unit: RMB

	31 December 2012		31 December 2011		Percentage change (%)	Explanation on the major changes
	Amount	Percentage of total assets (%)	Amount	Percentage of total assets (%)		
Funds	483,870,151.44	9.15%	413,632,018.60	8.82%	0.33%	Mainly as a result of the Group's increase in income of sales and rise in borrowings during the year.
Accounts receivables	455,105,433.22	8.61%	460,164,130.15	9.81%	-1.20%	Mainly as a result of more effort put in collection of account receivables and thus improving the collection of funds during the year.
Inventory	1,220,618,577.83	23.09%	1,176,981,854.52	25.1%	-2.01%	Mainly as a result of the addition of the 180 production line/lines during the year that increased the volume of production. However, sales of goods decreased as compared to the same period of last year has resulted in the increase in inventories at end of the year.
long-term equity investment	58,634,400.43	1.11%	12,580,624.11	0.27%	0.84%	Mainly as a result of the establishment of Shouguang Maolong Micofinance Co., Ltd by the subsidiary of the Company Shouguang Baolong Petroleum Material Company Limited.
Fixed assets	1,833,866,660.51	34.69%	1,831,368,142.96	39.06%	-4.37%	Mainly as a result of the relatively high increase in total assets of the year when compared with the same period of last year.
Construction in progress	134,351,091.69	2.54%	83,523,080.85	1.78%	0.76%	Mainly as a result of the investment of a 90 tons electric furnace by the subsidiary of the Company Shouguang Baolong Petroleum Material Company Limited.

IV. Directors' Report



2. Significant changes in liabilities

Unit: RMB

Item	2012		2011		Percentage change (%)	Explanation on the major changes
	Amount	Percentage of total assets (%)	Amount	Percentage of total assets (%)		
Short-term borrowings	1,030,006,883.57	19.49%	710,502,077.23	15.15%	4.34%	Mainly because the expenses on construction works of the Group were relatively high during the year, and we have increased the borrowings from external sources to meet our needs in the daily operation.

V. Core Competence Analysis

During the reporting period, the Group's cooperation with the four major domestic oil companies was further strengthened. Non-API products and customized products underwent mass production. As several new oil fields and areas have successfully explored, sales of non-oil well tubes and seamless tubes increased dramatically. Suspension pillar tubes and tubes for car cylinders started to occupy a significant share in some of the major domestic markets. In overseas markets, tubings & casings and line pipes gained several product certifications from different national oil companies has helped it to be recognized by more customers, thus enhancing the market share of the Group in overseas markets and the awareness of the Group's brand name in the international energy equipment market.

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 various research institutes to increase its efforts to develop high-end products, expand product structures and enrich product categories. The Group has successfully developed products including the large inner diameter tube, Cr anto-CO2 corrosion casing, and Anti-H2S tube, Anti-hydrogen sulfide corrosion tube, extra-long and thick tube, suspension pillar tube, thin-walled high-pressure alloy tube, nickel plating anticorrosion sucker rod, acidic line pipe, and other new products which was bulk supplied to domestic and overseas customers. Continuous development and introduction of new products to the market enables the Company to respond swiftly, thus enhancing our resistance to risk.



IV. Directors' Report

VI. Investment Situation Analysis

1. Use of proceeds

(1) Usage of total proceeds

Unit: RMB'0000

Total proceeds	119,673.83
Use of total proceeds during the Reporting Period	247.78
Accumulated use of total proceeds	119,673.83
Total proceeds with uses changed during the Period under Review	0
Accumulated total proceeds with use changed	0
Ratio of accumulated total proceeds with uses changed (%)	0%

Explanation on the use of proceeds

As at 31 December 2012, use of proceeds by the Company and its subsidiaries in total was RMB1,196,738,331.50, of which a total of RMB1,194,260,495.89 was the accumulated amount used in the previous years, RMB2,477,835.61 was used in 2012. Remaining balance of the proceeds is RMB48,583.10 (including interest income from the balance of proceeds RMB48,583.10).

IV. Directors' Report



(2) The status of the raising capital commitment projects

Unit: RMB'0000

Investment project undertaken and utilization of surplus net proceeds	Project change (partly changed included)	Total investment undertaken out of proceeds	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	72,000	72,000	0	72,000	100%			Yes	No
Sub-total-Investment project undertaken	—	72,000	72,000	0	72,000	—	—		—	—
Utilization of surplus net proceeds										
Petroleum pipes processing project	No	22,000	22,000	247.78	22,000	100%			Yes	No
Repayment of bank loans (if any)	—	25,673.83	25,673.83	0	25,673.83	100%			—	—
Sub-total-Utilization of surplus net proceeds	—	47,673.83	47,673.83	247.78	47,673.83	—			—	—
Total	—	119,673.83	119,673.83	247.78	119,673.83	—			—	—

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 and use of additional proceeds and their status

Applicable

The Company raised additional RMB476,738,331.50. The Company additionally raised RMB220,000,000.00 through public issue of A shares to finance the oil pipe material processing project; RMB256,738,331.50 raised through public issue of A shares was used as additional liquidity. As of 31 December 2012, all additional proceeds raised have been fully utilized. The remaining RMB48,583.10 was interest income and will be used as additional liquidity.

Change of use of the proceeds

N/A

Adjustment of use of the proceeds

N/A

Initial investment and change of use of the proceeds

N/A

Temporary use of the idle proceeds as additional liquidity

N/A

Amount and reasons for surplus proceeds not used as planned

N/A

Use and status of the remaining proceeds

The remaining proceeds of RMB48,583.10 will be used as additional liquidity.

Any other questions or situations existed regarding the use and disclosures of the proceeds

N/A



IV. Directors' Report

2. Analysis of main subsidiaries, joint stock company

Name of company	Company Type	Industry	The main products or services	Registered capital	Total assets (Unit: RMB)	Net assets (Unit: RMB)	Operating revenue (Unit: RMB)	Operating profit (Unit: RMB)	Net profit (Unit: RMB)
Shouguang Baolong	Subsidiary	Manufacturing	Manufacture and sales of oil equipment	150,000,000	751,358,423.97	207,429,940.10	1,752,336,828.87	24,362,061.81	18,617,776.37
Molong Logistic Company	Subsidiary	Servicing	Warehouse (not including restricted items), loading of goods, logistic information enquiry	3,000,000	2,881,671.93	2,881,671.93		-89,211.72	-89,211.72
Weihai Baolong	Subsidiary	Manufacturing	Manufacture and sales of metal material specialized for petroleum use	26,000,000	437,947,790.40	364,035,214.45	539,474,257.89	-10,016,013.87	-3,006,495.47
Maolong Machinery	Subsidiary	Manufacturing	Manufacture and sales of: petroleum equipment and accessories; high pressure isolation switch, high pressure electrical appliances, voltage electrical appliances and complete equipment; processing and sales of alloy accessories	12,380,000	59,019,491.75	57,761,315.54		179,015.65	277,230.20
Molong Electro-mechanical Equipment	Subsidiary	Manufacturing	Manufacture and sales of outer thickening oil well tubing and electrical complete equipment	USD1,000,000	87,257,262.28	47,773,909.45	105,665,914.38	12,223,142.91	9,336,558.59
Maolong Recycle	Subsidiary	Trading	Trading of scrap metals	500,000	2,002,210.51	1,211,281.91		-55,438.79	-55,438.79
Baolong Recyclable Resource	Subsidiary	Manufacturing	Trading and sales of scrap metals	300,000	2,529,484.97	2,504,505.76		-952.20	-952.20
MPM International Limited	Subsidiary	Trading	Acquisition and sales of petroleum extraction and chemical machinery electric equipment	USD1,000,000	36,315,036.95	13,189,525.73	62,549,676.69	3,563,709.31	3,256,316.90
Yalong Oil Machinery Co. Ltd (亞龍石油機械公司)	Joint stock company	Manufacturing	Design, produce and sales of machinery Equipment: sales of hardware & electric material, electronic products, construction materials, steel products.	6,400,000	18,768,535.86	8,833,428.58	20,132,805.52	1,186,132.85	967,555.54
Shouguang Maolong Microfinance Company Limited	Joint stock company	Servicing	Origination of loans in Shouguang City; development of small enterprise business; management.	150,000,000	154,492,960.93	153,045,032.18	6,019,158.81	3,966,709.58	3,045,032.18

IV. Directors' Report



3. Other investments during the reporting period

Unit: RMB'0000

Name of projects	Aggregate investment	The annual investment amount	Accumulated investment as at the end of the Reporting Period	Project progress	Benefits realized during the Reporting Period
90 tons electric furnace	13,362	8,845	8,845	66.2%	N/A
Φ1200 mm forging expansion project	18,032	5,218.83	5,226.97	28.99%	N/A
180 mm heat treatment machining project	7,195	2,657.86	6,724.4	100%	N/A
OCTG finish machining line	10,851	36.78	2,472.16	100%	N/A
High-end petroleum equipment project	6,000	31.71	82.03	100%	N/A
Total	55,440	16,790.18	23,350.56		

VII. Prospect of the Future Developments of the Company

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

According to the data disclosed in "World Energy Outlook" released by the U.S. International Energy Agency which expects a steady economic growth worldwide, the demand for crude oil will still keep a growth trend, and it will reach daily 110 million barrels in the year 2025 with global oil consumption yearly growth of 1.4%, and yearly growth of the oil production is 1.25%, a little lower than the oil consumption yearly growth. So 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. International Energy Agency, in the year 2025, China's oil consumption will remain 3.5% growth, higher than the global record.

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

The Group considers that with the effect of the above policies of global economy begin to recover, and the oil industry as the pillar industry of the PRC, the government of the PRC also clear the investment in petroleum industry in the "Twelfth 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.



IV. Directors' Report

2. In line with its strategic plans, the work of the Company will focus on the following areas in 2013:

1. In respect of product research and development, the Group plans to further enhance its efforts on the research and development of high value-added products non-API products of self propriety series. The Group will continue to place its focus on the development of new products such as high-end aluminum 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 anto-CO₂ corrosion casing, API acid conduit pipes, economy special thread casing, and anti-corrosion special casing, satisfy customized needs for the Group's products of various kinds of domestic and foreign customers, expanding the proportion of high-end products and thereby strengthening the profitability and competitiveness of the Group's products.
2. In respect of new product exploration, the Group will, being knowledge of the rich petroleum exploration machinery and technology as well as the demand for natural gas products, actively research on natural gas products of higher level in accordance with the special requirement and development trend of natural gas and coalbed methane by the market. For suspension pillars tubes, vehicle cylinder market tubes, thin-walled high-alloy seamless tubes and mechanical processing seamless tubes, 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 2012, 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 further strengthen the good cooperation relationship with CNPC Group, Sinopec Group, CNOOC, and Yanchang Petroleum, expanded the markets of 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 South America, Middle East and Africa to diversify market concentration. Meanwhile, long-term co-operation with foreign inventory operators with market resources, service advantages and good reputations will also be reinforced, 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 be adjusting product structure and market deployment in accordance with changes in market on a timely basis.
2. When there is any extraordinary fluctuation in raw material price, it will directly affect the production cost of the product and result in direct impact on the price of products.
3. When the exchange rate of Renminbi appreciates, it will lower the competitiveness of products in the international market, and we will adopt measures on expanding the coverage of market to avoid the risks resulted from any change in exchange rate of Renminbi.



VIII. Distribution of profit and dividend payment by the Company

Formulation, implementation and adjustment of profit distribution policy, especially cash dividend policy, during the reporting period

In accordance with the "Notice regarding Further Implementation of Cash Dividends Distribution of Listed Companies of CSRC" (Zheng Jian Fa [2012] No. 37) issued by China Securities Regulatory Commission and the related requirements of Notice of Reproducing Notice regarding Further Implementation of Cash Dividends Distribution of Listed Companies SRC (Lu Zheng Jian Fa [2012] No. 18) issued by Shandong branch of China Securities Regulatory Commission, the Company amended the terms of profit distribution as set out in the Articles of Association, and further clarified the profit distribution, especially the principles, form, intervals, conditions and proportion of the cash dividend, policy-making mechanism and process, adjustment mechanism, etc. At the same time, the Company strived to payback the investors, to heighten the investors' satisfaction in the Company, to perfect and optimize the scientific, continuing and stable profit distribution policymaking and regulatory mechanism, by formulating the dividend management mechanism and the dividend return plan for the next three years (2012–2014). Revised plan of Articles of Association, dividend management mechanism and the dividend return plan for the next three years (2012–2014) had been considered and approved by the 2012 First Extraordinary Meeting convened on 12 October 2012. Since its listing, the Company has always been putting emphasis on Shareholders' Return, and advocating the objective to create value for the shareholders. It implemented cash dividend policy in the past three years, and the ratio for the average net profit attributed to the cumulative cash dividend for the past three years was 58.59%.

Profit distribution and the proposals on conversion of capital reserves into share capital during the year:

The amount of the bonus shares granted for every 10 shares	0
Amount of dividend paid for every 10 shares (RMB)	0.5
Conversion of capital reserves for every 10 shares (tax included)	0
The basis of the share capital of distribution proposals	797,848,400.00
Total cash dividends (RMB) (including tax)	39,892,420.00
Distributable profit (RMB)	1,073,097,098.79

Details of profit distribution or conversion of capital reserves into share capital

In 2012, the Company implemented a profit distribution plan: Based on total share capital of 797,848,400 shares as of 31 December 2012, the Company distributed of RMB0.5 (including tax) for every 10 shares held by all shareholders.

The profit distribution plans and the conversion plans of conversion of capital reserves into share capital in the past three years (the reporting period inclusive).

In 2010, the Company implemented profit distribution plan: based on the total share capital of 398,924,200 shares of the company as at 31 December 2010, all shareholders received RMB1.50 (tax inclusive) for every 10 shares.

In 2011, the Company implemented profit distribution and the proposals on conversion of capital reserves into share capital: based on the total share capital of 398,924,200 shares of the company as at 31 December 2011, all shareholders received RMB1.00 (tax inclusive) for every 10 shares; all shareholders were converted and increased 10 shares for every 10 shares by the use of share capital reserves.

In 2012, the Company implemented profit distribution plan: based on the total share capital of 797,848,400 shares of the company as at 31 December 2011, the Company distributed of RMB0.5 (including tax) for every 10 shares held by all shareholders.



IV. Directors' Report

Bonus cash payment for the last three years

Unit: RMB

Cash bonus year	Amount for profit for cash bonus (including 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
2012	39,892,420.00	134,263,035.30	29.71%
2011	39,892,420.00	168,330,282.50	23.70%
2010	59,838,630.00	276,149,465.54	21.67%

IX Social Responsibility Report

During the reporting period, the Company attached great importance to the performance of social responsibility, and has taken a proactive stance in fulfilling social responsibility which was epitomized in the following aspects:

1. Safeguarding shareholders' interest

The Company has established a relatively well-established governance structure and a comprehensive internal control system. Such measures guaranteed the soundness and the level of control of the decision making mechanism of the Company on material issues. During the reporting period, the Company convened two general meetings. One of which adopted on-the-spot plus online voting to enhance the participation of shareholders. The assembly, convention and voting procedures of the meeting complied with the requirements of the laws, regulations and the Articles of Association. The Company established various forms of communication platforms and channels with the investors through different measures and conducted timely, true, accurate and comprehensive regular information disclosure in strict compliance with the relevant laws, regulations, the Articles of Association and the requirements of the relevant system of the Company in order to ensure that all shareholders of the Company were given fair, just, open and adequate opportunities to acquire the information of the Company, which is aim at protecting various legal rights of all shareholders as stipulated by the laws, regulations and articles in a fair manner.

2. Safeguarding employees' interest

The Company highly emphasised the nurture of talents. We strived to improve the quality of our staff and realize mutual growth of our staff and the enterprise through offering our staff with career planning and organising various corporate training. The Company offered various social insurance to our staff and established relief fund to care and support staff in difficult times and create a harmonious working environment.

3. Actively participate in social services

The Company paid great attention to the creation of social value and placed our focus of fulfilling social responsibility on actively participating in social services. We have spared no effort to join social services and charity activities and organize numerous donations with a view to rewarding the society within our capacity.

IV. Directors' Report



X. Registration report on reception of research investigations, communications and interviews during the reporting period

Time of reception	Place of reception	Manner of reception	Types of Parties accommodated	Parties accommodated	Main topics of discussion and information provided
7 February 2012	Shouguang, Shandong	On-site research and investigation	Organization	Shanghai Zhengxiang Investment Management Co., Ltd	Matters including recent development of the industry and development trend in the future, production and operation of the Company, as well as the condition of A Shares proceeds-funded projects
17 May 2012	Shouguang, Shandong	On-site research and investigation	Organization	Zexi Investment	Matters including recent development of the industry and development trend in the future, production and operation of the Company, as well as the condition of A Shares proceeds-funded projects
18 May 2012	Shouguang, Shandong	On-site research and investigation	Organization	China Merchants Securities, Minsheng Insurance Co., Ltd., Huangshang Fund Management Co., Ltd	Matters including recent development of the industry and development trend in the future, production and operation of the Company, as well as the condition of A Shares proceeds-funded projects
30 August 2012	Shouguang, Shandong	On-site research and investigation	Organization	Yingda Taihe Property Insurance Co., Ltd	Matters including recent development of the industry and development trend in the future, production and operation of the Company, as well as the condition of A Shares proceeds-funded projects

XI. 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 62 to 71 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

	2012 RMB'000	For the year ended 31 December			
		2011 RMB'000	2010 RMB'000	2009 RMB'000	2008 RMB'000
Total revenue from operation	2,952,064	2,738,692	2,703,907	2,075,551	2,809,629
Profit from operations	116,716	166,268	276,717	270,746	345,501
Total profit	165,854	200,065	324,484	324,280	353,256
Net profit	140,166	169,042	276,980	273,822	319,399
Minority interests	5,903	712	831	5,507	13,588
Net profit attributable to shareholders of the Company	134,263	168,330	276,149	268,315	305,811
Basic earnings share (RMB)	0.17	0.21	0.41	0.41	0.47



IV. Directors' Report

Assets and Liabilities

	2012 RMB'000	For the year ended 31 December			
		2011 RMB'000	2010 RMB'000	2009 RMB'000	2008 RMB'000
Total assets	5,285,751	4,688,931	4,586,411	3,256,607	3,335,410
Total liabilities	2,332,464	1,835,954	1,843,207	1,942,972	2,225,386
Net assets	2,953,287	2,852,978	2,743,203	1,313,634	1,110,024

3. Changes in Share Capital

Details of changes in the share capital of the Company for 2012 are set out in in note 5 to the consolidated financial statements.

4. Reserves and Distributable Reserves

Details of changes in the reserves of the Group for 2012 are set out in note 5 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 2012 are set out in note 5 to the consolidated financial statements.

6. Capitalised Interest

For 2012, the Group had capitalised interest amounting to RMB2.45 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 "11. The Board Committees of the Company" in the section VIII of this annual report.

9. Continuing Related Party Transactions

For continuing related party transaction with Yalong Oil Well Pump in 2012, please refer to note 6 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.



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 2012, 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	279,517,000	51.60%	35.03%
Lin Fu Long	Beneficial	34,216,000	6.32%	4.29%
Zhang Yun San	Beneficial	30,608,000	5.65%	3.84%
Xie Xin Cang	Beneficial	21,410,000	3.95%	2.68%

Name	Type of interest	Number of H shares	Percentage of H shares	Percentage of total issued share capital
Zhang Yun San	Beneficial	2,021,200	0.79%	0.25%

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 2012, please refer to section VII 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 2012.



IV. Directors' Report

13. Share Option Scheme

The Company does not have any share option scheme.

14. Substantial Shareholders

The details are set out section VI 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 2012 or at any time in 2012.

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 2012.

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 VIII 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.

V. Material Matters



I. Material Litigation or Arbitration

The Company had no Material Litigation or Arbitration during the Reporting Period.

The Company had no situation of the media questioned during the Reporting Period.

II. Degree of Performance

1. Undertakings made by the Company and shareholders interested in 5% or more of the shares of the Company made in the reporting period or subsisting to the reporting period

Item	Acceptor	Commitment to content	Commitment of time	Period for acceptance	Degree of performance
Share reform commitment	/	/	/	/	/
Undertaking made in offering documents or shareholding alternation documents	/	/	/	/	/
Undertaking made during asset reconstruction	/	/	/	/	/
Undertaking made on initial public offering or refinancing	Zhang En Rong, Zhang Yun San	Within 36 months since the date of the listing of the A Shares, shares shall not be transferred or entrusted to others to manage, and not be purchased by the Company. Also, they also committed that the shares transferred by them shall not exceed 25% of the total shares of the Company held by them during the terms of office after the above period expires, and they shall not transfer the shares held by them within half a year after leaving.	On 21 October 2010	36 months	During the Reporting period, the above officials strictly performed their commitment items.
Other undertakings made to minority shareholders of the Company	/	/	/	/	/
Does the undertaking performed timely?			Yes		
The status of the implementation of undertaking		During the Reporting period, strictly implemented the commitment items.			



V. Material Matters

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

Appointed accounting firm

Name of the domestic accounting firm	Deloitte Touche Tohmatsu CPA Ltd. Shenzhen Branch
Reward of the domestic accounting firm (Unit: RMB'0000)	120
Continued term of service of the domestic accounting firm	5 years
Name of CPA	Yang Yu Min, Huang Yue

IV. The status of the issue of corporate bonds by the Company

The Company received "Reply Letter in relation to the approval on the issue of corporate bonds by Shandong Molong Petroleum Machinery Company Limited from CSRS" (the Zhengjian Xuke [2012] No. 1735) on 31 December 2012 and was approved to make an public issuance of corporate bonds with face value not exceeding RMB1.00 billion. As at 31 December 2012, no corporate bonds has been issued by the Company yet.

VI. Changes in Share Capital and Shareholders



I. Changes In Share Capital

Item	Prior to the change		Bonus Issue of Shares	After the change	
	Number of shares	Percentage (%)		Sub-total Number of shares	Percentage (%)
I. Shares subject to lock-up	198,239,000	49.69%	198,239,000	396,478,000	49.69%
I.1 Other domestic shares	14,114,500	3.54%	14,114,500	28,229,000	3.54%
Comprising:					
Domestic natural person shares	14,114,500	3.54%	14,114,500	28,229,000	3.54%
I.2 Senior management shares	184,124,500	46.15%	184,124,500	368,249,000	46.15%
II. Shares not subject to lock-up	200,685,200	50.31%	200,685,200	401,370,400	50.31%
II.1 RMB ordinary shares	72,622,000	18.2%	72,622,000	145,244,000	18.2%
II.2 Overseas-listed foreign shares (H shares)	128,063,200	32.1%	128,063,200	256,126,400	32.1%
III. Total number of shares	398,924,200	100%	398,924,200	797,848,400	100%

Bonus Issue of Shares

On 29 March 2012, the Board also proposed the Bonus Issue of shares which will be made to the shareholders on the basis of 10 Bonus Shares to be issued for every 10 existing shares held for the Shareholders (the "Bonus Issue"). On 25 May 2012, based on the total share capital of 398,924,200 shares, the total share capital of the Company has been increased to 797,848,400 shares by using the share capital reserves to converse and issue 10 Bonus Shares for every 10 existing shares to all the shareholders, which was considered and approved at the 2011 Annual General Meeting and Class Meetings of the Company.

Reasons for Bonus Issue

The Board believes that the Bonus Issue (i) will provide the Company with a wider capital base and therefore increase the marketability of the shares; and (ii) is a return to the long-term support and care of the shareholders.

Other than the expenses incurred in relation to the Bonus Issue, the implementation of the same will not alter the underlying assets, business operations, management or financial position of the Company or the interests of its shareholders. The Board believes that the Bonus Issue will not have any adverse effect on the financial position of the Company.



VI. Changes in Share Capital and Shareholders

II. Issuance and listing of securities in the Last Three Years

In 2010, 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. As a result, the total issued share capital of the Company was increased to 398,924,200 with a nominal value of RMB1.00 each.

In 2012, based on the total share capital of 398,924,200 shares, the total share capital of the Company has been increased to 797,848,400 shares by using the share capital reserves to converse and issue 10 Bonus Shares for every existing 10 shares to all the shareholders, which was considered and approved at the 2011 Annual General Meeting and Class Meetings of the Company.

As at 31 December 2012, no staff shares of the Company have been issued in the last three years.

VI. Changes in Share Capital and Shareholders



III. Shareholders' Profiles

Domestic Shares of RMB1.00 each of the Company

Name of Shareholders	Nature of Shareholders	Percentage of shareholding (%)	Shares at the end of the year	Shares change this year	Number of Restricted shares held	Number of non-restricted shares held
Zhang En Rong	Domestic natural person	35.03%	279,517,000	increase 139,758,500 shares	279,517,000	0
Lin Fu Long	Domestic natural person	4.29%	34,216,000	increase 17,108,000 shares	34,216,000	0
Zhang Yun San	Domestic natural person	3.84%	30,608,000	increase 15,304,000 shares	30,608,000	0
Xie Xin Cang	Domestic natural person	2.68%	21,410,000	increase 10,705,000 shares	21,410,000	0
Liu Yun Long	Domestic natural person	1.84%	14,670,000	increase 7,335,000 shares	14,670,000	0
Cui Huan You	Domestic natural person	1.16%	9,238,000	increase 4,619,000 shares	9,238,000	0
Liang Yong Qiang	Domestic natural person	0.85%	6,819,000	increase 3,409,500 shares	6,819,000	0
Chen Sheng Gao	Domestic natural person	0.15%	1,186,743	increase 593,372 shares	0	1,186,743
GF Securities Co., Ltd. Customer credit collateral securities trading account	Domestic non-state-owned legal person	0.08%	677,690	increase 338,845 shares	0	677,690

H Shares of RMB1.00 each of the Company

Name of Shareholders	Nature of Shareholders	Percentage of shareholding (%)	Shares at the end of the year	Shares change this year	Number of Restricted shares held	Number of non-restricted shares held
HKSCC Nominees Limited	Overseas legal person	32.03%	255,521,890	increase 127,760,945 shares	0	255,521,890
Zhang Yun Sun	Overseas natural person	0.79%	2,021,200	increase 1,001,200 shares	0	2,021,200

Note: No Strategic investors or legal placement become the top ten shareholders upon placing of new shares.

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, a director of the Company. Save as disclosed, the Company has no further information as to whether the other shareholders have connected relationships or are acting in concert.



VI. Changes in Share Capital and Shareholders

Shareholdings of the major shareholders of non-restricted shares

Name of Shareholders	Shares at the end of the year	Class of shares
HKSCC Nominees Limited	255,521,890	H share
Chen Sheng Gao	1,186,743	A share
GF Securities Co., Ltd. Customer credit collateral securities trading account	677,690	A share
Xue Yue Hong	600,000	A share
Xue Xian Zhen	518,300	A share
Shen Ping	500,000	A share
Chen Ai Ming	490,286	A share
Shenyin & Wanguo Securities Co., Ltd. Customer credit collateral securities trading account	488,403	A share
The Guotai Junan Securities Co., Ltd. Customer credit collateral securities trading account	465,300	A share
Zhang Jian Zhao	452,661	A share

Notes:

- (1) The Company has no further information as to whether there is connected relationship or concerted-party relationship among each of the shareholders of non-restricted shares as above, and between the shareholders of non-restricted shares and other shareholders of the Company.
- (2) No Shareholders participate in the margin trading business.

2. Controlling shareholders of the Company

Natural person

Name of controlling shareholders	Citizenship	Whether obtained the residential right from other countries or districts
Zhang En Rong The occupation and duties in the past 5 years	China Director and Chairman of Shandong Molong Petroleum Machinery Co., Ltd.	No

VI. Changes in Share Capital and Shareholders

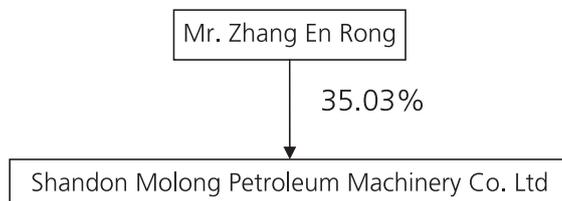


3. Beneficial controller of the Company

Natural person

Name of beneficial controller	Citizenship	Whether obtained the residential right from other countries or districts
Zhang En Rong	China	No
The occupation and duties in the past 5 years	Director and Chairman of Shandong Molong Petroleum Machinery Co., Ltd.	

Chart illustrating the relationship between the Company and the beneficial controllers:





VI. 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 2012, 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	30,500,000	11.91%	3.82%

Note 1: According to the best knowledge of the Directors of the Company and the disclosure of interest notices filed by Desmarais Paul G, Desmarais Paul G is deemed to be interested in 30,500,000 H Shares held by the companies controlled by him as at 31 December 2012.

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.

VII. Directors, Supervisors, Senior Management and Employees



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

Name	Position	Duty state	Sex	Age	Term start date	Term end date	Shares held at the beginning of the year (A share)	Shares change this year (A share)	Shares held at the end of the year (A share)
Zhang En Rong	Chairman of Company	Current	M	73	25 May 2010	24 May 2013	139,758,500	increase 139,758,500	279,517,000
Zhang Yun San	Deputy Chairman and General Manager	Current	M	51	25 May 2010	24 May 2013	15,304,000	increase 15,304,000	30,608,000
							1,020,000 (H share)	increase 1,001,200 (H share)	2,021,200 (H share)
Lin Fu Long	Executive Director	Current	M	61	25 May 2010	24 May 2013	17,108,000	increase 17,108,000	34,216,000
Xie Xin Cang	Executive Director	Current	M	51	25 May 2010	24 May 2013	10,705,000	increase 10,705,000	21,410,000
Xiao Qing Zhou	Non-executive Director	Current	M	64	6 May 2011	24 May 2013	0	0	0
Wang Ping	Non-executive Director	Former	M	57	12 May 2009	11 May 2012	0	0	0
Guo Hong Li	Non-executive Director	Current	M	57	25 May 2012	24 May 2013	0	0	0
Wang Chun Hua	Independent non-executive Director	Current	F	60	25 May 2012	24 May 2013	0	0	0
John Paul Cameron	Independent non-executive Director	Current	M	48	25 May 2012	24 May 2013	0	0	0
Chau Shing Yim, David	Independent non-executive Director	Current	M	50	12 May 2010	11 May 2013	0	0	0
Liu Huai Duo	Chairman of Supervisory Committee	Current	M	37	25 May 2012	24 May 2015	0	0	0
Fan Ren Yi	Supervisor	Current	M	48	25 May 2012	24 May 2015	0	0	0
Liu Wan Fu	Supervisor	Former	M	74	12 May 2009	11 May 2012	0	0	0
Zhang Jiu Li	Supervisor	Current	M	48	25 May 2012	24 May 2015	0	0	0
Guo Huan Ran	Deputy general manager	Current	M	45	28 March 2010	24 May 2013	0	0	0
Zhang Shou Kui	Deputy general manager	Current	M	43	28 March 2010	24 May 2013	0	0	0
Liu Yun Long	Deputy general manager	Current	M	44	28 March 2010	24 May 2013	7,335,000	increase 7,335,000	14,670,000
Cui Huan You	Financial Controller of Company	Former	M	64	28 March 2010	29 March 2012	4,619,000	increase 4,619,000	9,238,000
Yang Jin	Financial Controller of Company	Current	M	49	29 March 2012	24 May 2013	0	0	0
Zhao Hong Feng	Secretary to the Board	Current	M	34	26 October 2012	24 May 2016	0	0	0
Total (excluding H share)							194,829,500	increase 194,829,500	389,659,000

II. Working Conditions

Major work experience and employment of Directors, Supervisors and Senior Managers of the Company.

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 was the legal representative and factory manager of Shandong Shouguang Petroleum Machinery Parts Factory, Shandong Shouguang Petroleum Machinery Factory and Weifang Molong Industrial Company from 1987 to 1993 and the general manager of Shandong Molong Holdings Company from 1994 to 2001, Mr. Zhang has been the Chairman of the Company since 2001. Mr. Zhang is the father of Mr. Zhang Yun San, an executive Director of the Company.



VII. Directors, Supervisors, Senior Management and Employees

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 of the Company.

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" and "Advanced Person of Enterprise Technology Innovation of Weifang" in 2005, "Excellent Chief Information Officer of Weifang City" and "Outstanding Person of Shouguang of the Year" 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; awarded "Outstanding Entrepreneur of Weifang", "Outstanding Communist Party Member"; and was awarded the "Model Worker of Shandong Province" in 2008, "Top Ten Persons of 'Moving State Duty' of Weifang in 2007", and was awarded "Outstanding Entrepreneur of Shouguang City" in 2010 and 2011. Mr. Zhang was a member of the 15th session and 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 November 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.

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 to October 2012. Mr. Xie 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 tease!" 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 and eighth 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.

VII. Directors, Supervisors, Senior Management and Employees



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. Guo Hong Li, born in September 1956, Chinese nationality with no right of permanent residence abroad, Bachelor Degree, is a non-executive Director of the Company. Mr. Guo has more than 30 years of experience in financial industry. Has held director of shouguang city Credit Cooperatives, director of shouguang city bank, governor, deputy governor in shouguang branch of Agricultural Bank. Now he is general manager of the Weifang Binhai Yufeng Pawn Loan Co., LTD.

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 People's Court including the judge, associate chief judge and the chief judge of the No. 1 criminal justice division, vice-president, president and the Party secretary. 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 non-executive Director of the Company since 12 May 2009.

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.



VII. Directors, Supervisors, Senior Management and Employees

Mr. Chau Shing Yim, David, born in November 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 Disciplinary Panel of Hong Kong Institute of Certified Public Accountants, and a member of the 13th political consultative conference of Jinan. He is currently an executive director of Zhidao International Holdings Limited, non-executive director of Up Energy Development Group Limited, and independent non-executive director of Varitronix International Limited, Lee & Man Paper Manufacturing Limited, Evergrande Real Estate Group Limited and Man Wah Holdings Limited, all of these companies are 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. Zhang Jiu Li, Bachelor Degree, Chinese nationality with no right of permanent residence abroad, is a Supervisor of the Company and a senior accountant. Mr. Zhang Jiu Li has over ten years' experience in accounting, auditing, assets appraisal and business administration. He has served as member of Shouguang Personal Bureau and manager of Shouguang Bureau of Finance. Mr. Zhang is currently the director and Party Branch Secretary of Shouguang Shengcheng Limited Liability Accounting Firm, and holds a concurrent post of chairman of Shouguang Promote the Development of Private Enterprise Association, vice-chairman of Shouguang Association of Industry and Commerce, and vice-chairman of Shouguang Accounting Association.

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. He was the vice general manager and CFO of Shandong Charming Home-Textiles Co., Ltd., and is now CFO of the Shouguang Dongyu Hongxiang Timber Co. Ltd.

VII. Directors, Supervisors, Senior Management and Employees



3. Senior Management

As for the information about Zhang Yun San, the general manager, please refer to "1.Directors"of "II. Major work experience and employment of Directors, Supervisors and Senior Managers of the Company" 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 Shouguang Oil Machinery Factory (壽光石油機械廠) since March 1991 as technician, and held workshop supervisor and Production Director of Molong Group Company from 1994 to 2001. Mr. Guo has held the posts of Production Director and deputy general manager since 2001. Mr. Guo is responsible for marketing and technological works of the Group. 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 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 Shouguang Oil Machinery Factory (壽光石油機械廠) 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. Yang Jin, born in March 1964, graduated from Shandong Economics College with qualification in economic management, Chinese nationality with no right of permanent residence abroad, is the financial controller of the Company. Mr. Yang Jin joined Shandong Molong Petroleum Machinery Company Limited in 2008 and served as the manager of the Legal Affairs Division; he served also as the manager of the Human Resources Division in 2009; and from 2009-2012, he served as the assistant of the General manager, and from March 2012 till now, he has served as the financial controller of the Company.

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 Shouguang Oil Machinery Factory (壽光石油機械廠) 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 and Shouguang Baolong, and deputy general manager of the Company. Mr. Liu has significant experience in managing production of petroleum extraction machinery.

Mr. Zhao Hong Feng, born in August 1979, graduated from Beijing Institute of Technology (華北理工大學) with a degree in business administration, Chinese nationality with no right of permanent residence abroad, is the Deputy General Manager and Board secretary of the Company. Since Mr. Zhao Hong Feng joined Shandong Molong Petroleum Machinery Company Limited in 2003, he has served as the salesperson of the Import and Export Division, the Investor Relation Manager, the Director of the Board office, the Securities Officer, Deputy General Manager, Board secretary, etc. Since October 2012 up till now, Mr. Zhao has served as the Deputy General Manager and Board secretary of the company.



VII. Directors, Supervisors, Senior Management and Employees

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.

Major position at the subsidiaries of the Group:

Name	Name of subsidiaries	Position(s)	Whether receiving any remuneration or allowance from the shareholder unit
Zhang Yun San	MPM INTERNATIONAL LIMITED	Executive Director	No
Guo Huan Ran	Shouguang Baolong Petroleum Material Company Limited	Chairman	No
Guo Huan Ran	Shouguang Molong Electro-mechanical Equipment Company Limited	Director	No
Guo Huan Ran	Weihai Baolong Special Petroleum Materials Co., Ltd	Director	No
Guo Huan Ran	Shouguang Maolong Micro-credit Co., Ltd	Chairman	No
Lin Fu Long	Shouguang Maolong Machinery Company Limited	Executive Director	No
Zhang Shou Kui	Shouguang Mihe Water Company Limited	Director	No

VII. Directors, Supervisors, Senior Management and Employees



III. Remunerations of Directors, Supervisors and Senior Management

Decision process and basis for determining the remuneration for the remuneration of Directors, Supervisors and Senior Management

The remuneration proposal for the Directors and Supervisors is drafted by the Board of the Company and agreed by the Board, then presented to the Shareholders Meeting for consideration and approval; while the remuneration plan for the senior officials is approved by the Board. The subsidy for the Independent Directors and Supervisors of the Company is determined according to the industry level; the remuneration of the Worker's Director, Worker's Supervisor and Senior Management of the Company is decided based on the internal wage system and assessment system of the Company. During the reporting period, the Directors, Supervisors and Senior Management received their remuneration on a timely manner according to the wage system and assessment system of the Company. As for the Independent Directors, they received their remuneration semi-annually.

Remunerations of Directors, Supervisors and Senior Management during the reporting period

Name	Position	Sex	Age	Duty state	Total remuneration Received from the Company during the reporting period (RMB)	Total remuneration received from shareholder unit	Actual payment for the remuneration during the reporting period (RMB)
Zhang En Rong	Chairman	M	73	Current	701,945.33	0.00	701,945.33
Zhang Yun San	Deputy Chairman and General Manager	M	51	Current	601,665.05	0.00	601,665.05
Lin Fu Long	Executive Director	M	61	Current	316,030.65	0.00	316,030.65
Xie Xin Cang	Executive Director	M	51	Current	76,990.28	0.00	76,990.28
Xiao Qing Zhou	Non-executive Director	M	64	Current	33,740.00	0.00	33,740.00
Guo Hong Li	Non-executive Director	M	57	Current	20,567.50	0.00	20,567.50
Wang Chun Hua	Independent Non-executive Director	F	60	Current	33,740.00	0.00	33,740.00
John Paul Cameron	Independent non-executive Director	M	48	Current	88,012.50	0.00	88,012.50
Chau Shing Yim, David	Independent non-executive Director	M	50	Current	88,012.50	0.00	88,012.50
Liu Huai Duo	Chairman of Supervisory Committee	M	37	Current	82,728.48	0.00	82,728.48
Fan Ren Yi	Supervisor	M	48	Current	10,090.00	0.00	10,090.00
Zhang Jiu Li	Supervisor	M	48	Current	6,273.20	0.00	6,273.20
Liu Wan Fu	Supervisor	M	74	Former	10,090.00	0.00	10,090.00
Guo Huan Ran	Deputy general manager	M	45	Current	407,453.42	0.00	407,453.42
Liu Yun Long	Deputy general manager	M	44	Current	383,047.75	0.00	383,047.75
Zhang Shou Kui	Deputy general manager	M	43	Current	203,000.02	0.00	203,000.02
Yang Jin	Financial controller of the Company	M	49	Current	329,955.90	0.00	329,955.90
Zhao Hong Feng	Deputy general Manager and Secretary to the Board	M	34	Current	68,789.22	0.00	68,789.22
Total					3,462,131.80	0.00	3,462,131.80



VII. Directors, Supervisors, Senior Management and Employees

IV. Non-reappointment of directors, supervisors and senior managers

Name	Position	Type	Date of expiry	Reasons
Wang Ping	Non-executive Directors	resigned	11 May 2012	Term due
Liu Wan Fu	Supervisory	resigned	24 May 2012	Term due
Cui Huan You	Financial controller of the Company	dismissed	29 March 2012	Due to health reasons
Xie Xin Cang	Deputy general Manager and Secretary to the Board	dismissed	23 July 2012	Due to health reasons

Note: Mr. Xie Xin Cang shall remain as the Executive Director of the Company until 24 May 2013.

V. Change of key technical team or key technical staff (other than Directors, Supervisors and Senior Management)

During the reporting period, there is no changes of key technical team or key technical staff.

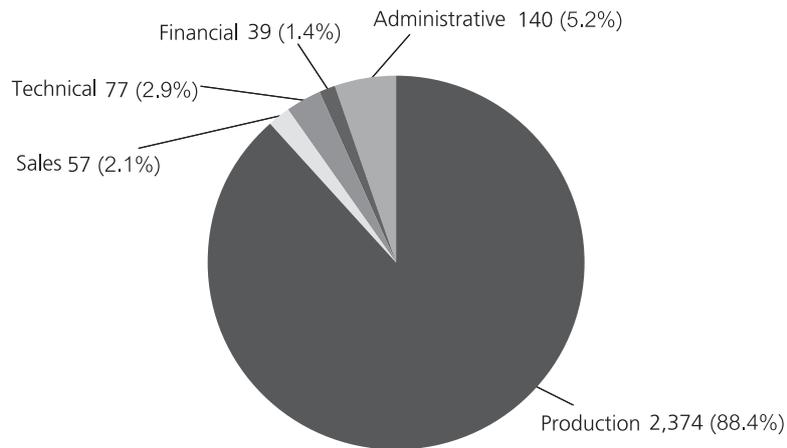
VII. Directors, Supervisors, Senior Management and Employees



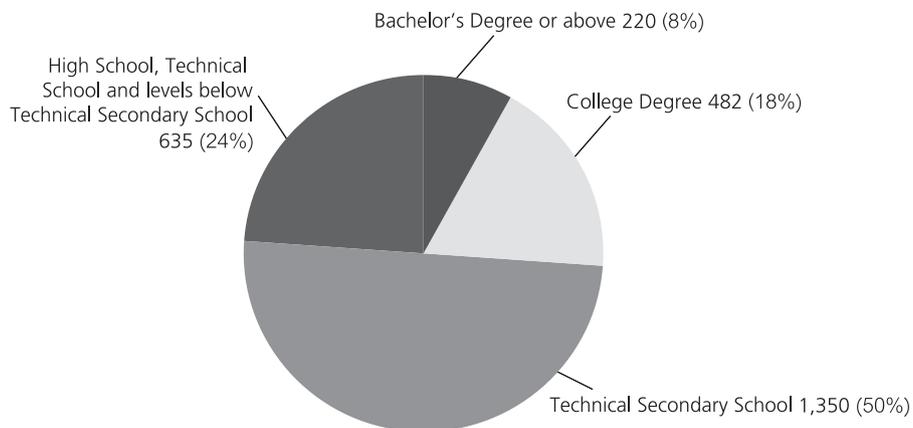
VI. Personnel of the Company

At the end of the reporting period, the Group had 2687 employees in aggregate, including 2374 production staff, 57 sales staff, 77 technical staff, 39 financial staff, 140 administrative staff. By level of education, there were 220 employees with bachelor's degree or above, 482 employees with college degree, 1350 employees with technical secondary school education and 635 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.

Diagram of number of Professionals Structures



Analytic Diagram of Academic Structures of the Company





VIII. Corporate Governance Report

I. Corporate Governance

During the reporting period, under the requirements 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》) and listing rules of Shenzhen Stock Exchange (《深圳證券交易所股票上市規則》) in the PRC, and other requirements of the relevant provisions of China Securities Regulatory Commission, and also the Code on Corporate Governance Practices (the “Code”) as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”), the Company has established a high standard of governance structure and sound internal management system to improve the company’s standard operation level. 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.

During the reporting period, the Company has successively amended its Articles of Association, Registration and Filing System of Personnel with Insider Information, System of Internal Control and Audit, Risk Management System, Administration System of External Investment and Administration System of External Guarantees, and also formulated the System of Comprehensive Budget Management and Dividend Distribution Policy for improving the structure of the Company’s system.

- (I) **Shareholders and general meetings:** The Company has established a corporate governance structure to ensure that all shareholders are able to 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 good opportunities 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.

VIII. 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 the Company. Senior management personnel are recruited and appointed in strict compliance with relevant rules, regulations and the Articles 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 2012.
- (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.



VIII. Corporate Governance Report

II. Disclosures in accordance with the Listing Rules of the Stock Exchange

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

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.

This corporate governance report (the “Corporate Governance Report”) is to outline the major principles of the Company’s corporate governance. Shareholders of the Company are encouraged to make their views known to the Group if they have issues with the Company’s corporate governance and to directly raise any matters of concern to the chairman of the Board (the “Chairman” or the “Chairman of the Board”).

The Code on Corporate Governance Practices (the “CG Code”) as set out in Appendix 14 to the Rules Governing the Listing of Securities (the “Listing Rules”) on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) was amended and revised as the Corporate Governance Code (the “Revised CG Code”) which became effective on 1 April 2012.

The Company has adopted the principles and complied with the former and revised CG Code as set out in Appendix 14 to the Listing Rules as its own code of corporate governance, which shall also be revised from time to time in accordance with the Listing Rules. During the reporting period, the Board considers the Company has complied with the code provisions as set out in the CG Code.

2. Securities Transactions by Directors

In accordance with the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) contained in Appendix 10 to the Listing Rules, the Company has adopted codes of conduct relating to securities transactions by the Directors on terms no less exacting than the required standard set out in the Model Code. The Model Code is also applicable to the senior management of the Company. Having making specific enquiries, all Directors have confirmed that they had fully complied with the Model Code throughout 2012.

3. The Composition and Responsibilities of 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 2012, 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 7(2) in this annual report. Pursuant to Rule 3.13 of the Listing Rule, the Company has received the written confirmation of independence 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. Beside from this, there is no financial, business and relatives relationship among members of the Board.

VIII. Corporate Governance Report



In 2012, the Board had convened eight meetings and the Directors shall meet more frequently as and when required. At least 14 days' notice of all regular Board meetings is given to all Directors, and all Directors are given the opportunity to include matters for discussion in the agenda. The individual attendance record of each Director at such Board meetings is shown as follows:

Members of Directors	Position	Number of meetings attended/ Total number of meetings
Zhang En Rong	Chairman and executive Director	8/8
Zhang Yun San	Vice Chairman and executive Director	8/8
Lin Fu Long	Executive Director	8/8
Xie Xin Cang	Executive Director	8/8
Xiao Qing Zhou	Non-executive Director	8/8
Wang Ping	Non-executive Director (resigned on 11 May 2012)	4/4
Guo Hong Li	Non-executive Director (appointed on 25 May 2012)	4/4
Chau Shing Yim David	Independent non-executive Director	8/8
John Paul Cameron	Independent non-executive Director	8/8
Wang Chun Hua	Independent non-executive Director	8/8

Note 1: The term of appointment of Mr. Wang Ping was expired on 11 May 2012 and the Board has decided not to renew his appointment. Mr. Guo Hong Li has been appointed as a non-executive director on 25 May 2012 with a term of 1 year, whose appointment has been effective from the date on which the resolution regarding his appointment was passed at the 2011 AGM.

Note 2: Mr. John Paul Cameron and Mr. Chau Shing Yim, David attended all the 8 Board meetings through telephone conference, which according to the Articles of the Company, should also be considered as valid attendance.

All the Directors have access to relevant information timely. They also have access to the advice and services of the company secretary of the Company, who is responsible for providing the Directors with Board papers and related materials. Where queries are raised by the Directors, prompt and full responses will be given as soon as possible.

Should a significant potential conflict of interest involving a substantial shareholder of the Company or a Director arise, the matter will be discussed at a duly convened Board meeting, as opposed to being dealt with by a written resolution. Independent Non-Executive Directors with no conflict of interest will be present at meetings dealing with such conflict issues. Independent Non-Executive Directors are identified in all corporate communications containing the names of the Directors. An updated list of the Directors identifying the Independent Non-Executive Directors and the roles and functions of the Directors is maintained on the website of the Company and the website of the Stock Exchange.

4. Skills, Knowledge, Experience and Attributes of Directors

All Directors of the Board had served in office during the year. Every Director committed sufficient time and attention to the affairs of the Company. The Directors also demonstrate their understanding and commit to high standards of corporate governance. The Executive Director brings his perspectives to the Board through his deep understanding of the Group's business. The Non-Executive Directors and the Independent Non-Executive Directors contribute their own skills and experience, understanding of local and global economies, and knowledge of capital markets as well as the business of the Group. The Company is responsible for arranging and funding suitable continuous professional development programmes for all Directors to hone and refresh their knowledge and skills.



VIII. Corporate Governance Report

5. Induction and training

Each newly appointed Director, executive or non-executive, is required to undertake an induction program to ensure that he has a proper understanding of his duties and responsibilities. The induction program includes an overview of the Group's business operation and governance policies, the Board meetings' procedures, matters reserved to the Board, an introduction of the Board committees, the Directors' responsibilities and duties, relevant regulatory requirements, review(s) of minutes of the Board and Board committees in the past 12 months, and briefings with senior officers of the Group and site visits (if necessary).

Pursuant to the Code Provision A.6.5 of the Revised CG Code, all Directors should participate in continuous professional development to develop and refresh their knowledge and skills. This is to ensure their contribution to the Board remains informed and relevant. During the Year, all Directors had participated in appropriate continuous professional development activities by ways of attending training and/or reading materials relevant to the Company's business or to the Directors' duties and responsibilities.

The company secretary of the Company maintains records of training attended by the Directors. The training attended by each Director during the Year is tabulated as follows:-

Training Records

Name	Type of trainings	Training matters
	(Note 1)	(Note 2)
Mr. Zhang En Rong (<i>Chairman</i>)	a, b	i, ii, iii, iv
Mr. Zhang Yun San (<i>Vice Chairman</i>)	a, b	i, ii, iii, iv
Mr. Lin Fu Long	a, b	i, ii, iii, iv
Mr. Xie Xin Cang	a, b	i, ii, iii, iv
Mr. Xiao Qing Zhou	a, b	i, ii, iii, iv
Mr. Wang Ping (resigned on 11 May 2012)	a, b	i, ii, iii, iv
Mr. Guo Hong Li (appointed on 25 May 2012)	a, b	i, ii, iii, iv
Mr. Chau Shing Yim David	a, b	i, ii, iii, iv
Mr. John Paul Cameron	a, b	i, ii, iii, iv
Ms. Wang Chun Hua	a, b	i, ii, iii, iv

Note 1:

- a. attending seminar or training session
- b. self-development and updates relating to general economy, business development, director's duties and responsibilities, etc.

Note 2:

- i. corporate governance
- ii. regulatory compliance
- iii. finance
- iv. management and operation

VIII. Corporate Governance Report



The Company also organized the Directors to take part in training activities which organized by the Stock Exchange, SZSE, and other regulators, which including rules amendments, system updates, and the latest market trend, in order to let the Directors have the updated knowledge to the latest regulatory system and rules.

6. Directors' and officers' liability insurance and indemnity

The Company has arranged appropriate liability insurance to indemnify its Directors and officers in respect of legal actions against the Directors. Throughout 2012, no claim had been made against the Directors and the officers of the Company.

7. 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. Pursuant to Code Provision A.2.1, 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.

8. The term of appointment of Directors

Each of the Executive Directors, Non-executive Directors and Independent Non-executive Directors has entered into a service contract or appointment letter with the Company. In respect of the term of appointment, please refer to Part I of section VII (Directors, Supervisors, Senior Management and Employees) of this annual report. The Directors have power at any time and from time to time to appoint any person to be a Director, either to fill a casual vacancy or as an addition to the existing Directors. Any Director so appointed shall hold office only until the next annual general meeting of our Company and shall then be eligible for re-election at that meeting.

The term of the third Board of Directors of the Company will be expired on May 2013. The Board has proposed that Mr. Zhang En Rong, Mr. Zhang Yun San, Mr. Lin Fu Long to be reappointed as the Executive Directors of the Company and Mr. Xiao Qing Zhou and Mr. Guo Hong Li to be reappointed as the Non-Executive Directors of the Company and Mr. John Paul Cameron and Ms. Wang Chun Hua as the Independent Non-Executive Directors of the Company, for the term commencing on the date of the AGM and ending on the date of the conclusion of the fourth appointment period for the Board (May 2016).

Resolutions will be proposed by the Board at the AGM to appoint and re-appoint the Directors and to authorise the Board and the remuneration committee of the Company to determine their remunerations in accordance with the Articles of Association of the Company. Subject to the Shareholders' approval, the Company will enter into a service contract with the elected directors, which is subject to termination by the either party giving not less than one months' written notice. The directors are also subject to retirement and re-election at the annual general meeting of the Company in accordance with the Articles of Association.

In accordance with the terms of appointment, Mr. Zhang En Rong, Mr. Zhang Yun San, Mr. Lin Fu Long, Mr. Xie Xin Cang, Mr. Xiao Qing Zhou, Mr. Guo Hong Li, Mr. Chau Shing Yim David, Mr. John Paul Cameron and Ms. Wang Chun Hua will retire from the position of Director, but being eligible, shall be able to offer themselves for re-election.

9. 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.



VIII. Corporate Governance Report

In preparing the financial statements for the Year, the Directors adopted appropriate and consistent accounting policies and made prudent and reasonable judgments and estimations.

The financial statements for the Year have been prepared by the Directors on a going concern basis. There are no material uncertainties relating to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. A statement by the external auditors of the Company regarding their reporting responsibilities on the accounts of the Group is set out in the "Independent Auditor's Report" in this annual report.

10. The Board Committees of the Company

(A) Discharge of duties by the strategic committee of the Board

The Strategic Committee was established on 26 December 2012 and its current members are Mr. Zhang Yun San, Mr. Chau Shing Yim David, Mr. John Paul Cameron and Ms Wang Chun Hua, with Mr. Zhang Yun San as the Chairman of the Committee. The Strategic Committee of the Board discharged of its duties with diligence in accordance with the related requirements of the China Securities Regulatory Commission, the Shenzhen Stock Exchange and the Hong Kong Stock Exchange and the implementation rules of the Strategic Committee of the Board of the Company.

(B) The Audit Committee

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

- (1) The following major tasks were completed during 2012:
 1. It conducted pre-audit communication with auditing institution engaged by the Company in respect of the financial report auditing on pre-auditing work, reviewed the 2011 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 2012, which was passed to the Board for approval.
 3. It reviewed the 2012 interim financial statements for the six months ended 30 June 2012, which was passed to the Board for approval.
 4. It reviewed the third quarter financial statements ended 30 September 2012, which was passed to the Board for approval.

VIII. Corporate Governance Report



- (2) Auditing work conducted on the 2012 financial report of the Company was as follows:
1. It reviewed the 2012 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 2012 financial statements of the Company with Deloitte Touche Tohmatsu Certified Public Accountants Ltd.;
 2. It reviewed the draft of financial statements of the Company prior to an annual on site audit performed by the auditing certified public accountants and issued its approval to audit;
 3. It kept in close contact with the auditors upon the annual on-site audit and issued a letter to the auditors to urge the submission of the auditors' report on schedule;
 4. It reviewed the financial statements of the Company again upon the issue of draft opinion on the annual audit by the auditing certified public accountants, and considered the financial statements of the Company true, accurate and complete to reflect the overall position of the Company;
 5. At the first meeting of the audit committee in 2013, 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 2012.

Auditors' Remuneration

The Board, based on the recommendation of its the Audit Committee, approved the appointment of Deloitte Touche Tohmatus Certified Public Accountants Ltd. (special general partner) ("Deloitte") as the Group's external auditor to perform audit services for the Group since 2008. A letter from Deloitte to Shandong Molong dated 2 August 2012 confirmed that Deloitte was independent from the Group.

During 2012, the Group paid an aggregate of 1.2 million to Deloitte for their services as external auditors including audit and non-audit services.

The Audit Committee is provided with sufficient resources to perform its duties. Latest terms of reference of the Audit Committee can be viewed on the website of the Company and the website of the Stock Exchange. The major roles of the Audit Committee include the following:

- (a) to act as the key representative body for overseeing the relationship with the external auditors;
- (b) to review the Company's annual and interim financial statements; and
- (c) to evaluate the effectiveness of the Group's internal control and risk management systems.



VIII. Corporate Governance Report

The individual attendance record of each member of the Audit Committee is tabulated as follows:

Members of the Audit Committee	Duties	Number of meetings attended/ Total number of meetings
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

(C) The Nomination Committee

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 Guo Hong Li as candidates for non-executive director of the Company, which then was passed to the 2011 Annual Shareholders' Meeting for consideration and approval. The individual attendance record of each member of the Nomination Committee is tabulated as follows:

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

According to the written terms of reference of the Nomination Committee, the major responsibilities of the Nomination Committee include:

- (a) to review the structure, size and composition (including the skills, knowledge and experience) of the Board at least annually and make recommendations on any proposed changes to the Board to complement the Company's corporate strategy;
- (b) to identify individuals suitably qualified to become members of the Board and select or make recommendations to the Board on the selection of individuals nominated for directorships;
- (c) to assess the independence of the Independent Non-Executive Directors; and
- (d) to make recommendations to the Board on the appointment or re-appointment of Directors and succession planning for Directors, in particular the Chairman of the Board and the Chief Executive Officer.

Details of the terms of reference of the Nomination Committee can be viewed on the website of the Company and the website of the Stock Exchange.



(D) The Remuneration and Assessment Committee

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 2012 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 2012 and assessment of the Directors and the Senior Management of the Company.

The Remuneration and Assessment Committee had met 1 time during 2012. Attendance of each member of the committee is shown in the table below:

Members of the Remuneration and Assessment Committee	Duties	Number of meetings attended
Mr. John Paul Cameron (<i>Chairman</i>)	Committee Chairman and Independent non-executive Director	1/1
Mr. Zhang Yun San	Deputy Chairman and executive Director	1/1
Ms. Wang Chun Hua	Independent non-executive Director	1/1
Mr. Chau Shing Yim, David	Independent non-executive Director	1/1

The Remuneration and Assessment Committee is provided with sufficient resources to perform its duties. The current duties and responsibilities of the Remuneration and Assessment Committee are more specifically set out in its latest terms of reference, details of which can be viewed on the website of the Company and the website of the Stock Exchange.

11. 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 2012, 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.



VIII. Corporate Governance Report

During the period, 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.

12. Ability of Going Concern

By 31 December 2012, there was no uncertainty or conditions of a material nature that would affect the Company's ability to continue as a going concern.

13. Investor Relations

During 2012, the Company has amended its Articles twice in order to enable the Articles to satisfy the actual condition and requirements of relevant regulatory authorities. Please refer to the circulars of the Company dated 5 April 2012 and 24 August 2012, respectively. The latest Articles can be viewed on the website of the Company and the website of the Stock Exchange.

14. Others

There is no incompliance of Companies Law and relevant requirements of CSRC in respect of corporate governance.

Progress of the corporate governance works and the formulation and implementation of the management policy on personnel with insider information.

During the reporting period, the Company strictly complied with the regulations and requirements of the "Management Policy on Information Disclosure", "Internal Reporting System of Material Information" and "Registration and Filing System of Personnel with Insider Information". We have also seriously performed our information disclosure duties, diligently carried out the confidential and management works with respect to insider information and strictly controlled and prevented the leak of insider information in order to eliminate insider trading of the securities of the Company. After performing self-inspection, during the reporting period, the relevant departments of the Company were capable of carrying out registration for the personnel with insider information and management of external parties with access to sensitive information. There was no incidence of illegal trading of the securities of the Company and illegal trading of the securities of the Company by the Directors, Supervisors and Senior Management of the Company. The listed company and the relevant personnel did not face regulatory measures and administrative penalties arising from the implementation of the Registration and Filing System of Personnel with Insider Information and suspected insider trading.



15. Communication with shareholders

The Group endeavors to disclose relevant information on its activities to its shareholders in an open and timely manner, subject to applicable legal requirements. Communication between the Company and its shareholders is achieved through:

- (a) The Company's annual and interim reports which have been enhanced to present a balanced, clear and comprehensive assessment of the Group's position and prospects;
- (b) Forum and notices of AGMs and other general meetings and accompanying explanatory materials;
- (c) Press releases on major development of the Group;
- (d) Disclosures to the Stock Exchange and relevant regulatory bodies;
- (e) Response to inquiries from shareholders or media by the Company Secretary; and
- (f) The website of the Company through which the public can access, among other things, corporate announcements, press releases, annual reports, and general corporate information of the Group.

The communication channels between the Company and its shareholders above will be reviewed by the Board on a regular basis to ensure their effectiveness in maintaining an on-going dialogue with shareholders.

Constructive use of general meetings

The Board values the general meetings as the principal opportunities for the Directors to meet shareholders of the Company and to develop a balanced understanding of the views of the shareholders. During 2012, two general meetings (i.e. AGM held on 25 May 2012 and EGM held on 13 October 2012) was held by the Company. The attendance record of the Directors at the general meetings is set out below:

Directors Attendance

Name	Attended in person
Mr. Zhang En Rong (<i>Chairman</i>)	2/2
Mr. Zhang Yun San (<i>Vice Chairman</i>)	2/2
Mr. Lin Fu Long	2/2
Mr. Xie Xin Cang	2/2
Mr. Xiao Qing Zhou	2/2
Mr. Wang Ping (resigned on 11 May 2012)	1/2
Mr. Guo Hong Li (appointed on 25 May 2012)	1/2
*Mr. Chau Shing Yim David	2/2
*Mr. John Paul Cameron	2/2
Ms. Wang Chun Hua	2/2

*Note: Mr. John Paul Cameron and Mr. Chau Shing Yim, David attended all the two general meetings through telephone conference, which according to the Articles of the Company, should also be considered as valid attendance.

Notice of general meetings, annual report, financial statements and related papers were posted to shareholders of the Company for their consideration at least 20 clear business days prior to the general meetings.



VIII. Corporate Governance Report

The resolutions passed and resolved at the general meetings are shown as below:

1. Resolutions passed in AGM:

The Meeting Time	Date	Name of Conference Bill	Resolutions	Date of Announcement	Media for publication
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	2011 Annual Report and Annual Report Summary	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	2011 Director's Report	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	2011 Supervisors Report	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	2011 Audited Consolidated Financial Statements and Auditor's Report	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Re-appoint auditor for 2012	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting for Classes of Shareholders	25 May 2012	Re-appoint Mr. John Paul Cameron as an independent non-executive directors	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Re-appoint Wang Chun Hua as independent non-executive directors	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Re-appoint Liu Huai Duo as Supervisory	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Appoint Zhang Jiu Li as Supervisory	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Re-appoint Fan Ren Yi as Supervisory	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Apply for the Comprehensive credit line (not over RMB8.05 billion) in 2012 from PRC banks	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Company and subsidiaries use our own idle funds to buy Financial products.	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Distribution of 2011 final dividend and bonus	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2011 Annual general meeting and Separate Meeting of Classes for Shareholders	25 May 2012	Amendments to the Articles of Association	Passed	26 May 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn



2. Resolutions passed in EGM

The Meeting Time	Date	Name of Conference Bill	Resolutions	Date of Announcement	Media for publication
2012 First provisional extraordinary general meeting	12 October 2012	Dividend planing in the next three years (2012-2014)	Passed	13 October 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2012 First provisional extraordinary general meeting	12 October 2012	Dividend Policy System	Passed	13 October 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2012 First provisional extraordinary general meeting	12 October 2012	Amendment of Articles of Association	Passed	13 October 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn
2012 First provisional extraordinary general meeting	12 October 2012	Resolution related to the issuance of Company Debenture in Renminbi	Passed	13 October 2012	http://www.hkex.com.hk ; http://www.cninfo.com.cn

16. The independent trustee proposes the objection situation to the company related item

During the reporting period, independent directors has not raise objection to related matters of the Company.

17. Other description of independent directors

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, to perfect the corporate governance structure, safeguard the rights and interests of company and all shareholders has played a positive role.



VIII. Corporate Governance Report

18. Shareholders' Rights

Set out below is a summary of certain rights of the shareholders of the Company as required to be disclosed pursuant to the mandatory disclosure requirements under Paragraph O of the Revised CG Code which is effective from 1 April 2012.

(a) Convening of extraordinary general meeting on requisition by shareholders

Shareholders who request to convene an extraordinary general meeting or a class shareholders' meeting shall follow the procedures set out below:

- (1) Two or more shareholders who in aggregate hold 10% or more of the voting rights of all the shares having the right to vote in such a meeting may sign one or several written requisitions in the same form requesting the board of directors to convene an extraordinary general meeting or a class shareholders' meeting, and the subject matter of the meeting shall be specified.
- (2) The board of directors should according to the laws, administrative rules and regulations and the articles of association express their acceptance or refusal of the request within 10 days in writing form with reasons on the convention of the general meeting.
- (3) If the board of directors agrees to convene an extraordinary general meeting, a notice of general meeting will be made within 5 days after the decision of the board of directors. If there is any change to the original proposed resolutions, consent from the original proposers should be obtained.

If the board of directors does not agree to convene an extraordinary general meeting or does not reply within 10 days upon receiving the request, amount of shares held by shareholders convening for the meeting cannot be less than 10% have the right to convene and preside the meeting on their own with similar procedures as a general meeting convening by board of directors. And shareholders have the right to request the supervisory committee to convene an extraordinary general meeting in writing form.

- (4) If the board of directors agrees to convene an extraordinary general meeting, a notice of general meeting will be made within 5 days after the decision of the board of directors. If there is any change to the original proposed resolutions, consent from the original proposers should be obtained.

The board of supervisors don't issue the shareholders' meeting notification within the rule time, it will be as the board of supervisors not convene and preside over the shareholders' meeting, continuous ninety days above alone or combined owned 10% above (contain 10%) shares of one or more shareholders (including shareholders agent) may make the call and preside over the meeting.

- (5) The Company shall be liable to pay all reasonable compensation for the expenses incurred in convening and holding a meeting by the shareholders as a result of the failure of the board of directors to convene such meeting upon the aforesaid requisitions and such compensation shall be deducted from any payment payable to the directors who are in default of their duties.

(b) Procedures for putting forward proposals at a Shareholders' meeting

The shareholders that alone or combined hold more than 3% shares in the company, they can put forward proposals and submit to convener by written before the shareholders' general meeting 20 days. Regarding the proposal that according with the provisions of article eighty-two, the Company should notice other shareholders after two working days receiving the temporary proposal, and they should issue a form letter and publish announcement before the shareholders' meeting scheduled date 14 days, and will submit the temporary proposal to the shareholders' meeting to review.

VIII. Corporate Governance Report



Detailed procedures for shareholders to propose a person for election as a Director have been mentioned in the Articles of Association of the Company and are available on the Company's website.

(c) Enquiries to the Board

Should shareholders have any enquiries to the Board of the Company, they are engaged to contact the Company by the following means:

Contact Information	For Holder of H Shares	For Holder of Domestic Shares
	Principal place of business in Hong Kong	Registered Address in the PRC
	Suite A, 11th Floor Ho Lee Commercial Building 38-44 D' Aguilar Street Central Hong Kong	No. 999 Wensheng Street Shouguang City Shandong Province The PRC

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

1. In terms of business: The Company was operated 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 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 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. 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.



IX. Internal Control

I. Progress of Internal Control

The Company has, taken into consideration the characteristics of the Company, set up a relatively more comprehensive and systematic internal control system which conformed with the characteristics of corporate operation in accordance with the requirements of the relevant laws and regulations such as the "Company Law of the People's Republic of China", "Securities Law of the People's Republic of China", "Guidelines for Standardized Operation of Companies Listed on the Small and Medium-Sized Enterprise Board" and "Basic Standard for Enterprise Internal Control". This is to guarantee the materialization of operating goals, sound and compliance operation, safety of assets and the truthfulness and completeness of accounting information. Besides, the Company has established general meeting, Board of Directors, Supervisory Committee and an internal corporate structure which is in tandem with the business nature and scale of operation with clearly defined responsibilities and the function of mutual monitoring. The Company has further supplemented and improved the internal control system in accordance with the relevant requirements of the regulatory departments of the Company and the practical situation of the Company.

II. The Board's representation about the responsibilities for internal control

The Board and all directors of the Company hereby warrant that there are no false representations, misleading statements or material omissions contained in this report, and severally and jointly accept full responsibility for the truthfulness, accuracy and completeness of its content. It is the responsibility of the Board of the Company to set up a well-established internal control system and ensure its effective implementation. The Supervisory Committee is responsible for monitoring the establishment and implementation of the internal control system by the Board. The management bears the responsibility of organizing and leading the daily operation of corporate internal control. The goals of corporate internal control is to establish and continuously improve the internal control system and procedures with a view to promoting the compliance of laws, regulations and company's policies, ensuring the legal and compliance operation, safeguarding the safety and completeness of assets. Moreover, it is to guarantee the truthfulness and completeness of the financial report and relevant information, perking up the operation efficiency and results of the Company and promoting the materialization of the development strategies of the Company. Due to the inherent constraints of internal control, only reasonable guarantees could be offered in respect of the above targets.

III. Basis of establishing internal control of financial reports

This evaluation report aims at assessing the effectiveness of the design and operation of the internal control system of the Company as at 31 December 2012 in accordance with the requirements of the "Basic Standard for Enterprise Internal Control" (hereinafter referred to as the "Basic Standard"), the "Implementation Guidelines for Enterprise Internal Control" (hereinafter referred to as the "Implementation Guidelines", "Guidelines for Assessment of Enterprise Internal Control" (hereinafter referred to as the "Assessment Guidelines") jointly issued by five ministries including the Ministry of Finance of the People's Republic of China and on the basis of the daily supervision and specific supervision of internal control.

IV. Self-assessment report on internal control

Particulars of material deficiencies in internal control detected during the reporting period
which was contained in the self-assessment report on internal control
No material deficiency was detected during the reporting period.

Date of disclosure of the full context of the self-assessment report on internal control 28 March 2013

Index of full disclosure of self-assessment report on internal controls www.cninfo.com.cn, announcement named "2012 Assessment Report on Internal Control of Shandong Molong Petroleum Machinery Company Limited"



V. Auditors' report on internal control

Auditors' opinion contained in the Auditors' report on internal control

The Company has conducted self-assessment on the design and operation of the internal control system of the Company as at 31 December 2012 in accordance with the Basic Standard and Implementation Guidelines and the requirements of other relevant laws and regulations. During the reporting period, the Company has established the internal control system with respect to the businesses and issues within the scope of assessment and guaranteed its effective implementation. Such measure fulfilled the goal of corporate internal control and was free from material and significant deficiencies. From the reference date of the self-assessment report on internal control to the date of issue of the self-assessment report on internal control, no material changes in internal control have occurred which would have a substantial effect on the conclusion of assessment. We noted that the internal control system shall be compatible with the scale of operation, business scope, competition status and risk level of the Company and shall be timely adjusted in accordance with the changes in situation. The Company would adhere to the two-pronged strategy of organic growth and external expansion. Leveraging on the domestic and overseas platforms of capital market, we will further strengthen our basic management, continuously improve the internal control system, regulate the implementation of internal control system, enhance the regulation and inspection of internal control, beef up the efficiency and execution ability of risk control, and to improve the risk control capability in a consistent manner in order to strive for further development of the Company, in which we believe will in turn create stable and continuous growth and investment reward for our shareholders.

Date of disclosure of the full context of the Auditors' report on internal control 28 March 2013

Index of full disclosure of Auditors' report on internal control www.cninfo.com.cn, announcement named "2012 Assessment Report on Internal Control of Shandong Molong Petroleum Machinery Company Limited"

Any non-standard opinions set out in the Auditors' Report on Internal Control issued by accountants

Yes No

Auditors' Report on Internal Control issued by accountants was in line with Directors' opinions contained in Self-assessment Report

Yes No

VI. Establishment of Accountability System for Major Errors in Information Disclosure in Annual Reports and its Implementation

In order to avoid material errors in information disclosure in the Annual Report and manage accountability, the Company established the 2010 "Accountability System on Material Errors with respect to Major Errors in Information Disclosure of Annual Report". During the reporting period, the Company conducted stringent self-inspection in accordance with the "Accountability System on Material Errors with respect to Major Errors in Information Disclosure of Annual Report". No major accounting discrepancy, material omission and violation of accounting regulations and corporate accounting standards were detected in periodic reports and the Company did not identify material deficiencies with respect to the internal control of financial reporting during the reporting period.



Deloitte.

德勤

De Shi Bao (Shen) Zi (13) No. [P0476]

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

We have audited the accompanying financial statements of Shandong Molong Petroleum Machinery Company Limited (the "Company"), which comprise the company's and consolidated balance sheets as at 31 December 2012, 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.



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 2012, 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
28 March 2013



Consolidated Balance Sheets

As at 31 December 2012

Item	Note	Closing balance RMB	Opening balance RMB
Current assets:			
Cash and bank balances	V.1	483,870,151.44	413,632,018.60
Bills receivable	V.2	197,194,589.32	73,528,915.23
Accounts receivable	V.3	455,105,433.22	460,164,130.15
Prepayments	V.4	33,896,626.16	42,127,891.20
Other receivable	V.5	18,953,847.29	29,820,567.73
Inventory	V.6	1,220,618,577.83	1,176,981,854.52
Other current assets	V.7	41,379,809.50	72,538,796.17
Total current assets		2,451,019,034.76	2,268,794,173.60
Non-current assets:			
Long-term equity investment	V.9	58,634,400.43	12,580,624.11
Fixed assets	V.10	1,833,866,660.51	1,831,368,142.96
Construction in progress	V.11	134,351,091.69	83,523,080.85
Construction materials	V.12	378,586,638.46	333,019,939.03
Intangible assets	V.12	7,077,238.89	—
Goodwill	V.13	132,723,383.21	142,973,383.21
Long-term unamortized expenses		243,055.56	—
Deferred income tax assets	V.14	19,249,475.31	16,672,092.94
Other non-current assets	V.16	270,000,000.00	—
Total non-current assets		2,834,731,944.06	2,420,137,263.10
Total assets		5,285,750,978.82	4,688,931,436.70

Consolidated Balance Sheets



As at 31 December 2012

Item	Note	Closing balance RMB	Opening balance RMB
Current liabilities:			
Short-term borrowings	V.17	1,030,006,883.57	710,502,077.23
Short-term borrowings Bills Payable	V.18	603,403,515.62	383,690,165.06
Accounts payable	V.19	570,841,701.67	616,716,194.34
Advance receipts	V.20	25,837,981.59	20,713,521.63
Salaries payable	V.21	18,425,303.12	19,905,460.32
Taxes payable	V.22	33,669,386.02	35,749,257.97
Interests payable	V.23	6,968,896.69	5,557,955.40
Other payables	V.24	24,475,042.80	22,561,056.57
Total current liabilities		2,313,628,711.08	1,815,395,688.52
Non-current liabilities:			
Deferred income tax liabilities	V.14	11,603,555.23	11,518,019.83
Other non-current liabilities	V.25	7,232,000.00	9,040,000.00
Total non-current liabilities		18,835,555.23	20,558,019.83
Total liabilities		2,332,464,266.31	1,835,953,708.35
Shareholders' equity:			
Share capital	V.26	797,848,400.00	398,924,200.00
Capital reserve	V.27	849,500,658.42	1,248,424,858.42
Surplus reserve	V.28	168,908,489.86	157,965,274.48
Undistributed profit	V.29	1,073,097,098.79	989,669,698.87
Foreign currency translation differences		62,065.54	30,361.41
Total equity attributable to owners of the Company		2,889,416,712.61	2,795,014,393.18
Minority interests	V.30	63,869,999.90	57,963,335.17
Total shareholders' equity		2,953,286,712.51	2,852,977,728.35
Total liabilities and shareholders' equity		5,285,750,978.82	4,688,931,436.70

The notes form an integral part of the financial statements.

The financial statements as set out from pages 64 to 189 have been signed by:

Legal Representative

Chief Financial Officer

Head of the Finance Section



Balance Sheets of the Company

As at 31 December 2012

Item	Note	Closing balance RMB	Opening balance RMB
Current assets:			
Cash and bank balances	V.1	469,439,865.77	377,139,037.54
Bills receivable	V.2	181,652,729.32	73,528,915.23
Accounts receivable	V.3	461,652,893.75	457,266,644.14
Prepayments	V.4	135,378,309.84	8,735,715.10
Other receivable	V.5	222,102,947.24	17,510,729.92
Inventory	V.6	989,379,929.85	959,063,493.57
Other current assets	V.7	1,521,778.24	39,474,432.06
Total current assets		2,461,128,454.01	1,932,718,967.56
Non-current assets:			
Long-term equity investment	V.9	652,069,921.73	652,069,921.73
Fixed assets	V.10	1,392,000,620.11	1,350,869,260.71
Construction in progress	V.11	45,916,706.90	84,726,317.92
Intangible assets	V.12	284,671,539.96	246,273,322.58
Development expenditure	V.12	5,527,255.20	—
Deferred income tax assets	V.14	14,135,986.30	10,219,763.81
Other non-current assets	V.16	33,000,000.00	—
Total non-current assets		2,427,322,030.20	2,344,158,586.75
Total assets		4,888,450,484.21	4,276,877,554.31

Balance Sheets of the Company



As at 31 December 2012

Item	Note	Closing balance RMB	Opening balance RMB
Current liabilities:			
Short-term borrowings	V.17	980,006,883.57	618,942,712.23
Bills payable	V.18	653,403,515.62	380,837,165.06
Accounts payable	V.19	377,503,612.67	462,726,552.20
Advance receipts	V.20	25,536,367.16	26,525,840.83
Salaries payable	V.21	13,068,782.18	12,801,416.26
Taxes payable	V.22	13,406,043.28	19,300,276.19
Interests payable	V.23	6,968,896.69	4,600,388.73
Other payables	V.24	13,490,303.33	13,937,011.55
Total current liabilities		2,083,384,404.50	1,539,671,363.05
Non-current liabilities:			
Deferred income tax liabilities	V.14	457,855.65	329,701.06
Other non-current liabilities	V.25	7,232,000.00	9,040,000.00
Total non-current liabilities		7,689,855.65	9,369,701.06
Total liabilities		2,091,074,260.15	1,549,041,064.11
Shareholders' equity:			
Share capital	V.26	797,848,400.00	398,924,200.00
Capital reserve	V.27	849,481,990.92	1,248,406,190.92
Surplus reserve	V.28	168,908,489.86	157,965,274.48
Undistributed profit	V.29	981,137,343.28	922,540,824.80
Total shareholders' equity		2,797,376,224.06	2,727,836,490.20
Total liabilities and shareholders' equity		4,888,450,484.21	4,276,877,554.31



Consolidated Income Statements

As at 31 December 2012

Item	Note	Amount for the current period RMB	Amount for the previous period RMB
I. Total revenue from operations	V. 31	2,952,063,832.16	2,738,691,830.21
Including: operating revenue		2,952,063,832.16	2,738,691,830.21
II. Total cost of operations		2,836,551,935.91	2,572,677,653.23
Including: Operating cost	V. 31	2,624,241,003.24	2,407,671,724.80
Business tax and surcharges	V. 32	1,568,674.39	1,931,536.70
Selling expenses	V. 33	67,450,580.50	57,586,499.79
Administrative expenses	V. 34	96,130,216.28	87,944,411.71
Finance costs	V. 35	37,123,383.67	14,649,473.96
Asset impairment losses	V. 36	10,038,077.83	2,894,006.27
Add: Investment income	V. 37	1,203,776.32	253,344.29
Including: Gains from investment in associates and joint ventures	V. 37	1,203,776.32	253,344.29
III. Operating profit		116,715,672.57	166,267,521.27
Add: Non-operating income	V. 38	49,857,539.87	34,476,972.35
Less: Non-operating expenses	V. 39	718,732.89	679,969.16
Including: Loss from disposal of non-current assets	V. 39	296,929.41	429,020.39
IV. Total profit		165,854,479.55	200,064,524.46
Less: Income tax expenses	V. 40	25,688,302.21	31,022,289.46
V. Net profit		140,166,177.34	169,042,235.00
Net profit attributable to shareholders of the Company		134,263,035.30	168,330,282.50
Minority interests		5,903,142.04	711,952.50
VI. Earnings per share:			
(1) Basic earnings per share	V. 41	0.17	0.21
(2) Diluted earnings per share	V. 41	N/A	N/A
VII. Other comprehensive income	V. 42	35,226.82	570,763.42
VIII. Total comprehensive income		140,201,404.16	169,612,998.42
Total comprehensive income attributable to owners of the Company		134,294,739.43	168,843,969.55
Total comprehensive income attributable to minority interests		5,906,664.73	769,028.87

Income Statements of the Company



As at 31 December 2012

Item	Note	Amount for the current period RMB	Amount for the previous period RMB
I. Operating revenue	V.31	3,052,778,099.41	2,863,903,457.10
Less: Operating cost	V.31	2,791,289,027.71	2,572,698,117.94
Business tax and surcharges	V.32	8,449.89	3,641.15
Selling expenses	V.33	67,336,718.75	57,450,067.29
Administrative expenses	V.34	83,061,658.17	73,513,273.32
Finance costs	V.35	31,511,115.16	8,769,296.55
Asset impairment losses	V.36	(2,082,443.15)	3,289,143.71
Add: Investment income	V.37	—	19,707,433.98
Including: Gains from investment in associates and joint ventures		—	—
II. Operating profit		81,653,572.88	167,887,351.12
Add: Non-operating income	V.38	43,545,998.65	32,689,260.86
Less: Non-operating expense	V.39	598,324.37	187,651.48
Including: Loss from disposal of non-current assets	V.39	228,262.37	70,967.01
III. Total profit		124,601,247.16	200,388,960.50
Less: Income tax expenses	V.40	15,169,093.30	24,670,686.34
IV. Net profit		109,432,153.86	175,718,274.16
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		109,432,153.86	175,718,274.16



Consolidated Cash Flow Statements

As at 31 December 2012

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		2,387,932,830.74	3,072,075,223.47
Tax rebate received		148,142,100.34	133,034,729.58
Other cash received relating to operating activities	V.43(1)	69,144,856.05	109,372,826.54
Sub-total of cash inflow from operating activities		2,605,219,787.13	3,314,482,779.59
Cash paid for purchasing goods and receiving services		1,839,625,964.15	2,962,042,147.34
Cash paid to and on behalf of employees		130,784,088.05	117,907,356.31
Taxes and surcharges paid		59,357,454.59	51,233,594.86
Other cash paid relating to operating activities	V.43(2)	129,521,379.05	95,671,106.01
Sub-total of cash outflow from operating activities		2,159,288,885.84	3,226,854,204.52
Net cash flows from operating activities	V.44(1)	445,930,901.29	87,628,575.07
II. Cash flows from investing activities:			
Cash received from return on investments		150,000.00	300,000.00
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		885,777.38	2,284,453.05
Cash inflow from other investing activities	V.43(3)	—	9,040,000.00
Sub-total of cash inflow from investing activities		1,035,777.38	11,624,453.05
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		604,837,780.57	408,924,455.38
Cash paid for investment		45,000,000.00	—
Sub-total of cash outflow from investing activities		649,837,780.57	408,924,455.38
Net cash flows from investing activities		(648,802,003.19)	(397,300,002.33)
III. Cash flows from financing activities:			
Cash received from equity investments		2,142,713,329.80	959,743,537.46
Other cash received relating to financing activities	V.43(4)	68,900,000.00	12,000,000.00
Sub-total of cash inflow from financing activities		2,211,613,329.80	971,743,537.46
Cash paid for repayment of liabilities		1,824,018,658.73	959,596,273.38
Cash paid for dividends, profits distribution or interest repayment Including: Dividend and profit paid by subsidiaries to minority shareholders		86,017,488.16	106,377,706.83
Other cash paid relating to financing activities	V.43(5)	—	—
Sub-total of cash outflow from financing activities		1,990,216,146.89	1,065,973,980.21
Net cash flows from financing activities		221,397,182.91	(94,230,442.75)
IV. Effect on cash and cash equivalents due to change in foreign currency exchange rate		(69,295.28)	312,859.41
V. Net increase(decrease) in cash and cash equivalents		18,456,785.73	(403,589,010.60)
Add: Balance of cash and cash equivalents at the beginning of the period	V.44(2)	350,636,120.73	754,225,131.33
VI. Balance of cash and cash equivalents at the end of the period	V.44(2)	369,092,906.46	350,636,120.73

Cash Flow Statements of the Company



As at 31 December 2012

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		2,419,764,636.46	2,105,354,810.53
Tax rebate received		140,337,116.18	133,034,729.58
Other cash received relating to operating activities	V.43(1)	57,292,000.44	98,546,453.69
Sub-total of cash inflow from operating activities		2,617,393,753.08	2,336,935,993.80
Cash paid for purchasing goods and receiving services		2,121,219,646.41	2,010,971,824.30
Cash paid to and on behalf of employees		93,990,478.41	80,990,888.88
Taxes and surcharges paid		36,827,292.25	28,353,741.64
Other cash paid relating to operating activities	V.43(2)	328,877,973.26	86,912,702.70
Sub-total of cash outflow from operating activities		2,580,915,390.33	2,207,229,157.52
Net cash flows from operating activities	V.44(1)	36,478,362.75	129,706,836.28
II. Cash flows from investing activities:			
Cash received from return on investments		—	3,156,000.00
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		849,893.85	1,773,345.40
Cash inflow from other investing activities	V.43(3)	—	9,040,000.00
Sub-total of cash inflow from investing activities		849,893.85	13,969,345.40
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		266,339,548.53	304,717,441.33
Cash paid for investment		—	223,000,000.00
Sub-total of cash outflow from investing activities		266,339,548.53	527,717,441.33
Net cash flows from investing activities		(265,489,654.68)	(513,748,095.93)
III. Cash flows from financing activities:			
Cash received from equity investments		1,885,229,653.80	854,184,172.46
Other cash received relating to financing activities	V.43(4)	68,900,000.00	12,000,000.00
Sub-total of cash inflow from financing activities		1,954,129,653.80	866,184,172.46
Cash paid for repayment of liabilities		1,524,975,617.73	776,356,083.38
Cash paid for dividends, profits distribution or interest repayment Including: Dividend and profit paid by subsidiaries to minority shareholders	V.43(5)	79,369,872.28	100,539,050.96
Other cash paid relating to financing activities		80,180,000.00	—
Sub-total of cash outflow from financing activities		1,684,525,490.01	876,895,134.34
Sub-total of cash outflow from financing activities		269,604,163.79	(10,710,961.88)
IV. Effect on cash and cash equivalents due to change in foreign currency exchange rate		(73,390.74)	(210,768.96)
V. Net increase (decrease) in cash and cash equivalents		40,519,481.12	(394,962,990.49)
Add: Balance of cash and cash equivalents at the beginning of the period	V.44(2)	314,143,139.67	709,106,130.16
VI. Balance of cash and cash equivalents at the end of the period	V.44(2)	354,662,620.79	314,143,139.67



Consolidated Statement of Change in Shareholders' Equity

As at 31 December 2012

Item	Amount for the current year						Amount for the previous year					
	Attributable to the shareholders of the Company			Minority interests			Attributable to the shareholders of the Company			Minority interests		
	Share capital RMB	Capital reserve RMB	Surplus reserve RMB	Undistributed profit RMB	Others RMB	Total equity RMB	Share capital RMB	Capital reserve RMB	Surplus reserve RMB	Undistributed profit RMB	Others RMB	Total equity RMB
I. Balance at the end of the previous year	398,924,200.00	1,248,424,858.42	157,965,274.48	989,669,898.87	30,361.41	2,852,977,728.35	398,924,200.00	1,248,424,858.42	140,393,447.06	898,749,873.79	(483,325.64)	2,743,203,359.93
II. Changes in the current year												
(1) Net profit	—	—	—	134,263,035.30	—	140,166,177.34	—	—	—	168,330,282.50	—	169,042,235.00
(2) Other comprehensive income	—	—	—	—	31,704.13	35,226.82	—	—	—	513,687.05	—	570,763.42
Sub-total of (1) and (2)	—	—	—	134,263,035.30	31,704.13	175,427.16	—	—	—	168,330,282.50	513,687.05	169,612,998.42
(3) Shareholder's capital injection and capital reduction	—	—	—	—	—	—	—	—	—	—	—	—
1. Capital injection from shareholders	—	—	—	—	—	—	—	—	—	—	—	—
2. Equity settled share expenses charged to equity	—	—	—	—	—	—	—	—	—	—	—	—
3. Others	—	—	—	—	—	—	—	18,667.50	—	—	—	(18,667.50)
(4) Profit distribution	—	—	—	—	—	—	—	—	—	—	—	—
1. Transfer to surplus reserves	—	—	10,943,215.38	(10,943,215.38)	—	—	—	—	17,571,827.42	—	—	—
2. Distribution to shareholders	—	—	—	(39,892,420.00)	—	(39,892,420.00)	—	—	—	—	—	(59,838,630.00)
3. Others	—	—	—	—	—	—	—	—	—	—	—	—
(5) Transfer of shareholders' equity	—	—	—	—	—	—	—	—	—	—	—	—
1. Transfer of capital reserve to share capital	398,924,200.00	(398,924,200.00)	—	—	—	—	—	—	—	—	—	—
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	797,848,400.00	849,500,658.42	168,908,489.86	1,073,932,934.17	62,065.54	2,953,286,712.51	398,924,200.00	1,248,424,858.42	157,965,274.48	989,669,698.87	30,361.41	2,852,977,728.35

Statement of Change in Shareholders' Equity of the Company



As at 31 December 2012

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	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	
II. Changes in the current year											
(1) Net profit	—	—	—	109,432,153.86	109,432,153.86	—	—	—	175,718,274.16	175,718,274.16	
(2) Other comprehensive income	—	—	—	—	—	—	—	—	—	—	
Sub-total of (1) and (2)	—	—	—	109,432,153.86	109,432,153.86	—	—	—	175,718,274.16	175,718,274.16	
(3) Shareholders' contributions and decrease in capital											
1. Shareholders' contributions in capital	—	—	—	—	—	—	—	—	—	—	
2. Others	—	—	—	—	—	—	—	—	—	—	
(4) Profit distribution											
1. Transfer to surplus reserves	—	—	10,943,215.38	(10,943,215.38)	—	—	—	17,571,827.42	(17,571,827.42)	—	
2. Distribution to shareholders	—	—	—	(39,892,420.00)	(39,892,420.00)	—	—	—	(59,838,630.00)	(59,838,630.00)	
3. Others	—	—	—	—	—	—	—	—	—	—	
(5) Transfer of shareholders' equity											
1. Transfer of capital reserve to share capital	398,924,200.00	(398,924,200.00)	—	—	—	—	—	—	—	—	
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	797,848,400.00	849,481,990.92	168,908,489.86	981,137,343.28	2,797,376,224.06	398,924,200.00	1,248,406,190.92	157,965,274.48	922,540,824.80	2,727,836,490.20	



Notes to the Financial Statements

As at 31 December 2012

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 HKD 0.70 per share with a nominal value of RMB0.10 each, which were listed in the Growth Enterprise Market of the Stock Exchange of Hong Kong.

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

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

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



As at 31 December 2012

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.

Pursuant to the resolutions of 2011 Annual General Meeting convened on 25 May 2012, on the basis of a total of 398,924,200 shares as at 31 December 2011, the Company enlarged its share capital through conversion from capital reserve in the proportion of 1 shares for each existing share, converting 398,924,200 shares in aggregate, and the conversion date was 19 July 2012. Upon the conversion, the Company's registered capital has changed to RMB797,848,400.00, and the total number of shares has changed to 797,848,400 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 Hong Kong Stock Exchange.

On 5 November 2012, Ministry of Finance issued CAS Interpretation No.5, which has been effective on 1 January 2013 and no recourse adjustment is required. The Group has not early applied the interpretation, and the directors of the Group anticipate that the application of the interpretation won't have significant impact on the financial statements of the Group.

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.



Notes to the Financial Statements

As at 31 December 2012

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

2. Statement of compliance

The financial statements truly and completely reflect the financial position of the Group and the Company as at 31 December 2012 and the results of their operations and their cash flows for the year ended 31 December 2012.

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.



As at 31 December 2012

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

As at 31 December 2012

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".



As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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.



As at 31 December 2012

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 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.



Notes to the Financial Statements

As at 31 December 2012

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.

As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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.



As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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.



As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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.



As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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.



As at 31 December 2012

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

As at 31 December 2012

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	5 years – 20 years	5%	19.00% – 4.75%
Electronic equipment	3 years – 5 years	5%	31.67% – 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, assuming that the estimated useful life of the fixed asset has expired and the fixed asset is 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.



As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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.

As at 31 December 2012

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.



Notes to the Financial Statements

As at 31 December 2012

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

20. Revenue (continued)

20.2 Revenue from provision of services

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

If the result of provision of service transaction cannot be reliably estimated, revenue from provision of service is recognized at the service cost incurred and estimated to receive as compensation, and service cost incurred will be regarded as the current cost. If service cost incurred is 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.



As at 31 December 2012

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

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

The Group recognizes deferred income tax liabilities arising from the temporary difference on tax payable related to investment in subsidiaries, associates and joint 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.



Notes to the Financial Statements

As at 31 December 2012

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



As at 31 December 2012

III. Taxation

1. Main Tax Types and Tax Rates

Tax type	Basis of taxing	Tax rate (%)
Value-added Tax	(Note 1)	17%
Business tax	Operation Revenue	5%
Building tax	(Note 2)	(Note 2)
Urban maintenance and construction tax	Paid-in value-added tax and business tax	7%
Education surtax	Paid-in value-added tax and business tax	3%
Education surcharge	Paid-in value-added tax and business tax	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	16.5%
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

As at 31 December 2012

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 [2009] No.12	Implement the income tax rate of 15%	2010.01.01–2013.12.31

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



As at 31 December 2012

IV. Merger of Companies and Consolidated Financial Statement

1. Subsidiaries

(1) Subsidiaries acquired through establishment or investment

Full Name of Subsidiaries (Note 4)	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	6,228,982.04	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》), 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 [2007] 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, 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 registered 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 [2007] 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 have never balance any issued securities by 31 December 2012.



Notes to the Financial Statements

As at 31 December 2012

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

1. Subsidiaries (continued)

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

Full Name of Subsidiaries (Note 6)	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
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
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
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
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	RMB1,641,017.86	Nil

As at 31 December 2012

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

As at 31 December 2012

IV. Merger of Companies and Consolidated Financial Statement

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

When the Company prepared these combined financial statements, all assets and liabilities items within MPM Company's (operated overseas) balance sheet were exchanged at the rate of US\$1 : RMB6.2855; all items within income statement and items that reflect the amount incurred by profit allocation were exchanged at the rate of US\$1 : RMB6.3932.

V. Notes to the Financial Statements

1. Cash & cash equivalents

Consolidation

Item	Closing balance			Opening balance			RMB
	Foreign currency amount	Exchange Rate	Amount in RMB	Foreign currency amount	Exchange Rate	Amount in RMB	
	Cash:						
RMB	38,135.44	1.0000	38,135.44	153,603.44	1.0000	153,603.44	
Cash in Bank:							
RMB	110,780,295.88	1.0000	110,780,295.88	182,144,267.32	1.0000	182,144,267.32	
USD	4,072,848.42	6.2855	25,599,876.14	6,787,589.31	6.3009	42,767,930.02	
HKD	1,440.86	0.8109	1,180.23	15,370.43	0.8107	12,460.81	
EURO	0.01	8.3176	0.08	104.71	8.1625	854.70	
Other cash and cash equivalents (note):							
RMB	347,450,663.67	1.0000	347,450,663.67	188,552,902.31	1.0000	188,552,902.31	
Total			483,870,151.44			413,632,018.60	

Notes to the Financial Statements



As at 31 December 2012

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	17,907.19	1.0000	17,907.19	54,105.00	1.0000	54,105.00
Cash in Bank:						
RMB	100,901,845.93	1.0000	100,901,845.93	161,653,147.49	1.0000	161,653,147.49
USD	3,352,072.06	6.2855	21,069,448.90	4,764,639.80	6.3009	30,021,518.88
HKD	—	—	—	11,729.57	0.8107	9,509.16
EURO	0.01	8.3176	0.08	104.71	8.1625	854.70
Other cash and cash equivalents (note):						
RMB	347,450,663.67	1.0000	347,450,663.67	185,399,902.31	1.0000	185,399,902.31
Total			469,439,865.77			377,139,037.54

Note: As at 31 December 2012, other monetary capital of the Group and the Company represented guarantee on bank promissory notes 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. As at 31 December 2012, Both the Group and the Company had restricted bank promissory notes with maturity over 3 months of RMB89,777,244.98. Both the Group and the Company had guarantee deposit over 3 months of RMB25,000,000.00. As at 31 December 2011 the Group and the Company had restricted bank promissory notes with maturity over 3 months of RMB49,275,897.87. The Group and the Company had guarantee on loans with maturity over 3 months of RMB13,720,000.00.

2. Bills receivable

(1) Classification of bills receivable

RMB

Item	Consolidated		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Bank acceptance	197,194,589.32	73,528,915.23	181,652,729.32	73,528,915.23



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

2. Bills receivable (continued)

- (2) As at 31 December 2011, have notes receivable pledge before five were as follows:

Consolidation and the Company

			RMB
Name of Ticket Units	Date of draft	Due date	Amount
China Petroleum & Chemical Co., Ltd. Supplies equipment department	09/11/2012	09/02/2013	6,103,286.06
Luoyang Branch Constant Special Steel Products Co., Ltd	25/07/2012	25/01/2013	5,000,000.00
Baotou North Toward Heavy Duty Truck Co., Ltd	31/08/2012	28/02/2013	3,000,000.00
Shaanxi Extend Oil (Group) Co., Ltd	23/10/2012	23/04/2013	2,000,000.00
Western Ordos City Gold Mining and Metallurgy Co., Ltd	24/07/2012	24/01/2013	2,000,000.00
Total			18,103,286.06

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

Consolidation and the Company

			RMB
Name of Ticket Units	Date of draft	Due date	Amount
SongYuan SIMS Rice Oil Special Pipe Manufacture Co., Ltd	18/07/2012	19/01/2013	10,000,000.00
China Petroleum & Chemical Co., Ltd. Supplies equipment department	24/10/2012	24/01/2013	10,000,000.00
Shandong Shouguang East Dragon Polyester Co., Ltd	15/11/2012	15/05/2013	9,000,000.00
Wuxi SIMS Rice Oil Special Pipe Manufacture Co., Ltd	15/11/2012	15/05/2013	8,500,000.00
Wuxi SIMS Rice Oil Special Pipe Manufacture Co., Ltd	16/10/2012	16/04/2013	6,500,000.00
Total			44,000,000.00

- (4) 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.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

2. Bills receivable (continued)

- (5) During the current year, the Group and the Company have accumulatively discounted commercial promissory notes of RMB136,759,023.90 and RMB86,759,023.90, respectively, to the bank (previous year: the Group and the Company have no discounted business). For the year ended 31 December 2012, the Group has discounted a balance of commercial promissory notes which were not matured of RMB50,000,000.00. The Group has not derecognized discounted bills receivable which were not matured, please refer to note V.17 for the corresponding recognized short-term loans. The discounting fees incurred by the Group and the Company during the current year amounted to RMB2,857,836.50 and RMB1,652,603.15, respectively (previous year: no discounting fees were incurred by the Group and the Company).
- (6) During the current year, the Group and the Company pledged bills receivable of RMB213,252,938.96 for issuing bills payable with equivalent amount to banks. Those bills receivable with maturity of 3 to 6 months will be fully matured by 26 May 2013. As at 31 December 2012, the bills receivable of the Group and the Company in the amount of RMB136,399,247.06 were successfully converted and automatically transferred and deposited as guarantee on bank's promissory notes, and a balance of bills receivable of RMB76,853,691.90 was secured as pledge.
- (7) During the current year, there was no underlying genuine commodity transaction for the bills receivable of the Group in the amount of RMB32,732,381.03. Those bills receivable with maturity of 3 to 6 months will be fully matured by 26 May 2013.

3. Accounts receivable

Consolidation

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

Category	Closing balance				Opening balance				RMB
	Book balance		Bad debt provision		Book balance		Bad debt provision		
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	
Single item with significant accounts receivables and provided for bad debt by single item	3,284,636.96	0.71	3,284,636.96	100.00	9,735,286.00	2.07	8,829,484.60	90.70	
Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item	455,105,433.22	98.86	—	—	459,258,328.75	97.90	—	—	
Single item with insignificant accounts receivables but provided for bad debt by single item	1,955,304.07	0.43	1,955,304.07	100.00	119,765.00	0.03	119,765.00	100.00	
Total	460,345,374.25	100.00	5,239,941.03	1.14	469,113,379.75	100.00	8,949,249.60	1.91	

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

As at 31 December 2012

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:

Aging	Closing balance				Opening balance				RMB
	Amount	Ratio (%)	Bad debt provision	Book balance	Amount	Ratio (%)	Bad debt provision	Book balance	
	Within 1 year	452,653,405.89	98.33	—	452,653,405.89	444,600,302.69	94.77	—	444,600,302.69
1 to 2 years	1,799,900.20	0.39	—	1,799,900.20	8,210,585.63	1.75	—	8,210,585.63	
2 to 3 years	491,300.86	0.11	—	491,300.86	5,247,762.19	1.12	1,358,702.10	3,889,060.09	
Over 3 years	5,400,767.30	1.17	5,239,941.03	160,826.27	11,054,729.24	2.36	7,590,547.50	3,464,181.74	
Total	460,345,374.25	100.00	5,239,941.03	455,105,433.22	469,113,379.75	100.00	8,949,249.60	460,164,130.15	

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 2012, single item with insignificant accounts receivable but provided for bad debt in single item is as follows:

Accounts receivable	Book balance	Bad debt balance	Provision ratio (%)	Reason	RMB
Trade receivable	1,955,304.07	1,955,304.07	100.00	Aged over three years, difficult to recover	

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

Consolidation (continued)

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

RMB

Accounts receivable	Reason for write-back or recovery	Basis for determination of original bad debt	Accumulated amount of bad debt provision before write-back or recovery	Amount written-back or recovered
Trade receivable	Recover the amount or signing of repayment agreement	Relatively long aged, difficult to recover	4,650,513.63	4,650,513.63

(3) No Situation of cancel after verification during the current year.

(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) 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 (%)
Changqing Oilfield Company, China National Petroleum Co., Ltd	customer	74,860,034.87	Within 1year	16.26
North China Petroleum Administration Bureau	customer	46,018,637.03	Within 1year	10.00
China Great Wall Drilling Oil Group Engineering Co., Ltd Supplies Company	customer	33,440,251.92	Within 1year	7.26
Shandong New Coal Machinery Co., Ltd	customer	32,988,426.03	Within 1year	7.17
Daqing Oilfield Supplies Company	customer	26,563,476.30	Within 1year	5.77
Total		213,870,826.15		46.46



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

Consolidation (continued)

(6) 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	2,716,477.70	0.59

(7) As at 31 December 2012, The group has no pledge of accounts receivable (As at 31 December 2011, The group of accounts receivable pledge amount is RMB26,825,651.15).

The Company

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

Category	Closing balance				Opening balance			
	Book balance		Bad debt provision		Book balance		Bad debt provision	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Single item with significant accounts receivable and provided for bad debt by single item	3,284,636.96	0.70	3,284,636.96	100.00	9,735,286.00	2.09	8,829,484.60	90.70
Single item with insignificant accounts receivable and single item with significant accounts receivable but not impaired under impairment test in single item	461,652,893.75	98.89	—	—	456,360,842.74	97.90	—	—
Single item with insignificant accounts receivables but provided for bad debt in single item	1,898,604.07	0.41	1,898,604.07	100.00	63,065.00	0.01	63,065.00	100.00
Total	466,836,134.78	100.00	5,183,241.03	1.11	466,159,193.74	100.00	8,892,549.60	1.91

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



As at 31 December 2012

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)

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:

Aging	Closing balance				Opening balance			
	Amount	Ratio (%)	Bad debt provision	Book balance	Amount	Ratio (%)	Bad debt provision	Book balance
	Within 1 year	459,271,053.43	98.38	—	459,271,053.43	442,527,267.69	94.93	—
1 to 2 years	1,799,900.20	0.39	—	1,799,900.20	7,387,730.62	1.58	—	7,387,730.62
2 to 3 years	491,300.86	0.10	—	491,300.86	5,246,166.19	1.13	1,358,702.10	3,887,464.09
Over 3 years	5,273,880.29	1.13	5,183,241.03	90,639.26	10,998,029.24	2.36	7,533,847.50	3,464,181.74
Total	466,836,134.78	100.00	5,183,241.03	461,652,893.75	466,159,193.74	100.00	8,892,549.60	457,266,644.14

RMB

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 2012, single item with insignificant accounts receivable but provided for bad debt in single is as follows:

Accounts receivable	Book balance	Bad debt balance	Provision ratio (%)	Reason
Trade receivable	1,898,604.07	1,898,604.07	100.00	Aged over three years, difficult to recover

RMB

- (2) Reversals and collection of the year are the same as notes to combined financial statements.
- (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.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

3. Accounts receivable (continued)

The Company (continued)

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

Name	Relationship with the Company	Amount	RMB
			Proportion of the total accounts receivables (%)
MPM Company	subsidiary	15,432,904.18	3.31
Ya Long Oil Pump Company Limited	affiliated company	2,716,477.70	0.58
Weihai Baolong Co., Ltd	subsidiary	2,008.16	—
Total		18,151,390.04	3.89

(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:

Aging	Closing balance		Opening balance	
	Amount	Ratio (%)	Amount	Ratio (%)
Within 1 year	33,836,143.94	99.82	42,099,676.98	99.93
1 to 2 years	32,268.00	0.10	—	—
Over 3 years	28,214.22	0.08	28,214.22	0.07
Total	33,896,626.16	100.00	42,127,891.20	100.00

Notes to the Financial Statements



As at 31 December 2012

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 Shouguang JuNeng Special Steel Co., Ltd	Supplier	5,989,756.93	within 1 year	hasn't received material
Shandong Longsheng Steel Co., Ltd	Supplier	4,813,981.41	within 1 year	hasn't accepted labour
Shouguang Power Supply Company	Supplier	3,845,823.17	within 1 year	hasn't received material
Wen Dengshi Power Supply Company	Supplier	3,095,336.98	within 1 year	hasn't received material
China National Minerals Co., Ltd	Supplier	2,982,160.44	within 1 year	hasn't received material
Total		20,727,058.93		

(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 other Advance payment	17,744,898.49	52.35	28,949,865.84	68.72
Single item without significant Advance payment but considered to be greater risks after arrived at by credit risk characteristics	60,482.22	0.18	28,214.22	0.07
Other items without significant other	16,091,245.45	47.47	13,149,811.14	31.21
Total	33,896,626.16	100.00	42,127,891.20	100.00

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

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



Notes to the Financial Statements

As at 31 December 2012

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 (%)
	Within 1 year	135,335,358.23	99.97	8,725,031.49
1 to 2 years	32,268.00	0.02	—	—
Over 3 years	10,683.61	0.01	10,683.61	0.12
Total	135,378,309.84	100.00	8,735,715.10	100.00

RMB

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

Name	Relationship with the Company	Amount	Aging	Reasons
Shouguang baolong Co., Ltd	Subsidiary	121,242,310.72	within 1 year	hasn't received material
Shouguang Power Supply Company	Supplier	3,845,823.17	within 1 year	hasn't received material
Shandong Shouguang JuNeng Special Steel Co., Ltd	Supplier	2,611,298.46	within 1 year	hasn't received material
Shouguang Shihua is Natural Gas Co., Ltd	Supplier	2,046,547.49	within 1 year	hasn't received material
Jiangyin Xingcheng Special Materials Co., Ltd	Supplier	406,107.23	within 1 year	hasn't received material
Total		130,152,087.07		

RMB

(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



As at 31 December 2012

V. Notes to the Financial Statements (continued)

4. Advance Payment (continued)

The Company (continued)

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

Category	Closing balance		Opening balance	
	Amount	Ratio (%)	Amount	Ratio (%)
	RMB			
Single item with significant other Advance payment	125,088,133.89	92.40	4,168,960.37	47.72
Single item without significant Advance payment but considered to be greater risks after arrived at by credit risk characteristics	42,951.61	0.03	10,683.61	0.12
Other items without significant other	10,247,224.34	7.57	4,556,071.12	52.16
Total	135,378,309.84	100.00	8,735,715.10	100.00

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

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

(5) There is 121242310.72 yuan of prepaid subsidiaries Shouguang Baolong company money prepaid account balances



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

5. 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	18,953,847.29	99.38	—	—	29,820,567.73	99.60	—	—
Single item with insignificant other receivables but provided for bad debt in single item	119,119.25	0.62	119,119.25	100.00	119,119.25	0.40	119,119.25	100.00
Total	19,072,966.54	100.00	119,119.25	0.62	29,939,686.98	100.00	119,119.25	0.40

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	Closing balance				Opening balance			
	Amount	Ratio (%)	Bad debt balance	Book Value	Amount	Ratio (%)	Bad debt balance	Book Value
Within 1 year	8,140,362.48	42.68	—	8,140,362.48	11,413,126.53	38.12	—	11,413,126.53
1 to 2 years	3,545,825.81	18.59	—	3,545,825.81	13,232,789.36	44.20	—	13,232,789.36
2 to 3 years	2,160,000.00	11.32	—	2,160,000.00	2,797,191.34	9.34	—	2,797,191.34
Over 3 years	5,226,778.25	27.41	119,119.25	5,107,659.00	2,496,579.75	8.34	119,119.25	2,377,460.50
Total	19,072,966.54	100.00	119,119.25	18,953,847.29	29,939,686.98	100.00	119,119.25	29,820,567.73

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

5. Other receivables (continued)

Consolidation (continued)

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

As at 31 December 2012, 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 Company mainly comprises of land acquisition payment advances due from Shouguang Baolong, land removal advances due from Gucheng Street Offices, and interests of deposits receivable from Huaxia Bank Weifang Branch, China Construction Bank Shouguang Branch and Bank of Weifang Zao Chun Yuan 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
The ancient city of street agency	Non-related party	6,891,320.00	within 4 year	36.13
Wen Dengshi high villages and towns government	Non-related party	3,000,000.00	1 to 2 years	15.73
Huaxia Bank, Weifang branch	Non-related party	1,191,058.35	within 1 year	6.24
Shouguang branch of China Construction Bank	Non-related party	785,779.04	within 1 year	4.12
Weifang Bank, Zao Chun Yuan branch	Non-related party	344,318.94	within 1 year	1.81
Total		12,212,476.33		64.03

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



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

5. 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	222,102,947.24	99.95	—	—	17,510,729.92	99.32	—	—
Single item with insignificant other receivables but provided for bad debt by single item	119,119.25	0.05	119,119.25	100.00	119,119.25	0.68	119,119.25	100.00
Total	222,222,066.49	100.00	119,119.25	0.05	17,629,849.17	100.00	119,119.25	0.68

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	214,909,801.43	96.71	—	214,909,801.43	7,402,640.62	41.99	—	7,402,640.62
1 to 2 years	298,825.81	0.13	—	298,825.81	5,237,873.84	29.71	—	5,237,873.84
2 to 3 years	2,060,000.00	0.93	—	2,060,000.00	2,766,093.96	15.69	—	2,766,093.96
Over 3 years	4,953,439.25	2.23	119,119.25	4,834,320.00	2,223,240.75	12.61	119,119.25	2,104,121.50
Total	222,222,066.49	100.00	119,119.25	222,102,947.24	17,629,849.17	100.00	119,119.25	17,510,729.92

As at 31 December 2012, 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



As at 31 December 2012

V. Notes to the Financial Statements (continued)

5. Other receivables (continued)

The Company (continued)

(3) The major receivable payments are the advance payment of buying land and Demolition compensation of Gucheng Town and interest of Huaxia Bank Weifang Branch, China Construction Bank Shouguang Branch and Weifang Bank Zaochunyuanyuan 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
Shouguang baolong Co., Ltd	Subsidiary	207,000,000.00	within 1 year	93.15
The Ancient City of Street Agency	Non-related party	6,891,320.00	within 4 year	3.10
Huaxia Bank, Weifang Branch	Non-related party	1,191,058.35	within 1 year	0.54
Shouguang Branch of China Construction Bank	Non-related party	785,779.04	within 1 year	0.35
Weifang Bank, Zao Chun Yuan branch	Non-related party	344,318.94	within 1 year	0.15
Total		216,212,476.33		97.29

(5) The balance of other receivables of RMB207,000,000.00 was amount due from Shouguang baolong, a subsidiary.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

6. 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	248,613,503.61	1,017,466.95	247,596,036.66	317,932,966.06	1,347,882.94
Work-in-progress	453,148,290.87	1,247,247.47	451,901,043.40	444,056,692.70	632,526.25	443,424,166.45
Entrusted processing materials	13,819,291.21	—	13,819,291.21	56,203,898.79	—	56,203,898.79
Finished product	511,401,336.43	4,099,129.87	507,302,206.56	362,249,067.17	1,480,361.01	360,768,706.16
Total	1,226,982,422.12	6,363,844.29	1,220,618,577.83	1,180,442,624.72	3,460,770.20	1,176,981,854.52

(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	1,347,882.94	
Work-in-progress	632,526.25	761,099.17	14,471.26	131,906.69	1,247,247.47
Finished product	1,480,361.01	2,819,165.83	12,614.01	187,782.96	4,099,129.87
Total	3,460,770.20	3,580,265.00	82,878.60	594,312.31	6,363,844.29

(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	0.02
Work-in-progress	Cost is higher than net realizable value	Value has rebounded and is higher than cost	—
Finished product	Cost is higher than net realizable value	Value has rebounded and is higher than cost	—

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

6. Inventory (continued)

The Company

(1) Inventory categories

RMB

Item	Closing balance			Opening balance		
	Book balance	Allowance for		Book balance	Allowance for	
		inventories	Book balance		Book balance	inventories
Raw materials	165,255,684.35	872,160.98	164,383,523.37	210,638,707.71	1,202,576.97	209,436,130.74
Work-in-progress	428,071,019.94	734,382.18	427,336,637.76	405,680,962.15	565,531.52	405,115,430.63
Consigned processing materials	13,816,477.26	—	13,816,477.26	56,169,021.96	—	56,169,021.96
Finished product	386,406,691.71	2,563,400.25	383,843,291.46	289,712,192.05	1,369,281.81	288,342,910.24
Total	993,549,873.26	4,169,943.41	989,379,929.85	962,200,883.87	3,137,390.30	959,063,493.57

(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	1,202,576.97	
Work-in-progress	565,531.52	315,228.61	14,471.26	131,906.69	734,382.18
Finished product	1,369,281.81	1,394,515.41	12,614.01	187,782.96	2,563,400.25
Total	3,137,390.30	1,709,744.02	82,878.60	594,312.31	4,169,943.41

(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	0.03
Work-in-progress	Cost is higher than net realizable value	Value has rebounded and is higher than cost	—
Finished product	Cost is higher than net realizable value	Value has rebounded and is higher than cost	—



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

7. Other current assets

Item	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Import tax pending deduction	39,243,016.22	71,148,262.69	1,521,778.24	38,931,374.18
Prepaid land usage tax	—	543,057.88	—	543,057.88
Prepaid income tax	1,289,983.67	539,301.51	—	—
Other prepaid tax	846,809.61	308,174.09	—	—
Total	41,379,809.50	72,538,796.17	1,521,778.24	39,474,432.06

RMB

8. Investment in equity joint ventures and investment in associates

Consolidation

Name of investee entity	Percentage of the shareholding of the investee entity (%)	Percentage of the shareholding of the investee entity (%)	Total assets at the end of period	Total liabilities at the end of period	Total net asset value at the end of period	Operating income for the current period	Net profit from the current period
<i>Consortium</i>							
Yalong Oil Pump	30.00	30.00	18,768,535.86	9,935,107.28	8,833,428.58	20,132,805.52	967,555.54
<i>Shouguang Maolong</i>							
Micofinance Co., Ltd ("Maolong Micofinance") (Note)	30.00	30.00	154,492,960.93	1,447,928.75	153,045,032.18	6,019,158.81	3,045,032.18

RMB

Note: On 12 March 2012, Shouguang baolong, a subsidiary of the Company, invested and established Maolong Micofinance jointly with 山東聖龍鋼結構有限公司 (Shenglong Steel Structures Co., Ltd.) (hereinafter referred to as "Shenglong Steel Structures"), 山東志達機械有限公司 (hereinafter referred to as "志達機械公司") and 6 natural person shareholders (all of which are non-key management personnel of the Company). The registered capital is RMB150,000,000.00, of which Shouguang baolong contributed RMB45,000,000.00 in cash, representing 30% of the equity interests; each of Shenglong Steel Structures and 志達機械公司 contributed RMB15,000,000.00 in cash, representing 10% of the respective equity interests; 3 of the natural person shareholders each contributed RMB15,000,000.00 in cash, representing 10% of the respective equity interests; the remaining 3 natural person shareholders each contributed RMB10,000,000.00 in cash, representing 6.67% of the respective equity interests. As at 15 February 2012, the above contributions have been injected, 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 [2012] No. 040 Assets Examination Report (壽魯會驗[2012]第040號驗資報告).

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

8. Investment in equity joint ventures and investment in associates (continued)

Consolidation (continued)

Maolong Microfinance is primarily engaged in handling various loans, and providing consultation services to small-scale enterprises regarding aspects including development, management and financial in the Shouguang district. As at 31 December 2012, the details of the lending and advancing businesses of Maolong Microfinance are as follows:

RMB

Item	Accumulated loans of the year	Closing balance		Weighted average annual interest rate % (Note 1)	Description
		Amounts of loans and advances issued	Allowance of loss for loans and advances issued		
Personal loans and advances	207,699,882.58	121,680,000.00	1,825,200.00	8.52	
Of which: loans of the Group (Note 2)	26,900,000.00	—	—	7.87	
Personal loans of staff of the Company	62,419,882.58	37,300,000.00	559,500.00	6.37	Mainly repaid by way of repaying both principal and interest due
Other personal loans	118,380,000.00	84,380,000.00	1,265,700.00	9.84	
Corporate loans and advances	77,130,000.00	4,350,000.00	65,250.00	11.04	
Of which: loans of the Group (Note 2)	42,000,000.00	—	—	7.05	
Other corporate loans	35,130,000.00	4,350,000.00	65,250.00	13.61	
Total	284,829,882.58	126,030,000.00	1,890,450.00	8.76	

Note 1: Weighted average annual interest rate is calculated by adding weights to interest rate of each loans under the segment, of which the numerator is represented by the equivalent calculated by discounting the principal of each loans under the segment over the maturity period of the loan, and the denominator is represented by the sum of the equivalents calculated by discounting the principal of each loans under the segment over the maturity period of the loan.

Note 2: Loans of the Group include: the loans, each amounted to RMB7,500,000.00, obtained by the Group from Maolong Microfinance through Maolong Recycle, Maolong Machinery and Molong Electro-mechanical Equipment, all of which are subsidiaries of the Company, totaling RMB22,500,000.00; the loans totaling RMB46,400,000.00 obtained by the Group from Maolong Microfinance through a third party. The Group has repaid the above loans by 18 September 2012, please refer to note VI.4(4).



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

9. Long-term equity investment

Consolidation

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

RMB

Investee entity (non-listed company)	Accounting method	Registration place	Investment	Opening balance	Change ment	Closing balance	Percentage	Percentage	Explanation of the inconsistent of shareholding percentage and voting right in the investee entity	Impairment provision	Provision of impairment for the current period	Cash bonuses for the current period
							in the investee entity (%)	of voting right in the investee entity (%)				
Yalong Oil Pump	Equity method	Xinjiang karamay	1,888,500.00	2,580,624.11	140,266.67	2,720,890.78	30.00	30.00	—	—	—	150,000.00
Maolong Microfinance	Equity method	Shandong shouguang	45,000,000.00	—	45,913,509.65	45,913,509.65	30.00	30.00	—	—	—	—
Shouguang Mihe Water Company Limited ("Mihe Water")	Cost method	Shandong shouguang	10,000,000.00	10,000,000.00	—	10,000,000.00	9.73	9.73	—	—	—	—
Total			56,888,500.00	12,580,624.11	46,053,776.32	58,634,400.43	—	—	—	—	—	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 2012 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 ment	Closing balance	Percentage	Percentage	Explanation of the inconsistent of shareholding percentage and voting right in the investee entity	Impairment provision	Provision of impairment for the current period	Cash bonuses for the current period
						in the investee entity (%)	of voting right in the investee entity (%)				
Molong Drilling Equipment	Cost method	3,000,000.00	3,000,000.00	—	3,000,000.00	100.00	100.00	N/A	—	—	—
MPM International Limited	Cost method	7,276,230.00	7,276,230.00	—	7,276,230.00	90.00	90.00	N/A	—	—	—
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	—	—	—
Shouguang Maolong 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	N/A	—	—	—
Mihe Water	Cost method	10,000,000.00	10,000,000.00	—	10,000,000.00	9.73	9.73	N/A	—	—	—
Total	Cost method	652,069,921.73	652,069,921.73	—	652,069,921.73	—	—	—	—	—	—

(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 2012 to transfer capital to the Group.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

10. Fixed Assets

Consolidation

(1) Overview of fixed assets

Item	RMB				
	Opening book balance	Additions for the current period	Deductions for the current period	Closing book balance	
I. Total original book value:	2,323,217,046.69	178,337,144.52	2,104,560.17	2,499,449,631.04	
Of which: Buildings	395,940,668.59	43,380,607.45	—	439,321,276.04	
Machinery and equipment	1,840,165,646.65	119,311,988.38	1,179,026.70	1,958,298,608.33	
Electronic equipment and others	72,815,383.39	15,044,461.54	271,654.70	87,588,190.23	
Vehicles	14,295,348.06	600,087.15	653,878.77	14,241,556.44	
II. Total accumulated depreciation:	475,642,567.92	Additions for the current period	Provision for the current year	1,031,332.64	649,376,634.72
Of which: Buildings	58,466,467.80	—	18,551,558.87	—	77,018,026.67
Machinery and equipment	373,439,722.83	—	140,530,112.50	299,209.82	513,670,625.51
Electronic equipment and others	36,259,171.76	—	13,489,286.47	208,453.72	49,540,004.51
Vehicles	7,477,205.53	—	2,194,441.60	523,669.10	9,147,978.03
III. Total fixed assets — net book value	1,847,574,478.77				1,850,072,996.32
Of which: Buildings	337,474,200.79				362,303,249.37
Machinery and equipment	1,466,725,923.82				1,444,627,982.82
Electronic equipment and others	36,556,211.63				38,048,185.72
Vehicles	6,818,142.53				5,093,578.41
IV. Total Impairment provision	16,206,335.81		—	—	16,206,335.81
Of which: Buildings	4,986,478.28		—	—	4,986,478.28
Machinery and equipment	11,219,857.53		—	—	11,219,857.53
Electronic equipment and others	—		—	—	—
Vehicles	—		—	—	—
V. Total fixed assets — net book value	1,831,368,142.96				1,833,866,660.51
Of which: Buildings	332,487,722.51				357,316,771.09
Machinery and equipment	1,455,506,066.29				1,433,408,125.29
Electronic equipment and others	36,556,211.63				38,048,185.72
Vehicles	6,818,142.53				5,093,578.41

Note 1: The original book value over the current year increased as acquisition increased by RMB40,558,531.33, while the transfer in of construction in progress increased by RMB137,778,613.19.

Note 2: The original book value over the current year decreased as the disposal led to a decrease of RMB2,104,560.17.

Note 3: The accumulated depreciation increased over the current year as the provision over the current year amounted to RMB174,765,399.44.

Note 4: The accumulated depreciation decreased over the current year as the disposal led to decrease of RMB1,031,332.64.

Note 5: The surplus amortized deadlines of land-use right of the above buildings were 38.75 years to 48.50 years.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

10. Fixed Assets (continued)

Consolidation (continued)

(2) Fixed assets without duly prepared title certificates

Item	Original value	Reason for title certificate not duly prepared	Estimate time for preparing title certificates
Steel structure major plant zone	77,002,837.30	Is still in the process	2013
Office Building	1,124,948.75	Is still in the process	2013
180 electric rooms	2,229,256.25	Is still in the process	2013
Major electricity room	2,734,967.16	Is still in the process	2013
Steel pipes storage	2,982,953.13	Is still in the process	2013
Workshop for pumping unit and sucker rod	19,591,187.69	Is still in the process	2013
Casing and tubing storage	13,288,209.80	Is still in the process	2013
Bathroom, Gatehouse, washroom, and so on	1,154,537.04	Is still in the process	2013
Dormitory building	6,095,893.00	Is still in the process	2013
140 Plant	9,651,174.86	Is still in the process	2013
Logistics park plant	11,152,202.50	New Construction	2013
1200 Plant	19,054,024.58	New Construction	2013
Total	166,062,192.06		

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

10. Fixed Assets (continued)

The Company

(1) Overview of fixed assets

				RMB
Item	Opening book balance	Additions for the current period	Deductions for the current period	Closing book balance
I. Total original book value:	1,663,528,790.33	162,600,723.51	3,577,142.44	1,822,552,371.40
Of which: Buildings	293,202,590.36	42,454,907.45	—	335,657,497.81
Machinery and equipment	1,327,102,243.45	108,740,450.84	2,530,990.86	1,433,311,703.43
Electronic equipment and others	31,793,332.28	10,914,178.07	269,554.70	42,437,955.65
Vehicles	11,430,624.24	491,187.15	776,596.88	11,145,214.51
II. Total accumulated depreciation:	312,659,529.62	Additions for the current period	Provision for the current year	2,549,702.34
		—	—	430,551,751.29
Of which: Buildings	41,317,885.62	—	13,889,084.96	55,206,970.58
Machinery and equipment	253,485,085.07	—	99,232,001.73	350,992,108.56
Electronic equipment and others	12,178,666.54	—	5,610,363.87	17,582,466.69
Vehicles	5,677,892.39	—	1,710,473.45	6,770,205.46
III. Total fixed assets — net book value	1,350,869,260.71	—	—	1,392,000,620.11
Of which: Buildings	251,884,704.74	—	—	280,450,527.23
Machinery and equipment	1,073,617,158.38	—	—	1,082,319,594.87
Electronic equipment and others	19,614,665.74	—	—	24,855,488.96
Vehicles	5,752,731.85	—	—	4,375,009.05
IV. Total Impairment provision	—	—	—	—
Of which: Buildings	—	—	—	—
Machinery and equipment	—	—	—	—
Electronic equipment and others	—	—	—	—
Vehicles	—	—	—	—
V. Total fixed assets — net book value	1,350,869,260.71	—	—	1,392,000,620.11
Of which: Buildings	251,884,704.74	—	—	280,450,527.23
Machinery and equipment	1,073,617,158.38	—	—	1,082,319,594.87
Electronic equipment and others	19,614,665.74	—	—	24,855,488.96
Vehicles	5,752,731.85	—	—	4,375,009.05

Note 1: Original book value for the period increased, an increase of RMB24,745,644.37 was due to acquisition, an increase of RMB137,855,079.14 was due to construction in progress transferred to fixed assets,

Note 2: Original book value for the period decreased, a decreased of RMB3,577,142.44 was due to disposal of fixed assets.

Note 3: Accumulated depreciation for the period increased, an amount of RMB120,441,924.01 was provided for during the period.

Note 4: Accumulated depreciation for the period decreased, a decrease of RMB2,549,702.34 was due to disposal.

Note 5: The surplus amortized deadlines of land-use right of above buildings were 38.75 years to 48.5 years.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

10. Fixed Assets (continued)

The Company (continued)

(2) Fixed assets without duly prepared title certificates

RMB

Item	Original value	Reason for title certificate not duly prepared	Estimate time for preparing title certificates
Steel structure major plant zone	77,002,837.30	Is still in the process	2013
Office Building	1,124,948.75	Is still in the process	2013
180 electric rooms	2,229,256.25	Is still in the process	2013
Major electricity room	2,734,967.16	Is still in the process	2013
Steel pipes storage	2,982,953.13	Is still in the process	2013
Workshop for pumping unit and sucker rod	19,591,187.69	Is still in the process	2013
Casing and tubing storage	13,288,209.80	Is still in the process	2013
Bathroom, Gatehouse, washroom, and so on	1,154,537.04	Is still in the process	2013
Logistics park plant	11,152,202.50	New Construction	2013
1200 Plant	19,054,024.58	New Construction	2013
Total	150,315,124.20		

11. Construction in progress

Consolidation

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

RMB

Items	Book balance	Closing balance		Opening balance		
		Impairment provision	Net book value	Book balance	Impairment provision	Net book value
90 tons of electric furnace project	88,434,384.79	—	88,434,384.79	—	—	—
Φ1200 mm forging expansion project	32,180,097.24	—	32,180,097.24	81,339.21	—	81,339.21
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
High-end petroleum equipment project	—	—	—	503,219.19	—	503,219.19
Others	13,736,609.66	—	13,736,609.66	17,919,257.56	—	17,919,257.56
Total	134,351,091.69	—	134,351,091.69	83,523,080.85	—	83,523,080.85

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

11. Construction in progress (continued)

Consolidation (continued)

(2) Change in material constructions in progress projects

Project name	Budget amount	Opening balance	Additions for the current period		Transfer to fixed assets	Investment to budgeted costs (%)	Progress (%)	Accumulated capitalized interest amount	Of which:		Closing balance
			the current period	period					capitalized interest amount for the current period	Capitalized interest amount for the current period	
90 tons of electric furnace project	133,620,000.00	—	88,450,044.79	15,660.00	66.20	66.20	1,236,283.75	1,236,283.75	6.00%	Loan from financial institution and Self-raised	88,434,384.79
φ1200 mm forging expansion project	180,320,000.00	81,339.21	52,188,349.87	20,089,591.84	28.99	28.99	1,151,397.57	1,148,582.64	6.48%	Loan from financial institution and Self-raised	32,180,097.24
180mm heat treatment machining project	71,950,000.00	40,665,467.84	26,578,577.26	67,244,045.10	93.46	100.00	1,488,278.70	617,205.29	6.48%	Loan from financial institution and Self-raised	—
OCTG finish machining line	108,510,000.00	24,353,797.05	367,811.39	24,721,608.44	109.43	100.00	4,891,586.43	367,811.39	6.48%	Loan from financial institution and Self-raised	—
High-end petroleum equipment project	60,000,000.00	503,219.19	317,102.97	820,322.16	85.26	100.00	322,411.05	—	—	Loan from financial institution and Self-raised	—
Others	17,919,257.56	20,704,737.75	24,887,385.65	—	—	—	824,325.89	315,497.72	6.48%	Loan from financial institution and Self-raised	13,736,609.66
Total	83,523,080.85	188,606,624.03	137,778,613.19	9,914,283.39	3,685,380.79	134,351,091.69					



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

11. Construction in progress (continued)

The Company

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

RMB

Items	Closing balance			Opening balance		
	Book balance	Impairment provision	Net book value	Book balance	Impairment provision	Net book value
Φ1200 mm forging expansion project	32,180,097.24	—	32,180,097.24	81,339.21	—	81,339.21
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
High-end petroleum equipment project	—	—	—	503,219.19	—	503,219.19
Others	13,736,609.66	—	13,736,609.66	17,101,949.84	—	17,101,949.84
Total	45,916,706.90	—	45,916,706.90	84,726,317.92	—	84,726,317.92

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

11. Construction in progress (continued)

The Company (continued)

(2) Change in material constructions in progress projects

Project name	Budget amount	Opening balance	Additions for the current period		Transfer to fixed assets	Investment to budgeted costs (%)	Progress (%)	Accumulated capitalized interest amount	Of which:		Closing balance
			Opening balance	period					capitalized interest amount for the current period	capitalized interest amount for the current period	
φ1200 mm forging expansion project	180,320,000.00	81,339.21	52,188,349.87	20,089,591.84	28.99	28.99	1,151,397.57	1,148,582.64	6.48%	Loan from financial institution and Self-raised	32,180,097.24
180mm heat treatment machining project	71,950,000.00	40,665,467.84	26,578,577.26	67,244,045.10	93.46	93.46	1,488,278.70	617,205.29	6.48%	Loan from financial institution and Self-raised	—
OCTG finish machining line	108,510,000.00	26,374,341.84	367,811.39	26,742,152.23	111.29	100.00	4,891,586.43	367,811.39	6.48%	Loan from financial institution and Self-raised	—
High-end petroleum equipment project	60,000,000.00	503,219.19	317,102.97	820,322.16	85.26	100.00	322,411.05	—	—	Loan from financial institution and Self-raised	—
Others		17,101,949.84	19,593,626.63	22,958,966.81	—	—	824,325.89	315,497.72	6.48%	Loan from financial institution and Self-raised	13,736,609.66
Total		84,726,317.92	99,045,468.12	137,855,079.14			8,677,999.64	2,449,097.04			45,916,706.90

RMB



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

12. 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:	385,829,680.84	88,543,706.23	—	474,373,387.07
Land use rights	224,286,488.49	—	—	224,286,488.49
Software	770,036.72	—	—	770,036.72
non-patent technology	159,721,405.63	87,529,186.23	—	247,250,591.86
patent technology	1,051,750.00	1,014,520.00	—	2,066,270.00
II. Total accumulated amortization	52,809,741.81	42,977,006.80	—	95,786,748.61
Land use rights	13,503,443.38	4,510,173.74	—	18,013,617.12
Software	710,421.32	13,589.76	—	724,011.08
non-patent technology	38,511,898.32	38,149,088.83	—	76,660,987.15
patent technology	83,978.79	304,154.47	—	388,133.26
III. Total intangible assets net book value	333,019,939.03	—	—	378,586,638.46
Land use rights	210,783,045.11	—	—	206,272,871.37
Software	59,615.40	—	—	46,025.64
non-patent technology	121,209,507.31	—	—	170,589,604.71
patent technology	967,771.21	—	—	1,678,136.74
IV. Total impairment provision	—	—	—	—
Land use rights	—	—	—	—
Software	—	—	—	—
non-patent technology	—	—	—	—
patent technology	—	—	—	—
V. Total intangible assets book value	333,019,939.03	—	—	378,586,638.46
Land use rights	210,783,045.11	—	—	206,272,871.37
Software	59,615.40	—	—	46,025.64
non-patent technology	121,209,507.31	—	—	170,589,604.71
patent technology	967,771.21	—	—	1,678,136.74

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

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

12. Intangible assets (continued)

Consolidation (continued)

(1) Intangible assets (continued)

The land-use right by liquidity:

Item	RMB	
	Closing book balance	Opening book balance
Current assets	4,510,173.74	4,485,729.77
Non-current assets	201,762,697.63	206,297,315.34
Total	206,272,871.37	210,783,045.11

Note 1: Of the increase of original carrying amount during the year, Independent development led to an increase of RMB87,529,186.23, the purchase of patent technology led to an increase of RMB1,014,520.00.

Note 2: Accumulated amortization for the period increased, an amount of RMB42,977,006.80.

(2) Research project expenditure of the Company

Item	Opening book balance	Additions for the current period	Deductions for the current period		Closing book balance
			Credited to profit or loss of previous year	Recognized as intangible assets	
Research expenditure	—	5,616,345.55	5,616,345.55	—	—
Development expenditure	—	94,606,425.12	—	87,529,186.23	7,077,238.89
Total	—	100,222,770.67	5,616,345.55	87,529,186.23	7,077,238.89

Note: During the year, development expenditure represented 94.40% of the total research and development project expenditure.

Intangible assets formed from internal research and development of the Company represented 45.06% of the carrying amount of intangible assets at the end of the year.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

12. 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:	291,082,008.03	76,589,219.33	—	367,671,227.36
Land use rights	139,053,498.28	—	—	139,053,498.28
Software	770,036.72	—	—	770,036.72
Non-patent technology	150,206,723.03	75,574,699.33	—	225,781,422.36
Patent technology	1,051,750.00	1,014,520.00	—	2,066,270.00
II. Total accumulated amortization	44,808,685.45	38,191,001.95	—	82,999,687.40
Land use rights	5,937,545.44	2,689,158.47	—	8,626,703.91
Software	710,421.32	13,589.76	—	724,011.08
Non-patent technology	38,076,739.90	35,184,099.25	—	73,260,839.15
Patent technology	83,978.79	304,154.47	—	388,133.26
III. Total intangible assets net book value	246,273,322.58	—	—	284,671,539.96
Land use rights	133,115,952.84	—	—	130,426,794.37
Software	59,615.40	—	—	46,025.64
Non-patent technology	112,129,983.13	—	—	152,520,583.21
Patent technology	967,771.21	—	—	1,678,136.74
IV. Total impairment provision	—	—	—	—
Land use rights	—	—	—	—
Software	—	—	—	—
Non-patent technology	—	—	—	—
Patent technology	—	—	—	—
V. Total intangible assets book value	246,273,322.58	—	—	284,671,539.96
Land use rights	133,115,952.84	—	—	130,426,794.37
Software	59,615.40	—	—	46,025.64
Non-patent technology	112,129,983.13	—	—	152,520,583.21
Patent technology	967,771.21	—	—	1,678,136.74

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

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

12. Intangible assets (continued)

The Company (continued)

(1) Intangible assets (continued)

The land-use right by liquidity:

Item	Closing book balance	Opening book balance
Current assets	2,689,158.47	2,781,069.97
Non-current assets	127,737,635.90	130,334,882.87
Total	130,426,794.37	133,115,952.84

Note 1: Of the increase of original carrying amount during the year, Independent development led to an increase of RMB75,574,699.33, the purchase of patent technology led to an increase of RMB1,014,520.00.

Note 2: Accumulated amortization for the period increased, an amount of RMB38,191,001.95.

(2) Research project expenditure of the Company

Item	Opening book balance	Additions for the current period	Deductions for the current period		Closing book balance
			Credited to profit or loss of previous year	Recognized as intangible assets	
Research expenditure	—	5,616,345.55	5,616,345.55	—	—
Development expenditure	—	81,101,954.53	—	75,574,699.33	5,527,255.20
Total	—	86,718,300.08	5,616,345.55	75,574,699.33	5,527,255.20

Note: During the year, development expenditure represented 93.52% of the total research and development project expenditure.

Intangible assets formed from internal research and development of the Company represented 53.58% of the carrying amount of intangible assets at the end of the year.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

13. Goodwill

Consolidation

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.

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	10,250,000.00

The management of the Company judged, via impairment test on goodwill, that goodwill formed by investment in Maolong Machinery Company requires impairment provision of RMB10,250,000.00.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

14. 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	809,529.04	1,365,925.33	795,354.04	1,351,750.33
Including: Accounts receivable	791,661.15	1,348,057.44	777,486.15	1,333,882.44
Other receivables	17,867.89	17,867.89	17,867.89	17,867.89
Allowance for inventories	1,173,966.73	551,453.53	625,491.51	470,608.55
Salaries payable	3,299,529.41	3,696,223.46	1,960,317.33	1,920,212.44
Intangible assets amortization	9,552,641.92	4,817,635.02	9,127,623.42	4,759,592.49
Fixed assets Impairment provision	1,907,905.37	2,141,584.71	—	—
Deductible losses	878,702.84	1,834,039.02	—	—
Unrealized profit of intragroup transaction	—	547,631.87	—	—
Deferred income	1,627,200.00	1,717,600.00	1,627,200.00	1,717,600.00
Total	19,249,475.31	16,672,092.94	14,135,986.30	10,219,763.81
Deferred income tax liabilities:				
Adjustment of fair value (Note 1)	8,902,130.64	9,237,072.73	—	—
Including: long-term equity investments	3,809.38	3,809.38	—	—
Fixed assets	1,012,090.71	1,161,091.77	—	—
Intangible assets	7,886,230.55	8,072,171.58	—	—
Balance of value-added tax rebates due from government	—	1,951,246.04	—	—
Interest receivable	457,855.65	329,701.06	457,855.65	329,701.06
Unrealized loss of intragroup transaction	2,243,568.94	—	—	—
Total	11,603,555.23	11,518,019.83	457,855.65	329,701.06

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

As at 31 December 2012

V. Notes to the Financial Statements (continued)

14. 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	5,359,060.28	9,068,368.85	5,302,360.28	9,011,668.85
Including: Accounts receivable	5,239,941.03	8,949,249.60	5,183,241.03	8,892,549.60
Other receivables	119,119.25	119,119.25	119,119.25	119,119.25
Allowance for inventories	6,363,844.29	3,460,770.20	4,169,943.41	3,137,390.30
Salaries payable	18,425,303.12	19,905,460.32	13,068,782.18	12,801,416.26
Intangible assets amortization	38,330,493.58	19,270,540.03	36,630,419.58	19,038,369.95
Fixed assets Impairment provision	7,631,621.50	8,566,338.84	—	—
Deductible losses	3,514,811.37	7,336,156.08	—	—
Unrealized profit of intragroup transaction	—	3,650,879.15	—	—
Deferred income	7,232,000.00	9,040,000.00	7,232,000.00	9,040,000.00
Total	86,857,134.14	80,298,513.47	66,403,505.45	53,028,845.36
Deferred income tax liabilities:				
Adjustment of fair value	35,608,522.54	36,948,290.92	—	—
Including: long-term equity investments	15,237.51	15,237.51	—	—
Fixed assets	4,048,362.82	4,644,367.09	—	—
Intangible assets	31,544,922.21	32,288,686.32	—	—
Balance of value-added tax rebates due from government	—	7,804,984.16	—	—
Interest receivable	3,052,370.97	2,198,007.08	3,052,370.97	2,198,007.08
Unrealized loss of intragroup transaction	14,957,126.30	—	—	—
Total	53,618,019.81	46,951,282.16	3,052,370.97	2,198,007.08

(3) Unconfirmed deferred income tax asset details

Item	Closing balance	Opening balance
The deductible losses (Note)	56,390.99	—

Note: 31 December 2012. Maolong Recycle and Baolong Recyclable Resource, both are subsidiaries of the Company, could not anticipate whether there will be enough taxable profits available for deducting deductible losses. According to the prudent principle, Maolong Recycle and Baolong Recyclable Resource have not recognized the deferred income tax assets.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

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

(4) Unconfirmed deferred tax assets of deductible losses is set to expire this year:

	RMB		
Time	Closing balance	Opening balance	Note
2017	56,390.99	—	—

15. Provision for impairment of assets

Consolidation

	RMB				
Items	Opening balance	Additions for the current period	Deductions		Closing balance
			Reversals	Write-offs	
I. Provisions for bad debts	9,068,368.85	941,205.06	4,650,513.63	—	5,359,060.28
Of which: trade receivables	8,949,249.60	941,205.06	4,650,513.63	—	5,239,941.03
Other receivables	119,119.25	—	—	—	119,119.25
Provisions for inventory impairment	3,460,770.20	3,580,265.00	82,878.60	594,312.31	6,363,844.29
Including: Raw materials	1,347,882.94	—	55,793.33	274,622.66	1,017,466.95
Work-in-progress	632,526.25	761,099.17	14,471.26	131,906.69	1,247,247.47
Finished product	1,480,361.01	2,819,165.83	12,614.01	187,782.96	4,099,129.87
Fixed assets Impairment provision	16,206,335.81	—	—	—	16,206,335.81
Including: Building	4,986,478.28	—	—	—	4,986,478.28
Machinery and equipment	11,219,857.53	—	—	—	11,219,857.53
Provisions for goodwill impairments	—	10,250,000.00	—	—	10,250,000.00
Total	28,735,474.86	14,771,470.06	4,733,392.23	594,312.31	38,179,240.38



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

15. Provision for impairment of assets (continued)

The Company

RMB

Items	Opening balance	Additions for the current period	Deductions		Opening balance
			Reversals	Write-offs	
I. Provisions for bad debts	9,011,668.85	941,205.06	4,650,513.63	—	5,302,360.28
Of which: trade receivables	8,892,549.60	941,205.06	4,650,513.63	—	5,183,241.03
Other receivables	119,119.25	—	—	—	119,119.25
Provisions for inventory impairment	3,137,390.30	1,709,744.02	82,878.60	594,312.31	4,169,943.41
Including: Raw materials	1,202,576.97	—	55,793.33	274,622.66	872,160.98
Work-in-progress	565,531.52	315,228.61	14,471.26	131,906.69	734,382.18
Finished product	1,369,281.81	1,394,515.41	12,614.01	187,782.96	2,563,400.25
Total	12,149,059.15	2,650,949.08	4,733,392.23	594,312.31	9,472,303.69

16. Other non-current assets

Consolidation

RMB

Item	Closing balance	Opening balance
The purchase of land use rights advance payment	270,000,000.00	—

The Company

RMB

Item	Closing balance	Opening balance
The purchase of land use rights advance payment	33,000,000.00	—

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

17. Short-term borrowings

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Credit loans (Note 1)	980,006,883.57	680,888,976.90	980,006,883.57	589,329,611.90
Guarantee loans (Note 1)	—	5,581,812.10	—	5,581,812.10
Secured borrowings (Note 2)	—	24,031,288.23	—	24,031,288.23
Discount loan (Note 3)	50,000,000.00	—	—	—
Total	1,030,006,883.57	710,502,077.23	980,006,883.57	618,942,712.23

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

Note 1: Those credit loans and guarantee loans were neither pledged nor charged.

Note 2: The secured borrowings of the previous year were the loans obtained by the Company from banks by pledging accounts receivable, please refer to note V.3(7) for the relevant pledged amount.

Note 3: Bill discounted loans were the loans resulted from the Group's discounted bills receivable which were not matured for the year, please refer to note V.2(5).

18. 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	603,403,515.62	383,690,165.06	603,403,515.62	380,837,165.06
Trade acceptance	—	—	50,000,000.00	—
Total	603,403,515.62	383,690,165.06	653,403,515.62	380,837,165.06

Notes payable of the Group and the Company as at 31 December 2012 will be fully due by 27 June 2013.

(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.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

18. Bills payable (continued)

- (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		
Name of related parties	Closing balance	Opening balance
Shouguang Baolong	543,142,679.76	233,973,085.56
Molong Electro-mechanical Equipment Company Limited	9,946,535.80	9,885,396.97
Weihai Baolong	—	22,000,000.00
Total	553,089,215.56	265,858,482.53

19. 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
Material fees payable	462,477,431.54	509,741,645.18	302,538,024.48	385,727,717.16
Project equipment fees payable	108,364,270.13	106,974,549.16	74,965,588.19	76,998,835.04
Total	570,841,701.67	616,716,194.34	377,503,612.67	462,726,552.20

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

RMB				
Aging	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Within 2 months	161,689,188.60	326,502,011.50	129,334,600.37	299,383,264.67
2 to 3 months	81,002,548.65	93,061,285.35	50,125,193.27	64,611,237.67
3 to 4 months	62,288,584.06	60,918,726.73	43,327,540.78	45,997,382.81
4 months to 1 years	201,137,128.21	74,405,272.87	121,372,444.44	13,155,595.85
1 to 2 year	44,550,531.57	41,850,903.42	24,276,109.20	32,884,199.70
2 to 3 year	6,823,230.96	5,317,135.68	5,380,912.38	2,833,068.73
Over 3 years	13,350,489.62	14,660,858.79	3,686,812.23	3,861,802.77
Total	570,841,701.67	616,716,194.34	377,503,612.67	462,726,552.20

The Group and the Company recognize accounts payable and calculate its age when the purchased goods was put in storage, and the average credit period for purchase is two months. As at 31 December 2012, 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 RMB14,873,119.52 and RMB12,667,964.20, respectively. This represented the acquisition fees for equipment. As the credit period is over 1 year, such amounts are outstanding.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

19. Accounts payable (continued)

- (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 of related parties	RMB	
	Closing balance	Opening balance
Molong Electro-mechanical Equipment Company Limited	33,116,283.18	30,473,480.99
Shouguang Baolong	—	16,701,218.40
Weihai Baolong	—	64,209,376.84
Total	33,116,283.18	111,384,076.23

20. Advance receipts

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

Items	RMB		RMB	
	Closing balance	Opening balance	Closing balance	Opening balance
Advance sales	25,837,981.59	20,713,521.63	25,536,367.16	26,525,840.83

As at 31 December 2012, 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 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 of related parties	RMB	
	Closing balance	Opening balance
MPM International Limited	—	13,784,097.22



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

21. Employee benefits payable

Consolidation

RMB

Items	Opening balance	Accrued during the period	Paid during the period	Closing balance
Salaries, bonuses, allowance and subsidies	19,556,802.06	92,087,766.20	93,560,647.82	18,083,920.44
Staff welfare	101,235.82	12,688,768.41	12,688,768.41	101,235.82
Social insurance premiums	—	18,453,728.83	18,453,728.83	—
Housing provident funds	—	5,359,324.42	5,359,324.42	—
Others	247,422.44	714,342.99	721,618.57	240,146.86
Total	19,905,460.32	129,303,930.85	130,784,088.05	18,425,303.12

The Company

RMB

Items	Opening balance	Accrued during the period	Paid during the period	Closing balance
Salaries, bonuses, allowance and subsidies	12,801,416.26	67,449,217.83	67,181,851.91	13,068,782.18
Staff welfare	—	8,990,130.01	8,990,130.01	—
Social insurance premiums	—	13,199,168.28	13,199,168.28	—
Housing provident funds	—	4,048,167.30	4,048,167.30	—
Others	—	571,160.91	571,160.91	—
Total	12,801,416.26	94,257,844.33	93,990,478.41	13,068,782.18

22. Tax payables

RMB

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Income tax	25,748,546.01	26,687,827.54	11,518,178.52	14,804,663.13
Value added tax	4,932,510.60	3,030,940.82	—	—
Individual income tax	44,353.28	4,028,147.55	40,380.12	4,023,213.13
Others	2,943,976.13	2,002,342.06	1,847,484.64	472,399.93
Total	33,669,386.02	35,749,257.97	13,406,043.28	19,300,276.19

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

23. Interest payables

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Interest of Bank loan	6,968,896.69	4,600,388.73	6,968,896.69	4,600,388.73
Interest of loan from Finance Bureau	—	957,566.67	—	—
Total	6,968,896.69	5,557,955.40	6,968,896.69	4,600,388.73

RMB

24. Other payables

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

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Advance in electricity fees, gas fee and delivery expenses	17,816,245.51	14,833,788.59	6,640,756.06	7,078,230.94
Cash pledge	4,840,877.44	4,703,106.23	3,150,025.44	3,727,271.23
Others	1,817,919.85	3,024,161.75	3,699,521.83	3,131,509.38
Total	24,475,042.80	22,561,056.57	13,490,303.33	13,937,011.55

RMB

(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:

Name of related parties	Closing balance	Opening balance
Molong Logistics Company	2,751,100.00	—
Maolong Old Metals Recycle Company Limited	—	622,553.06
Shouguang Baolong Company	—	3,723,785.85
Total	2,751,100.00	4,346,338.91

RMB



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

25. Other non-current liabilities

Consolidation and the Company

	RMB	
Item	Closing balance	Opening balance
Deferred income	7,232,000.00	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. This year's amortization amount is RMB1,808,000.00.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

26. Share capital

Consolidation and the Company

	Opening balance	Change for the period			Closing balance
		New Issue	Shares transfer from reserve (Note 1)	Others (Note 2) Sub-total	
2012:					
I. Restricted shares outstanding					
1. Other domestic shares	198,239,000.00	—	198,239,000.00	—	198,239,000.00
Total number of restricted shares outstanding	198,239,000.00	—	198,239,000.00	—	198,239,000.00
II. Non-restricted shares					
1. RMB ordinary shares	72,622,000.00	—	72,622,000.00	—	72,622,000.00
2. Overseas listed foreign shares	128,063,200.00	—	128,063,200.00	—	128,063,200.00
Total number of non-restricted shares	200,685,200.00	—	200,685,200.00	—	200,685,200.00
Total shares	398,924,200.00	—	398,924,200.00	—	398,924,200.00
2011:					
I. Restricted shares					
1. Other domestic shares	214,861,000.00	—	—	(16,622,000.00)	(16,622,000.00)
Total number of restricted shares outstanding	214,861,000.00	—	—	(16,622,000.00)	(16,622,000.00)
II. Non-restricted shares					
1. RMB ordinary shares	56,000,000.00	—	—	16,622,000.00	16,622,000.00
2. Overseas listed foreign shares	128,063,200.00	—	—	—	—
Total number of non-restricted shares	184,063,200.00	—	—	16,622,000.00	16,622,000.00
Total shares	398,924,200.00	—	—	—	—

Note 1: Pursuant to the resolutions of 2011 Annual General Meeting convened on 25 May 2012, on the basis of a total of 398,924,200 shares as at 31 December 2011, the Company enlarged its share capital through conversion from capital reserve in the proportion of 1 share for each existing share, converting 398,924,200 shares in aggregate, and the conversion date was 19 July 2012. Upon the conversion, the Company's registered capital has changed to RMB797,848,400.00, and the total number of shares has changed to 797,848,400 shares.

Note 2: On 21 January 2011, 14,000,000 shares issued through the off-line allotment started to circulate in the market. On 21 October 2011, the 2,622,000 shares of the Company held by Shengli Oil Field Kaiyuan Petroleum Development Company were released and circulated in the market.

Note 3: The Company has no buyback of shares in Hong Kong Stock Exchange during the year.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

27. Capital reserves

Consolidation

RMB				
Items	Opening balance	Increase for the period	Decrease for the period	Closing balance
2012:				
Capital premium	1,248,424,858.42	—	398,924,200.00	849,500,658.42
Of which: Capital contribution from investors	1,248,406,190.92	—	398,924,200.00 (Note)	849,481,990.92
Purchase minority equity of subsidiary	18,667.50	—	—	18,667.50
Total	1,248,424,858.42	—	398,924,200.00	849,500,658.42
2011:				
Capital 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
Purchase minority equity of subsidiary	—	18,667.50	—	18,667.50
Total	1,248,406,190.92	18,667.50	—	1,248,424,858.42

Note: Pursuant to the resolutions of 2011 Annual General Meeting convened on 25 May 2012, the Company enlarged its share capital through the capital reserve of RMB398,924,200.00, and the conversion date was 19 July 2012.

The Company

RMB				
Items	Opening balance	Additions for the year	Deductions for the year	Closing balance
2012:				
Capital premium	1,248,406,190.92	—	398,924,200.00	849,481,990.92
Of which: Capital contribution from investors	1,248,406,190.92	—	398,924,200.00	849,481,990.92
Total	1,248,406,190.92	—	398,924,200.00	849,481,990.92
2011:				
Capital premium	1,248,406,190.92	—	—	1,248,406,190.92
Of which: Capital contribution from investors	1,248,406,190.92	—	—	1,248,406,190.92
Total	1,248,406,190.92	—	—	1,248,406,190.92

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

28. Surplus reserve

Consolidation and the Company

RMB

Items	Opening balance	Increase for the period	Decrease for the period	Closing balance
2012:				
Statutory surplus reserve	157,965,274.48	10,943,215.38	—	168,908,489.86
2011:				
Statutory surplus reserve	140,393,447.06	17,571,827.42	—	157,965,274.48

Statutory surplus reserve is detailed in note V. 29.

29. Undistributed profits

Consolidation

RMB

Items	Amount	Proportion of appropriation or allocation
2012:		
Undistributed profits at the beginning of the year	989,669,698.87	—
Add: Net profits attribute to the shareholders of the Company of the year	134,263,035.30	—
Less: Appropriation of statutory surplus reserves	10,943,215.38	Note 1
Ordinary shares dividend payable	39,892,420.00	Note 2
Undistributed profits at the end of the year	1,073,097,098.79	—
2011:		
Undistributed profits 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
Ordinary shares dividend payable	59,838,630.00	Note 2
Undistributed profits at the end of the year	989,669,698.87	—



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

29. Undistributed profits (continued)

The Company

Items	Amount	RMB Proportion of appropriation or allocation
2012:		
Undistributed profits at the beginning of the year	922,540,824.80	—
Add: Net profit for the current year	109,432,153.86	—
Less: Appropriation of statutory surplus reserves	10,943,215.38	Note 1
Ordinary shares dividend payable	39,892,420.00	Note 2
Undistributed profits at the end of the year	981,137,343.28	—
2011:		
Undistributed profits at the beginning of the year	824,233,008.06	—
Add: Net profit for the current year	175,718,274.16	—
Less: Appropriation of statutory surplus reserves	17,571,827.42	Note 1
Ordinary shares dividend payable	59,838,630.00	Note 2
Undistributed profits at the end of the year	922,540,824.80	—

As at 31 December 2012, the statutory surplus reserve provided for each subsidiary as calculated by the shareholding proportion of the undistributed profit of the Group amounted to RMB48,911,665.20 (31 December 2011: RMB47,608,420.85). As at 31 December 2012, the profit distributed to shareholders of the Company was RMB981,137,343.28 (31 December 2011: RMB922,540,824.80).

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 2010–2011 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.

According to the Board resolution of the Company convened on 29 March 2012, with 19 July 2012 as the reference 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 RMB0.10 per share was distributed to all shareholders, totaling RMB39,892,420.00. Such resolution has been passed in the 2011 Annual General Meeting.

Note 3: Distribution of profits after Balance Sheet

The proposed profit distribution plan of 2012 was passed in the twenty-second Board meeting of the third session which was held on 28 March 2013, based on the total share capital of 797,848,400 shares as at 31 December 2012, cash bonuses of RMB0.5 per 10 shares shall be distributed, with a total amount of RMB39,892,420.00. The above dividend distribution proposal is subject to the approval at the Shareholders' Meeting.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

30. Minority shareholders' interest

Minority shareholders' interest is as follows:

Name	RMB	
	Closing balance	Opening balance
MPM International Limited	1,641,017.86	1,319,686.04
Shouguang Baolong	62,228,982.04	56,643,649.13
Total	63,869,999.90	57,963,335.17

31. Operating Revenue and Cost of operations

Consolidation

(1) Operating Revenue

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Principal operating revenue	2,905,348,601.16	2,684,115,540.14
Other business revenue	46,715,231.00	54,576,290.07
Cost of operations	2,624,241,003.24	2,407,671,724.80

(2) Principal operations (by product)

Products	RMB			
	Incurred during the current period		Incurred during the previous period	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
Casing and Tubing	2,598,091,671.18	2,326,621,571.34	2,334,253,537.27	2,055,296,640.95
Three kinds of pumping units	83,240,409.14	68,249,565.23	78,296,157.27	65,384,600.08
Petroleum machinery	173,068,574.45	139,725,958.06	165,947,013.60	138,060,140.84
Others	50,947,946.39	50,802,546.57	105,618,832.00	105,777,961.11
Total	2,905,348,601.16	2,585,399,641.20	2,684,115,540.14	2,364,519,342.98

(3) Principal operations (by Geographical segment)

Regions	RMB			
	Incurred during the current period		Incurred during the previous period	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
PRC	1,755,204,212.99	1,599,362,657.11	1,653,957,527.10	1,498,457,075.50
Overseas	1,150,144,388.17	986,036,984.09	1,030,158,013.04	866,062,267.48
Total	2,905,348,601.16	2,585,399,641.20	2,684,115,540.14	2,364,519,342.98



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

31. 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	720,370,069.42	24.40
Campex Inc	172,147,618.00	5.83
Offshore Engineering & Marketing Ltd., Company	158,084,340.07	5.35
Shandong Luxin Steel Pipes Co., Ltd	149,907,140.51	5.08
Hebei Zhongtai Steel Pipe Manufacture Co., Ltd	106,776,360.82	3.62
Total	1,307,285,528.82	44.28

The Company

(1) Operating Revenue

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Principal operating Revenue	2,856,644,219.94	2,657,191,558.57
Other operating Revenue	196,133,879.47	206,711,898.53
Cost of operations	2,791,289,027.71	2,572,698,117.94

(2) Principal operations (by product)

Products	RMB		RMB	
	Operating Revenue	Cost of operations	Operating Revenue	Cost of operations
Casing and Tubing	2,593,093,332.55	2,386,512,528.54	2,399,352,089.95	2,164,033,335.58
Three kinds of pumping units	83,240,409.14	68,249,565.23	78,296,157.27	65,384,600.08
Petroleum machinery	173,068,574.45	139,725,958.06	165,947,013.60	138,060,140.84
Others	7,241,903.80	4,380,250.52	13,596,297.75	8,724,007.33
Total	2,856,644,219.94	2,598,868,302.35	2,657,191,558.57	2,376,202,083.83

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

31. 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	1,769,049,508.46	1,671,091,735.40	1,627,033,545.53	1,510,139,816.35
Overseas	1,087,594,711.48	927,776,566.95	1,030,158,013.04	866,062,267.48
Total	2,856,644,219.94	2,598,868,302.35	2,657,191,558.57	2,376,202,083.83

(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	720,370,069.42	23.60
Campex Inc	172,147,618.00	5.64
Shandong Luxin Steel Pipes Co., Ltd	149,907,140.51	4.91
Shandong Luxin Steel Pipes Co., Ltd	142,157,980.91	4.66
Hebei zhongtai steel pipe manufacture co., LTD	106,776,360.82	3.50
Total	1,291,359,169.66	42.31

32. Tax and levies on operations

Consolidation

RMB

Items	Incurred during the current period	Incurred during the previous period
Business tax	6,927.50	—
Urban maintenances and construction tax	840,931.24	1,064,181.19
Educational surcharges	600,604.64	783,373.20
Others	120,211.01	83,982.31
Total	1,568,674.39	1,931,536.70



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

32. Tax and levies on operations (continued)

The Company

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Business tax	6,927.50	—
Urban maintenances and construction tax	745.15	3,641.15
Others	777.24	—
Total	8,449.89	3,641.15

33. Selling Expenses

Consolidation

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Delivery expenses	58,411,741.86	48,094,190.29
Agency fees	2,307,103.84	2,062,726.28
Salary	1,587,540.90	1,752,893.62
Travelling expenses	1,019,971.15	1,214,644.85
Business reception fees	872,826.41	550,452.04
Transportation fees	538,068.91	396,865.80
Office expenses	329,154.69	329,943.63
Intermediate fees	95,737.45	280,000.00
Depreciation charge	280,615.97	177,462.19
Other	2,007,819.32	2,727,321.09
Total	67,450,580.50	57,586,499.79

The Company

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Delivery expenses	58,329,597.75	48,094,190.29
Agency fees	2,307,103.84	2,034,047.28
Salary	1,587,540.90	1,700,095.02
Travelling expenses	998,078.51	1,205,026.55
Business reception fees	863,001.41	526,934.00
Transportation fees	538,068.91	396,865.80
Office expenses	329,154.69	329,004.73
Intermediate fees	280,615.97	177,462.19
Depreciation charge	95,737.45	280,000.00
Other	2,007,819.32	2,706,441.43
Total	67,336,718.75	57,450,067.29

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

34. Management fees

Consolidation

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Amortization of intangible assets	42,977,006.80	25,935,653.80
Taxes	10,548,368.92	8,065,329.90
Salary and Staff welfare expenses	9,714,973.32	10,487,686.97
Depreciation charges	9,209,453.25	8,965,906.75
Machinery material consumption	6,729,086.03	7,770,147.71
Research and development fees of new products	5,616,345.55	15,057,324.94
Intermediate fees	2,095,451.57	1,489,266.29
Electricity fees	1,832,106.83	1,161,829.12
Business reception fees	1,292,258.12	586,747.00
Environmental protection expenses	1,281,919.35	1,208,663.48
The Board fees	893,967.56	1,209,562.50
Transportation fees	614,063.46	488,266.42
Repair fees	523,053.49	1,643,337.08
Delivery expenses	428,053.84	864,993.45
Property insurance fees	402,698.12	454,931.35
Travelling expenses	259,359.87	685,457.13
Promotion expenses	174,701.52	165,256.71
Water fees	156,968.52	182,540.06
Other	1,380,380.16	1,521,511.05
Total	96,130,216.28	87,944,411.71



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

34. Management fees (continued)

The Company

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Amortization of intangible assets	38,191,001.95	23,746,943.10
Salary and Staff welfare expenses	8,217,353.16	8,406,196.18
Depreciation charges	7,685,444.82	7,306,230.20
Taxes	7,307,084.86	5,073,763.77
Machinery material consumption	6,640,408.98	7,362,986.36
Research and development fees of new products	5,616,345.55	13,313,852.14
Intermediate fees	2,086,151.57	1,436,266.29
Electricity fees	1,832,106.83	1,119,450.61
Business reception fees	983,408.47	276,837.60
The Board fees	893,967.56	1,209,562.50
Environmental protection expenses	882,819.35	296,423.48
Transportation fees	448,344.06	467,832.42
Delivery expenses	428,053.84	860,357.45
Property insurance fees	303,322.67	353,266.72
Repair fees	235,819.56	362,589.10
Travelling expenses	216,481.66	562,373.78
Promotion expenses	173,493.52	165,112.71
Water fees	107,838.52	129,440.06
Other	812,211.24	1,063,788.85
Total	83,061,658.17	73,513,273.32

35. Finance fees

Consolidation

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Interest expenses (Bank loan due within 1 year)	50,655,585.69	28,496,324.62
Less: Capitalized interest expenses	3,685,380.79	4,746,373.93
Less: Interest income	11,734,207.72	11,521,908.44
Foreign exchange difference	(4,594,132.74)	(1,394,006.70)
Other	6,481,519.23	3,815,438.41
Total	37,123,383.67	14,649,473.96

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

35. Finance fees (continued)

The Company

Items	RMB	
	Incurring during the current period	Incurring during the previous period
Interest expenses (Are all bank loan due within 1 year)	44,965,536.48	21,903,852.08
Less: Capitalized interest expenses	2,449,097.04	4,746,373.93
Less: Interest income	12,696,636.96	10,597,526.28
Foreign exchange difference	(4,594,132.74)	(1,394,006.70)
Other	6,285,445.42	3,603,351.38
Total	31,511,115.16	8,769,296.55

36. Loss on impairment of assets

Consolidation

Items	RMB	
	Incurring during the current period	Incurring during the previous period
Provision of bad debt	(3,709,308.57)	2,227,325.85
Including: accounts receivable	(3,709,308.57)	2,227,325.85
Other accounts receivable	—	—
Provision of allowance for inventory	3,497,386.40	666,680.42
Including: Raw materials	(55,793.33)	774,172.97
Finished product	2,806,551.82	(33,984.45)
Work-in-progress	746,627.91	(73,508.10)
Goodwill impairment loss	10,250,000.00	—
Total	10,038,077.83	2,894,006.27



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

36. Loss on impairment of assets (continued)

The Company

Items	Incurred during the current period	Incurred during the previous period
Provision of bad debt	(3,709,308.57)	2,391,084.01
Including: accounts receivable	(3,709,308.57)	2,391,084.01
Other accounts receivable	—	—
Provision of allowance for inventory	1,626,865.42	898,059.70
Including: Raw materials	(55,793.33)	817,516.29
Finished product	1,381,901.40	104,727.20
Work-in-progress	300,757.35	(24,183.79)
Total	(2,082,443.15)	3,289,143.71

37. Investment income

Consolidation

(1) Breakdown of investment income

Items	Incurred during the current period	Incurred during the previous period
Gain from long-term equity investments accounted for using the equity method	1,203,776.32	253,344.29

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

Investee	Incurred during the current period	Incurred during the previous period	Reason of change from the previous period to the current period
Yalong Oil Pump	290,266.67	253,344.29	The invested entity of the net profit
Mao-long small loan companies	913,509.65	—	The invested entity of the net profit
Total	1,203,776.32	253,344.29	

(3) There are no significant restrictions on remittance of investment gains back to the Company, the investment department of non-listed company investment income.

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

37. Investment income (continued)

The Company

(1) Breakdown of investment income

RMB

Items	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
Investment gain received from the disposal of long-term equity investments	—	16,551,433.98
Total	—	19,707,433.98

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

RMB

Investee	Incurred during the current period	Incurred during the previous period	Reason for increase or decrease
Maolong Machinery Company Limited	—	3,156,000.00	Dividend distribution of investee in current year

(3) There are no significant restrictions on remittance of investment gains back to the Company, the investment department of non-listed company investment income.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

38. 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	109,479.26	152,697.88	109,479.26
Of which: Income on disposal of fixed assets	109,479.26	152,697.88	109,479.26
Government grants	49,141,000.00	31,474,069.50	49,141,000.00
Income from penalty	364,282.53	1,562,707.27	364,282.53
Others	242,778.08	1,287,497.70	242,778.08
Total	49,857,539.87	34,476,972.35	49,857,539.87

(2) Breakdown of Government grants

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Financial subsidies (Note)	49,141,000.00	31,474,069.50

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
			recurring profit or loss during the current year
Total loss on disposal of non-current assets	50,716.12	113,911.99	50,716.12
Of which: Loss on disposal of fixed assets	50,716.12	113,911.99	50,716.12
Government grants	43,131,000.00	31,414,069.50	43,131,000.00
Income from penalty	364,282.53	1,161,279.37	364,282.53
Total	43,545,998.65	32,689,260.86	43,545,998.65

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

38. Non-operating income (continued)

The Company (continued)

(2) Breakdown of Government grants

RMB

Items	Incurred during the current period	Incurred during the previous period
Financial subsidies (Note)	43,131,000.00	31,414,069.50

Note: On June 2012, the Company received the financial subsidies for technology research and development of RMB15,000,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No. 129 "Notice Regarding the Allocation of Special Fund" (壽財預指[2012] 129號文《關於撥付專項資金的通知》). On December 2012, the Company received the financial subsidies of RMB9,000,000.00 granted by Shouguang Finance Bureau. On July 2012, the Company received the financial subsidies of RMB8,000,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No. 701 "Notice Regarding the Allocation of Research Award Fund for Shandong Molong Petroleum Machinery Company Limited" (壽財預指[2012] 701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》). On November 2012, the Company received the financial subsidies of RMB8,000,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No. 959 "Notice Regarding the Allocation of Research Award Fund for Shandong Molong Petroleum Machinery Company Limited" (壽財預指[2012] 959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》). On March 2012, the Company received the financial subsidies of RMB660,000.00 granted by Shouguang Finance Bureau pursuant to Shou Wei [2012] No. 15 "Circular Regarding the Subsidies Realized for the Work of Commercial Trade and Foreign Trade of the Whole City of 2011" (壽委[2012] 15號文《關於對2011年度全市商貿流通及外經貿工作兌現獎勵的通報》). On October 2012, the Company received the financial subsidies of RMB78,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No.837 "Notice Regarding the Allocation of Support Foreign Trade Development Fund of 2011" (壽財預指[2012] 837號文《關於撥付2011年度扶持外經貿發展資金的通知》). On November 2012, the Company received the financial subsidies of RMB400,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No.878 "Notice Regarding the Allocation of Support Foreign Trade Development Relevant Policy Fund in Shandong Province of 2012" (壽財預指[2012] 878號文《關於撥付2012年度山東省支持外經貿發展相關政策資金的通知》). On November 2012, the Company received the financial subsidies of RMB25,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No.879 "Notice Regarding the Allocation of Support Foreign Trade Development Relevant Policy Fund (Second Batch) in Shandong Province of 2012" (壽財預指[2012] 879號文《關於撥付2012年度第二批山東省支持外經貿發展相關政策資金的通知》). On July 2012, the Company received the subsidies of RMB100,000.00 granted 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)" (濰科規字[2011]48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 February 2012, the Company received the financial subsidies of RMB60,000.00 granted by Shouguang Finance Bureau pursuant to Shou Cai Yu Zhi [2012] No.79 "Notice Regarding the Allocation of Award Funds of Assessment to Departments Directly under City Government and Enterprises in 2011" (壽財預指[2012] 79號文《關於撥付2011年度市直部門及企業考核獎勵資金的通知》). As at 30 December 2011, the Company received the central budget investment of RMB9,040,000.00 from Shandong Province Development and Reform Committee according to the notice of Lu Fa Gai Invest [2011] No.1354 (魯發改投資[2011] 1354號) for the construction of the high-end petroleum equipment project. The government grant was recognized as deferred income when received by the Company. The amortized amount for the year was RMB1,808,000.

In 2012, Weihai Baolong received the project incentive fund of RMB6,000,000.00 granted by the People's Government of Wendeng City Gaocun Town, and Shouguang Baolong received the incentive fund of RMB10,000.00 granted by Shouguang City Gucheng Street Offices.



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

39. Non-operating expenses

Consolidation

Items	Incurred during the current period	Incurred during the previous period	RMB
			Amounts credited to non-recurring profit or loss for the current year
Total loss on disposal of non-current assets	296,929.41	429,020.39	296,929.41
Of which: Loss on disposal of fixed assets	296,929.41	429,020.39	296,929.41
Donation expenses	212,000.00	200,000.00	212,000.00
Other	209,803.48	50,948.77	209,803.48
Total	718,732.89	679,969.16	718,732.89

The Company

Items	Incurred during the current period	Incurred during the previous period	RMB
			Amounts credited to non-recurring equity for the current year
Total loss on disposal of non-current assets	228,262.37	70,967.01	228,262.37
Of which: Loss on disposal of fixed assets	228,262.37	70,967.01	228,262.37
Donation expenses	165,000.00	114,000.00	165,000.00
Other	205,062.00	2,684.47	205,062.00
Total	598,324.37	187,651.48	598,324.37

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

40. Income tax expenses

RMB

Items	Consolidation		The Company	
	Incurred during the current period	Incurred during the previous period	Incurred during the current period	Incurred during the previous period
Income tax for the current period calculated according to tax laws and relevant rules	28,180,149.18	34,107,953.83	18,957,161.20	27,908,699.60
— Hong Kong	—	120,470.56	—	—
— In mainland China	28,180,149.18	33,987,483.27	18,957,161.20	27,908,699.60
Adjustment on deferred income tax	(2,491,846.97)	(3,085,664.37)	(3,788,067.90)	(3,238,013.26)
Total	25,688,302.21	31,022,289.46	15,169,093.30	24,670,686.34



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

40. Income tax expenses (continued)

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

Items	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	165,854,479.55	200,064,524.46	124,601,247.16	200,388,960.50
Income tax calculated at tax rate of 15% on the Company	24,878,171.94	30,009,678.67	18,690,187.07	30,058,344.08
Effect of non-deductible expenses	1,709,660.76	288,320.00	182,352.41	49,830.55
Effect of non-taxable income	(180,566.45)	(550,873.84)	—	(3,729,061.89)
Unrecognized can affect the tax deductible losses	14,097.75	44,674.79	—	—
Additional charge on research and development expenses	(1,874,628.33)	(1,947,676.90)	(1,763,441.22)	(1,800,598.00)
Effect of non-consistent tax rates among branch companies of subsidiaries	3,081,571.50	3,085,995.14	—	—
Difference between applicable income tax rate for previous year and applicable tax rate for deferred income tax assets/liabilities recognized	(1,940,004.96)	(1,431,012.13)	(1,940,004.96)	(1,431,012.13)
Changes on balance of deferred income tax assets at the beginning of the year caused by adjustment of tax rate	—	1,523,183.73	—	1,523,183.73
Income tax expense	25,688,302.21	31,022,289.46	15,169,093.30	24,670,686.34

RMB

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

41. 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:

Items	RMB	
	Incurred during the current period	Incurred during the previous period
Net profits for the period attributable to ordinary shareholders	134,263,035.30	168,330,282.50
Of which: net profits attributable to going concern	134,263,035.30	168,330,282.50

- (2) For the purpose of calculating earnings per share, the denominator is the weighted average of outstanding ordinary shares. The calculation is as follows:

Items	Unit: share	
	Incurred during the current period	Incurred during the previous period (repeat)
Number of outstanding ordinary shares at the beginning of the year	797,848,400.00	797,848,400.00
Add: number of weighted ordinary shares issued during the period	—	—
Number of outstanding weighted ordinary shares at the end of the year	797,848,400.00	797,848,400.00

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 (repeat)
Calculated based on net profits attributable to the equity holders of the Company:		
Basic earnings per share	0.17	0.21
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	0.17	0.21
Diluted earnings per share	N/A	N/A



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

42. Other comprehensive income

Consolidation

RMB

Items	Incurred during the current period	Incurred during the previous period
Translation difference of financial statements denominated in foreign currency	35,226.82	570,763.42

43. Notes to cash flow statements

(1) Receipt of other cash related to operating activities

RMB

Items	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	47,333,000.00	31,474,069.50	41,323,000.00	31,414,069.50
Interest income	10,879,843.83	11,521,908.44	11,842,273.07	10,597,526.28
Other	10,932,012.22	3,311,287.87	4,126,727.37	3,469,297.18
Total	69,144,856.05	109,372,826.54	57,292,000.44	98,546,453.69

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

43. Notes to cash flow statements (continued)

(2) Payment of other cash related to operating activities

RMB

Items	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	57,463,223.05	48,959,183.74	57,381,078.94	48,954,547.74
Development fees for new products	4,227,585.59	13,469,334.15	4,227,585.59	11,794,658.95
Consumable	7,022,788.23	7,770,147.71	6,907,988.23	7,362,986.36
Agency fees	2,307,103.84	2,062,726.28	2,307,103.84	2,034,047.28
Travel expense	1,279,331.02	1,900,101.98	1,214,560.17	1,767,400.33
Expense Intermediary service	2,191,189.02	1,769,266.29	2,181,889.02	1,716,266.29
Repair expense	523,293.49	1,643,337.08	235,819.56	362,589.10
Electricity expense	1,832,106.83	1,161,829.12	1,832,106.83	1,119,450.61
Hospitality expense	2,165,084.53	1,137,199.04	1,846,409.88	803,771.60
Increase in guarantees of promissory foreign exchange notes	40,501,347.11	—	40,501,347.11	—
Other	10,008,326.34	15,797,980.62	210,242,084.09	10,996,984.44
			(Note)	
Total	129,521,379.05	95,671,106.01	328,877,973.26	86,912,702.70

Note: During the current year, the Company advanced a land prepayment of RMB207,000,000.00 for its subsidiary, Shouguang Baolong, please refer to note VI. 4(4).



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

43. Notes to cash flow statements (continued)

(3) Receipt of other cash related to invest 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 other cash related to fund raising 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
The cash From the Associate Companies to obtain through a subsidiary	22,500,000.00	—	22,500,000.00	—
The cash From the Associate Companies to obtain through a subsidiary	46,400,000.00	—	46,400,000.00	—
Total	68,900,000.00	12,000,000.00	68,900,000.00	12,000,000.00

(5) Payment of other cash related to fund raising 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
Guarantee deposit	11,280,000.00	—	11,280,000.00	—
Cash repaid to associates through subsidiaries	22,500,000.00	—	22,500,000.00	—
Cash repaid to associates through third parties	46,400,000.00	—	46,400,000.00	—
Total	80,180,000.00	—	80,180,000.00	—

Notes to the Financial Statements



As at 31 December 2012

V. Notes to the Financial Statements (continued)

44. Supplementary information on cash flow statements

(1) Supplementary information on cash flow statements

RMB

Supplementing Information	Consolidation		The Company	
	Incurred during the current period	Incurred during the previous period	Incurred during the current period	Incurred during the previous period
(1) Reconciliation of net profits as cash flows from operating activities:				
Net profits	140,166,177.34	169,042,235.00	109,432,153.86	175,718,274.16
Add: Provision of impaired assets	10,038,077.83	2,894,006.27	(2,082,443.15)	3,289,143.71
Depreciation of fixed assets	174,765,399.44	146,990,346.37	120,441,924.01	104,037,588.59
Depreciation of real estate held for investment	—	—	—	91,235.10
Intangible assets amortized	42,977,006.80	25,935,653.80	38,191,001.95	23,746,943.10
Losses (Gains) on disposal of fixed assets, intangible assets and other long-term assets	187,450.15	276,322.51	177,546.25	(42,944.98)
Financial expenses (gains)	47,849,635.45	20,925,487.23	43,399,965.45	14,856,643.06
Investment losses (gains)	(1,203,776.32)	(253,344.29)	—	(19,707,433.98)
Decrease (Increase) in deferred income tax assets	(2,577,382.37)	(1,576,231.82)	(3,916,222.49)	(3,045,515.12)
Decrease (Increase) in deferred income liabilities	85,535.40	(1,509,432.55)	128,154.59	(192,498.14)
Decrease (Increase) in stock operating receivables	(46,539,797.40)	(433,428,161.55)	(31,348,989.39)	(346,890,299.47)
Increase (Decrease) in operating receivables	(136,733,551.15)	164,307,318.25	(480,093,577.67)	142,687,196.09
Other — deferred income amortized	218,724,126.12	(5,975,624.15)	243,956,849.34	35,158,504.16
Other — deferred income amortized	(1,808,000.00)	—	(1,808,000.00)	—
Net cash flows from operating activities	445,930,901.29	87,628,575.07	36,478,362.75	129,706,836.28
(2) Net change in cash and cash equivalents:				
Cash balance at the end of the year	369,092,906.46	350,636,120.73	354,662,620.79	314,143,139.67
Less: cash balance at the beginning of the year	350,636,120.73	754,225,131.33	314,143,139.67	709,106,130.16
Net increase in cash and cash equivalents	18,456,785.73	(403,589,010.60)	40,519,481.12	(394,962,990.49)



Notes to the Financial Statements

As at 31 December 2012

V. Notes to the Financial Statements (continued)

44. Supplementary information on cash flow statements (continued)

(2) Components of cash and cash equivalents

RMB

	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
1. Cash				
Consist of: treasury cash	38,135.44	153,603.44	17,907.19	54,105.00
Bank deposits readily available for payment	136,381,352.33	224,925,512.85	121,971,294.91	191,685,030.23
Other currency capital readily available for payment	232,673,418.69	125,557,004.44	232,673,418.69	122,404,004.44
2. Cash and cash equivalent balance at the end of year	369,092,906.46	350,636,120.73	354,662,620.79	314,143,139.67
Other restricted currency capital	114,777,244.98	62,995,897.87	114,777,244.98	62,995,897.87
3. Currency capital at the end of the year	483,870,151.44	413,632,018.60	469,439,865.77	377,139,037.54

VI. Related Party and Transactions

1. Situation on Controlling Shareholders of the Group

As at 31 December 2012, 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. 8.

Notes to the Financial Statements



As at 31 December 2012

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction

(1) Purchase and Sales of Commodities. Rendering and Acceptance of Service

Table on situation on commodities procurement:

The Company

Related party	Subject of connected transaction	Pricing method and decision procedures of connected transaction	RMB			
			Incurred during			
			the current period	the previous period		
			As a proportion to same type of transaction amount (%)	As a proportion to same type of transaction amount (%)		
			Amount	Amount	Amount	Amount
Shouguang Baolong	Casting	Agreed price (Note 1)	1,731,766,705.09	67.18	1,684,924,524.83	62.55
Molong Electro-mechanical Equipment Company Limited	Casting, accessories, cold bed and electrical cabinet	Agreed price (Note 2)	94,633,494.12	3.67	97,096,637.29	3.61
Molong Electro-mechanical Equipment Company Limited	Accessories and cold bed	Agreed price (Note 2)	2,948,339.36	0.11	3,104,306.15	0.12
Weihai Baolong	Oil well pipes, casing and tubing	Agreed price (Note 3)	489,298,350.10	18.98	587,696,671.40	21.82
Total			2,318,646,888.67	89.94	2,372,822,139.67	88.10

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 not more than RMB100 per ton. Meanwhile, Weihai Baolong Company promised to provide the Company with a commodity price of not more than that provided to independent third party for the same commodity at the same time.



Notes to the Financial Statements

As at 31 December 2012

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(1) Purchase and Sales of Commodities. Rendering and Acceptance of Service (continued)

Table on situation of commodities sales:

Consolidation

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 pumping sand accessories	Agreed price (Note 4)	12,526,646.30	0.43	12,259,827.00	0.45

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 (%)
Shouguang Baolong	Scrap steel	Agreed price (Note 4)	81,294,497.29	2.85	58,962,797.04	2.06
Molong Electro-mechanical Equipment Company Limited	Scrap steel metal	Agreed price (Note 4)	35,468,025.73	1.24	42,143,387.97	1.47
Weihai Baolong	Scrap steel and cylindric steel, etc	Agreed price (Note 4)	42,864,261.28	1.50	70,685,838.45	2.47
Yalong Oil Pump	Oil well pumping sand accessories	Agreed price (Note 4)	12,526,646.30	0.44	12,259,827.00	0.43
MPM Internal Company Limited	Oil casing, etc.	Agreed price (Note 4)	58,260,460.66	2.04	—	—
Total			230,413,891.26	8.07	184,051,850.46	6.43

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



As at 31 December 2012

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 Lessor	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 (%)	
Molong Logistics Company Limited	Fixed Asset	Sales	Net carrying value	83,076.92	1.65	—	—	
Shouguang Baolong	Fixed Asset	Sales	Net carrying value	122,025.70	2.42	—	—	
Weihai Baolong	Fixed Asset	Sales	Net carrying value	4,188,034.20	83.13	899,866.46	50.74	
Total				4,393,136.82	87.20	899,866.46	50.74	
Weihai Baolong	Fixed Asset	Purchase	Net carrying value	314,830.31	1.27	833,615.02	0.42	
Molong Electro-mechanical Equipment Company Limited	Fixed Asset	Purchase	Net carrying value	199,525.56	0.81	21,222,426.86	10.73	
Total				514,355.87	2.08	22,056,041.88	11.15	



Notes to the Financial Statements

As at 31 December 2012

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(4) Lending/Borrowing to/from Related Parties:

Consolidation

RMB

Related-party	Inter-bank lending amount	Starting date	Maturity date	At the end of the balance
Borrowing				
Mao-long small loan companies (Note 1)	7,500,000.00	27/03/2012	03/05/2012	—
Mao-long small loan companies (Note 1)	7,500,000.00	27/03/2012	27/04/2012	—
Mao-long small loan companies (Note 1)	7,500,000.00	27/03/2012	27/04/2012	—
Mao-long small loan companies (Note 2)	46,400,000.00	28/03/2012	18/09/2012	—
Total	68,900,000.00			—

The Company

RMB

Related-party	Inter-bank lending amount	Starting date	Maturity date	At the end of the balance
Borrowing				
Mao-long small loan companies (Note 1)	7,500,000.00	27/03/2012	03/05/2012	—
Mao-long small loan companies (Note 1)	7,500,000.00	27/03/2012	27/04/2012	—
Mao-long small loan companies (Note 1)	7,500,000.00	27/03/2012	27/04/2012	—
Mao-long small loan companies (Note 2)	46,400,000.00	28/03/2012	18/09/2012	—
Total	68,900,000.00			—
Lending				
Shouguang Baolong	207,000,000.00	12/10/2012		207,000,000.00

Notes to the Financial Statements



As at 31 December 2012

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(4) Lending/Borrowing to/from Related Parties: (continued)

The Company (continued)

Note 1: The Company lent RMB22,500,000.00 in aggregate to Maolong Micofinance through its subsidiaries, namely Maolong Machinery, Maolong Recycle and Molong Electro-mechanical Equipment, please refer to note V.8.

Note 2: The Company obtained non-interest bearing borrowings amounted to RMB46,400,000.00 in aggregate from Maolong Micofinance through a third party. The respective term of borrowing of the borrowings varies and the first borrowing date was 28 March 2012. All borrowings were repaid by 18 September 2012.

(5) payment for the use of state funds

Consolidation

Related party	Subject of connected transaction	Type of connected transaction	Pricing principles for connected transaction	RMB			
				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 (%)
Mao-long small loan companies	Payment for the use of state funds	Interest expense	Note	142,065.00	0.28	—	—

Note: Capital cost calculated according to 0.574% interest.



Notes to the Financial Statements

As at 31 December 2012

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(6) Remuneration of Key Management

Consolidation and the Company

The remuneration of key management of the Company in 2012 amounted to RMB3,173,283.39 (2011: RMB3,092,369.02).

The emoluments paid or payable on each of the 14 (2011: 13) directors and supervisors were as follows:

	Executive directors				Independent non-executive directors						Supervisors			RMB	
	Zhang En Rong	Lin Fu Long	Xie Xin Cang	Wang Ping	Guo Hong Li	Xiao Qing Zhou	Wang Chun Hua	John Paul Cameron	Chau Shing Yim, David	Liu Huai Duo	Liu Wan Fu	Fan Ren Yi	Zhang Jiu Li		Total
2012:															
Fees	—	—	—	—	20,567.50	33,740.00	33,740.00	88,012.50	88,012.50	—	10,090.00	10,090.00	6,273.20	290,525.70	
Basic salaries and allowances	701,945.33	300,970.59	68,020.65	—	—	—	—	—	—	72,688.34	—	—	—	1,730,229.90	
Retirement scheme contributions	—	9,856.83	5,721.22	—	—	—	—	—	—	6,571.41	—	—	—	32,006.29	
Other	—	5,203.23	3,248.41	—	—	—	—	—	—	3,468.73	—	—	—	17,123.60	
	701,945.33	316,030.65	76,990.28	—	20,567.50	33,740.00	33,740.00	88,012.50	88,012.50	82,728.48	10,090.00	10,090.00	6,273.20	2,069,885.49	
2011:															
Fees	—	—	—	—	—	22,200.00	36,000.00	90,600.00	90,600.00	—	—	—	—	239,400.00	
Basic salaries and allowances	701,933.27	314,342.35	376,627.65	—	—	—	—	—	—	61,414.38	24,000.00	12,000.00	—	2,080,814.38	
Retirement scheme contributions	—	9,359.40	9,359.40	—	—	—	—	—	—	6,240.36	—	—	—	34,318.56	
Other	—	6,291.24	6,291.24	—	—	—	—	—	—	5,475.66	—	—	—	24,349.38	
	701,933.27	329,992.99	392,278.29	—	—	22,200.00	36,000.00	90,600.00	90,600.00	73,130.40	24,000.00	12,000.00	—	2,378,882.32	

Notes to the Financial Statements



As at 31 December 2012

VI. Related Party and Transactions (continued)

4. Situation on Connected Transaction (continued)

(6) Remuneration of Key Management (continued)

Consolidation and the Company (continued)

Note 1: These personnel have not received remuneration of any form from the Group.

Note 2: These personnel have resigned on 25 May 2012.

Note 3: These personnel have been in office on 25 May 2012.

Note 4: Payment of remuneration for key management are all made in the form of monetary currency.

Note 5: In 2012 and 2011, 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 (2011: 3) of the five top remuneration persons are directors of the Company, whose remuneration was shown in Note (VI) 4(6). The other 2 (2011: 2) persons' remuneration is as follows:

Name of item	RMB	
	Occurred in the current year	Occurred in the previous year
Salaries	760,381.05	778,078.60
Retirement scheme contribution	19,713.66	18,718.80
Other	10,406.46	12,582.48
Total	790,501.17	809,379.88

Salary range:

HK\$1,000,000 the following	RMB	
	The number of this year	The number of last year
	5	5



Notes to the Financial Statements

As at 31 December 2012

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	2,716,477.70	—	957,200.50	—
Bill receivable	Yalong Oil Pump	5,000,000.00	—	—	—

The Company

RMB

Item	Related party	Closing balance		Opening balance	
		Book balance	Bad debt balance	Book balance	Bad debt balance
Accounts receivable	Yalong Oil Pump	2,716,477.70	—	957,200.50	—
	MPM Internal Company Limited	15,432,904.18	—	—	—
	Weihai Baolong	2,008.16	—	—	—
	Total	18,151,390.04	—	957,200.50	—
Bill receivable	Yalong Oil Pump	5,000,000.00	—	—	—
	Weihai Baolong	2,000,000.00	—	—	—
	Total	7,000,000.00	—	—	—
Other receivables	Molong Logistics Company	—	—	20,000.00	—
	Shouguang Baolong	207,000,000.00	—	—	—
	Total	207,000,000.00	—	20,000.00	—
Advance Payment	Shouguang Baolong	121,242,310.72	—	—	—

Notes to the Financial Statements



As at 31 December 2012

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	Related party	Closing balance	Opening balance
Accounts receivable	Shouguang Baolong	—	16,701,218.40
	Weihai Baolong	—	64,209,376.84
	Molong Electro-mechanical Equipment Company Limited	33,116,283.18	30,473,480.99
	Total	33,116,283.18	111,384,076.23
其他應付款	Maolong Old Metals Recycle Company Limited	—	622,553.06
	Shouguang Baolong	—	3,723,785.85
	Molong Logistics Company	2,751,100.00	—
	Total	2,751,100.00	4,346,338.91
Advance Payment	MPM Internal Company Limited	—	13,784,097.22
Bills payable	Molong Electro-mechanical Equipment Company Limited	9,946,535.80	9,885,396.97
	Weihai Baolong	—	22,000,000.00
	Shouguang Baolong	543,142,679.76	233,973,085.56
	Total	553,089,215.56	265,858,482.53



Notes to the Financial Statements

As at 31 December 2012

VII. Commitments

1. Capital Commitment

	RMB	
	Closing balance	Opening balance
Contracted but not recognized in financial statements		
— Commitment on acquisition and construction of long-term assets	85,892,970.52	45,726,786.00

VIII. Non-adjustment subsequent to balance sheet date

	RMB
Item	Amount
Profit or dividend which would distribute (Note)	39,892,420.00

Note: For details, please refer to Note (V) 29.

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



As at 31 December 2012

IX Other Significant Items (continued)

1. Segment Reporting (continued)

(1) Segment Reporting Information

Combined segment reporting — 2012

							RMB
	Casing and Tubing	Three kinds of pumping units	Petroleum machinery	Other	Unallocated Items	Intersegment elimination	Total
Operation Revenue							
External transaction income	2,598,091,671.18	83,240,409.14	173,068,574.45	97,663,177.39	—	—	2,952,063,832.16
Income for inter-segment transaction	—	—	—	—	—	—	—
Total Segment Operation Revenue	2,598,091,671.18	83,240,409.14	173,068,574.45	97,663,177.39	—	—	2,952,063,832.16
Total operation revenue presented	2,598,091,671.18	83,240,409.14	173,068,574.45	97,663,177.39	—	—	2,952,063,832.16
Segment Costs	2,393,184,938.36	70,123,182.16	143,691,598.12	96,298,617.32	—	—	2,703,298,335.96
Segment operating profit	204,906,732.82	13,117,226.98	29,376,976.33	1,364,560.07	—	—	248,765,496.20
Adjustment items:							
Administrative Expenses	—	—	—	—	96,130,216.28	—	96,130,216.28
Finance expenses	—	—	—	—	37,123,383.67	—	37,123,383.67
Investment income	—	—	—	—	1,203,776.32	—	1,203,776.32
Operation Profit	204,906,732.82	13,117,226.98	29,376,976.33	1,364,560.07	(132,049,823.63)	—	116,715,672.57
Non-operation income	—	—	—	—	49,857,539.87	—	49,857,539.87
Non-operation expenditure	—	—	—	—	718,732.89	—	718,732.89
Total Profit	204,906,732.82	13,117,226.98	29,376,976.33	1,364,560.07	(82,911,016.65)	—	165,854,479.55
Income tax	—	—	—	—	25,688,302.21	—	25,688,302.21
Net profit	204,906,732.82	13,117,226.98	29,376,976.33	1,364,560.07	(108,599,318.86)	—	140,166,177.34
Total segment assets	3,871,642,444.97	179,253,472.12	256,359,484.93	416,741,549.62	561,754,027.18	—	5,285,750,978.82
Total segment liabilities	1,134,162,295.81	21,065,646.76	69,541,809.50	59,115,178.75	1,048,579,335.49	—	2,332,464,266.31
Supplementary Information:							
Depreciation	100,042,110.26	6,058,573.01	3,265,015.65	8,526,522.75	56,873,177.77	—	174,765,399.44
Amortize	35,478,019.65	8,545.77	1,688.29	—	7,488,753.09	—	42,977,006.80
Interest Income	—	—	—	—	11,734,207.72	—	11,734,207.72
Interest cost	—	—	—	—	46,970,204.90	—	46,970,204.90
Impairment losses recognized							
in current year:	10,038,077.83	—	—	—	—	—	10,038,077.83
Non-current assets other than long-term							
equity investment	2,246,050,246.04	77,794,772.28	162,953,510.31	270,049,539.69	19,249,475.31	—	2,776,097,543.63
Capital expenditure	284,795,959.66	10,804,212.48	87,641.11	22,021,048.34	—	—	317,708,861.59
Consist of : Expenses on construction							
in progress	170,650,752.36	—	—	17,955,871.67	—	—	188,606,624.03
Expenses on purchase of							
fixed assets	30,625,194.91	5,780,518.64	87,641.11	4,065,176.67	—	—	40,558,531.33
Expenses on purchase							
of intangible assets	83,520,012.39	5,023,693.84	—	—	—	—	88,543,706.23
Non-cash expenses other than depreciation							
and amortization	—	—	—	—	—	—	—



Notes to the Financial Statements

As at 31 December 2012

IX. Other Significant Items (continued)

1. Segment Reporting (continued)

(1) Segment Reporting Information (continued)

Combined segment reporting — 2011

	RMB						
	Casing and Tubing	Three kinds of pumping units	Petroleum machinery	Other	Unallocated Items	Intersegment elimination	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	—	—	—	—	23,749,950.69	—	23,749,950.69
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	—	—	—	—	—	—	—



As at 31 December 2012

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 2012 and 2011, 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	1,801,919,443.99	1,708,533,817.17
Foreign external transaction income	1,150,144,388.17	1,030,158,013.04
Total	2,952,063,832.16	2,738,691,830.21

RMB

(3) Reliability on major customers

The Group's major customers are PetroChina Company Limited, PPC Limited, Campex Inc, OEML Middle East Company, Shandong Luxin Steel Pipes Co., Ltd, Hebei Zhongtai Steel Pipe Manufacture Co., Ltd. Specific details could be referred to Note V.31.

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

As at 31 December 2012

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, Hong Kong dollars, euro and yen; except for the Company and its subsidiaries MPM of which effect purchases and sales in USD, Hong Kong dollars, euro and yen; all the business activities of the remaining principal operations of the Group are settled with RMB. On 31 December 2012, except for the USD balances in assets and liabilities, odd monies in EUR and balances in HKD as set out below, all the balances of assets and liabilities of the Group were denominated in RMB. The foreign exchange risk arising from assets and liabilities in such USD balances may affect the operating results of the Group.

	RMB	
	Closing balance	Opening balance
Cash and cash equivalents — USD	25,599,876.14	42,767,930.02
Cash and cash equivalents — HKD	1,180.23	12,460.81
Cash and cash equivalents — EUR	0.08	854.70
Accounts receivable — USD	75,226,451.95	153,878,561.49
Accounts receivable — EUR	4,142,276.67	1,863,200.41
Other payables — USD	158,583.67	282,533.87
Short-term borrowings — USD	300,006,883.57	373,920,265.13
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.

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. In addition to entering into fixed-rate bank borrowing contracts, most of the borrowing contracts of the Group are floating-rate borrowings. The Group has not adopted other measures including entering into interest swap contract to avoid the fair value risk resulted from changes in interest rate.



As at 31 December 2012

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 2012, 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	213,870,826.15



Notes to the Financial Statements

As at 31 December 2012

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 2012, the Group had outstanding bank facilities of RMB2,650,125,038.27 (On 31 December 2011, the Group had unutilized bank facilities of RMB4,466,290,596.71), including outstanding short-term bank facilities of RMB42,650,125,038.27 (On 31 December 2011, the Group had unutilized bank facilities of RMB4,466,290,596.71).

Maturity analysis of financial assets and financial liabilities of the Group at undiscounted remaining contractual obligations are set out as follows:

Items	Closing balance		Total
	within 1 year	Over 1 year	
Monetary capital	483,870,151.44	—	483,870,151.44
Bills receivable	197,194,589.32	—	197,194,589.32
Account receivables	455,105,433.22	—	455,105,433.22
Other receivables	18,953,847.29	—	18,953,847.29
Short-term borrowings	1,058,419,078.67	—	1,058,419,078.67
Bills payables	603,403,515.62	—	603,403,515.62
Account payables	570,841,701.67	—	570,841,701.67
Interests payables	6,968,896.69	—	6,968,896.69
Other payables	24,475,042.80	—	24,475,042.80

Notes to the Financial Statements



As at 31 December 2012

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	RMB			
		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	(10,131,487.95)	(10,131,487.95)	(9,063,080.61)	(9,063,080.61)
All foreign currency	Depreciate 5% relative to RMB	10,131,487.95	10,131,487.95	9,063,080.61	9,063,080.61



Notes to the Financial Statements

As at 31 December 2012

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 aftertax 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%	2,393,783.68	2,393,783.68	5,432,610.29	5,432,610.29
Floating-rate borrowings	Increased by 1%	(2,393,783.68)	(2,393,783.68)	(5,432,610.29)	(5,432,610.29)

Notes to the Financial Statements



As at 31 December 2012

IX. Other Significant Items (continued)

3. Retirement/Pension Scheme Benefits

RMB

Items	Consolidation	
	Amount for the current period	Amount for the current period
Retirement and Pension Scheme Benefits	11,282,537.60	9,970,146.29
Less: amount capitalised	277,780.93	34,314.36
Total	11,004,756.67	9,935,831.93

The Group is required to make contributions to the retirement plans at a rate of 12% 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

Items	Consolidation		The Company	
	Closing balance	Opening balance	Closing balance	Opening balance
Net current assets	2,451,019,034.76	2,268,794,173.60	2,461,128,454.01	1,932,718,967.56
Subtraction: current liabilities	2,313,628,711.08	1,815,395,688.52	2,083,384,404.50	1,539,671,363.05
Net current assets	137,390,323.68	453,398,485.08	377,744,049.51	393,047,604.51
Total assets	5,285,750,978.82	4,688,931,436.70	4,888,450,484.21	4,276,877,554.31
Subtraction: current liabilities	2,313,628,711.08	1,815,395,688.52	2,083,384,404.50	1,539,671,363.05
Total assets less current liabilities	2,972,122,267.74	2,873,535,748.18	2,805,066,079.71	2,737,206,191.26

RMB

Items	Consolidation		The Company	
	Amount for the current period			
Depreciation	174,765,399.44	146,990,346.37	120,441,924.01	104,128,823.69
Amortization	42,977,006.80	25,935,653.80	38,191,001.95	23,746,943.10
Annual auditor's fee	1,200,000.00	1,100,000.00	1,200,000.00	1,100,000.00

X. Approval of the Financial Statements

These financial statements had been approved by the Board of Directors of the Company on 28 March 2013.



Supplementary Information

I. Breakdown of Extraordinary Gains and Losses

RMB

Items	Amount	Remarks
Profit or loss from disposal of non-current assets	(187,450.15)	
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 a fixed standard amount or quantity as stipulated by the State)	49,141,000.00	
Reversal of impairment provision on receivables tested for impairment on individual basis	4,650,513.63	
Non-operating gains and losses other than the above items	185,257.13	
Effect of income tax	(8,011,893.61)	
Effect of minority interests (after tax)	(12,134.31)	
Total	45,765,292.69	

II. Return on Net Assets and Earnings Per Share

This calculation of return on net assets and earnings per was prepared by Shandong Molong in accordance with the relevant requirements of the spare "Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 09) — Calculations and disclosures for the return on net assets and earnings per share" (as amended in 2010) issued by the China Securities Regulatory Commission.

Profit during the reporting period	Weighted average return on assets (%)	Earnings per share	
		Basic	Basic
Net profit attributable to holders of ordinary shares of the Company	4.73	0.17	N/A
Net profit attributable to holders of ordinary shares of the Company, after deducting extraordinary gains and losses	3.12	0.11	N/A

III. Irregular Movements in Major Items of the Accounting Statements of the Company and Explanation on their Reasons

This movements in items of the accounting statements of the Company was prepared by Shandong Molong in accordance with the relevant requirements of the spare "Compilation Rules for Information Disclosures by Companies that Offer Securities to the Public (No. 15) — general regulation of financial statement" (as amended in 2010) issued by the China Securities Regulatory Commission.

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 2012 with relatively material changes as compared with that as at 31 December 2011 are set forth below:

RMB'000

Items		31 December 2011	31 December 2010	Increase/decrease from the last year (%)
Cash and bank balances	(1)	483,870	413,632	16.98
Bills receivable	(2)	197,195	73,529	168.19
Accounts receivable	(3)	455,105	460,164	(1.10)
Prepayments	(4)	33,897	42,128	(19.54)
Receivable other	(5)	18,954	29,821	(36.44)
Inventory	(6)	1,220,619	1,176,982	3.71
Other current assets	(7)	41,380	72,539	(42.95)
Construction in progress	(8)	134,351	83,523	60.86
Intangible assets	(9)	378,587	333,020	13.68
Development expenditure	(10)	7,077	—	100.00
Goodwill	(11)	132,723	142,973	(7.17)
Deferred tax assets	(12)	19,249	16,672	15.46
Other non-current assets	(13)	270,000	—	100.00
Short-term borrowings	(14)	1,030,007	710,502	44.97
Bills payable	(15)	603,404	383,690	57.26
Accounts payable	(16)	570,842	616,716	(7.44)
Account collected in advance	(17)	25,838	20,714	24.74
Payable interest	(18)	6,969	5,558	25.39
Other non-current liabilities	(19)	7,232	9,040	(20.00)

- (1) The increase in currency fund was mainly due to the increase in sales revenue and borrowings of the Group during the year.
- (2) The increase in bills receivables was mainly due to the fact that most of the Group's receivables in the year were in the form of bank promissory notes, which together with the concentrated collection of the accounts receivables at the end of the year, resulted in an increase of the balance of bills receivables as compared with that at the end of last period.
- (3) The accounts receivable decreased in the current year, which was mainly because the Company strengthen the collection efforts of accounts receivable, and the cash collection improved.
- (4) The decrease in prepayments was mainly due to the decrease in prepayments from Weihai Baolong Special Petroleum Materials Co., Ltd and Shouguang Baolong Petroleum Material Company Limited, both are subsidiaries of the Company, to suppliers during the year.
- (5) The decrease in other receivables was mainly due to the collection of tender bond from CPMC by the Company during the year and the rebates on value-added tax received from Finance Bureau by Shouguang Maolong Old Metals Recycle Company Limited during the year.



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 2012 with relatively material changes as compared with that as at 31 December 2011 are set forth below: *(continued)*

- (6) The increase in inventory increase was mainly due to the increase in annual output of the Company's 180 production lines, but the closing product balance increased at the end of the year resulted from the decrease in shipments at the end of the year as compared with that of the same period last year.
- (7) Other current assets decreased.
- (8) The increase in work in progress was mainly attributable to the newly established 90 tons electric furnace invested by a subsidiary of the Company, Shouguang Baolong Petroleum Material Company Limited, during the year.
- (9) The increase in intangible assets was mainly due to the success in the research and development of new products of the Company and its subsidiaries, Shouguang Baolong Petroleum Material Company Limited and Shouguang Molong Electro-mechanical Equipment Company Limited, which were transferred to intangible assets.
- (10) The increase in development expenditure was mainly due to the fact that there were new products still at the development stage during the year.
- (11) The decrease in goodwill was mainly due the impairment provision for goodwill of RMB10,250.00 thousand recognized by the Group during the year.
- (12) The increase in deferred income tax assets was mainly due to the deductible temporary differences of the new intangible assets of the Group arising from the difference in audit based on tax laws and accounting to amortization period.
- (13) The increase in other non-current assets was mainly due to the land prepayments of RMB270,000.00 paid by the Group.
- (14) The increase in short-term borrowings was mainly due to the increase in expenses on construction of the Group during the year, coupled with the increase in external financing for satisfying the daily working capital requirement.
- (15) The increase in bills payable was mainly due to the fact that most of the Group's payment in the year were in the form of bank promissory notes.
- (16) The decrease in accounts receivable was mainly due to the decrease in purchase of raw materials as a result of the relatively longer period of production suspension for repair and maintenance of Weihai Baolong Special Petroleum Materials Co., Ltd, a subsidiary of the Company, during the year.
- (17) The increase in advance receipts was mainly due to the fact that most of the new customers developed by the Group at the end of the year chose to prepay for products for settlement.
- (18) The increase in interests payable was mainly due to the increase in the Group's short-term borrowings of the year.



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 2012 with relatively material changes as compared with that as at 31 December 2011 are set forth below: *(continued)*

- (19) The decrease in other non-current liabilities was mainly due to the recognition of the assets related government subsidies as deferred income in 2011 and the amortization of RMB1,808.00 thousand during the year.

2. Items of combined income statement as at 31 December 2012 with relatively material changes as compared with that as at 31 December 2011 are set forth below:

		RMB'000		
		2012	2011	Change (%)
Operation revenue	(1)	2,952,064	2,738,692	7.79
Operation costs	(2)	2,624,241	2,407,672	8.99
Selling expenses	(3)	67,451	57,586	17.13
Administrative Expenses	(4)	96,130	87,944	9.31
Finance Expenses	(5)	37,123	14,649	153.42
Asset Impairment Losses	(6)	10,038	2,894	246.86
Non-operation revenue	(7)	49,858	34,477	44.61
Income tax expense	(8)	25,688	31,022	(17.19)

- (1) The operation revenue increased, which was mainly because with the steady economic situation, the sales of the Group in domestic and overseas increased.
- (2) The increase in cost of operations was mainly due to the increase in sales, as well as the increase in fixed cost to be shared by unit products due to the relatively short commencement period for production of the 180mm heat treatment machining line and OCTG finish machining line.
- (3) The increase in selling expenses was mainly due to that the export port miscellaneous expenses and freight charges increased resulted from the increased sales volume and freight price.
- (4) The increase in administrative expenses was mainly due to the increase in amortization resulted from the increase in the Group's intangible assets of the year.
- (5) The increase in financing cost was mainly due to the increase in interest expenses of borrowings resulted from the increase in the Group's short-term borrowing of the year.
- (6) The increase in loss on impairment of assets was mainly due to the impairment provision for goodwill made by the Group for goodwill during the year.
- (7) The increase in non-operating income was mainly due to the fact that the Company and its subsidiary, Weihai Baolong Special Petroleum Materials Co., Ltd, received government subsidies during the year.
- (8) The decrease in income tax expense was mainly because the total profit of the current year decreased as, compared with that of 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

March 29, 2013

