



沈機集團昆明機床股份有限公司

**SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED**

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



**Create Classic of  
High Precision Machine Made in China**

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Annual Report 2012

## IMPORTANT NOTICE

1. The Board of Directors, Supervisory Committee, Directors, Supervisors and Senior Management Officers of the Company have declared that the content of this annual report is true, accurate and complete with no false information, misleading statements or material omissions for which they jointly and severally accept legal responsibility.

2. Directors who did not attend the Board meeting

<b>Positions of directors who did not attend the board meeting</b>	<b>Names of directors who did not attend the board meeting</b>	<b>Reasons for not attending the Board meeting</b>	<b>Appointee</b>
Independent director	Xiao Jianming	Office duty	Chen Fusheng
Director	Guan Xin	Office duty	Wang Xing
Director	Zhang Tao	Office duty	Li Zhenxiong

3. The financial statements for the year ended 31st December 2012 of the Company prepared in accordance with Accounting Standards for Business Enterprises were audited by KPMG Huazhen (Special General Partnership) who has issued unqualified opinions in their auditors' report.

4. Wang Xing, Chairman, Li Shunzhen, the person in charge of accounting affairs, and Li Hongning, head of accounting department (Accounting Supervisor), have declared that they assured for the truthfulness, accuracy and completeness of the financial statements in the Annual Report.

5. Proposal on profit distribution or capitalization of capital reserve to increase share capital for the reporting period approved by the Board: Proposal on profit distribution for the year 2012: In accordance with the PRC accounting standards, in 2012, the Group recorded a net profit of RMB-73,220,000. Without the transfer of profit to surplus reserves, the profit distributed for the previous year amounted to RMB10,622,000, and the accumulated profit available for distribution amounted to RMB643,404,000. In particular, the Company recorded a net profit of RMB-62,585,000. Without the transfer of profit to surplus reserves, the profit distributed for the previous year amounted to RMB10,622,000, and the accumulated profit available for distribution amounted to RMB621,506,000. No cash dividend was declared for the year 2012.

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

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

8. This annual report is prepared in both Chinese and English, in the event that different interpretation occurs, the Chinese version shall prevail.

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# DEFINITION AND MATERIAL RISK ALERT

## I. DEFINITION

"The Company", "Company", "Parent"	Shenji Group Kunming Machine Tool Company Limited
"Industry"	the machine tool industry in the PRC
"Horizontal machine"	horizontal boring and milling machine tool
"Floor-type machine"	floor-type boring and milling machine tool
"Machining center"	horizontal products machining center
"Gantry machine"	gantry boring and milling machine tool
"Company Law"	the Company Law of the People's Republic of China
"Securities Law"	the Securities Law of the People's Republic of China
"Accounting Law"	the Accounting Law of the People's Republic of China
"RMB", "RMB'000" and "RMB0'000"	RMB, RMB thousand and RMB ten thousand

## II. MATERIAL RISK ALERT

In this report, the Company has described in details the industry risks existed. For details on the risks that the Company may undertake, please refer to the discussion and analysis on the future development of the Company set out in Section IV Directors' Report.

# COMPANY PROFILE

## I. COMPANY INFORMATION

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

## II. CONTACT PERSON AND CONTACT INFORMATION

	Secretary to the Board	Securities Affairs Representative
Name	Luo Tao	Wang Bihui
Correspondence address	23 Ciba Road, Kunming City, Yunnan Province	23 Ciba Road, Kunming City, Yunnan Province
Telephone number	86-871-66166612	86-871-66166623
Facsimile number	86-871-66166288	86-871-66166288
E-mail	luotao@kmtcl.com.cn	wangbh@kmtcl.com.cn

## III. BASIC INFORMATION

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

## IV. PLACE OF INFORMATION DISCLOSURE AND DOCUMENT INSPECTION

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

# COMPANY PROFILE

## V. SHARE LISTING

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

## VI. CHANGES IN REGISTRATION OF THE COMPANY DURING THE REPORTING PERIOD

### 1. Basic information

There was no change in registration of the Company during the reporting period.

### 2. Related information of the first business registration of the Company

Please refer to the section "Overview of the Company" in 2011 Annual Report for the first business registration of the Company.

### 3. Changes in the controlling shareholders of the Company since the listing

On 25th December 2000, Xi'an Jiaotong University Industrial (Group) Incorporation ("Jiaotong Group") entered into Shares Transfer Agreement of Jiaoda Kunji High-tech Company Limited with the People's Government of Yunnan Province ("Yunnan Government") whereby Yunnan Government would transfer 71,052,146 state-owned shares of the Company to Jiaotong Group. The transaction was approved by [2001] No. 283 Cai Qi – the Approval of State-owned Shares Transfer of Jiaoda Kunji High-tech Company Limited issued by the Ministry of Finance of the PRC. Upon completion of share transfer procedure on 5th June 2001, Jiaotong Group became the largest shareholder of the Company.

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

## VII. OTHER RELEVANT INFORMATION

Appointed Auditor of the Company (domestic)	Name	KPMG Huazhen (Special General Partnership)
	Address	8/F, Office Tower E.2, Oriental Plaza, No.1 East Chang An Ave, Beijing, China
	Signature of accountants	Peng Jing  Zhong Dan

# SUMMARY OF ACCOUNTING DATA AND FINANCIAL INDICATORS

## I. PRINCIPAL ACCOUNTING DATA AND FINANCIAL HIGHLIGHTS FOR THE LATEST FIVE YEARS UP TO THE END OF THE REPORTING PERIOD

### 1. Principal accounting data

Unit: RMB

Principal accounting data	2012	2011	Increase/ Decrease as compared with the corresponding period last year (%)	2010	2009	2008
	As at the end of 2012	As at the end of 2011	corresponding period last year (%)	As at the end of 2010	As at the end of 2009	As at the end of 2008
Operating income	1,086,311,095.78	1,804,857,564.29	(39.81)	1,597,705,267.19	1,372,196,639.36	1,563,105,398.47
Net profit attributable to equity shareholders of the Company	(73,220,171.53)	54,567,125.16	(234.18)	178,324,801.52	215,847,994.25	276,564,904.31
Net profit (excluding extraordinary gains and losses) attributable to equity shareholders of the Company	(84,933,422.22)	51,897,930.57	(263.65)	167,747,132.71	193,475,241.55	250,747,388.75
Net cash flow from operating activities	7,571,011.30	654,756.70	1056.31	129,272,783.34	105,749,466.18	120,047,854.09
Net assets attributable to equity shareholders of the Company	1,318,296,555.83	1,402,138,349.42	(5.98)	1,374,125,279.42	1,217,014,036.12	1,041,230,512.25
Total assets	2,548,752,225.10	2,558,664,361.12	(0.39)	2,247,730,361.63	2,024,433,625.56	1,911,770,243.50

### 2. Principal financial data

Principal financial data	2012	2011	Increase/ Decrease as compared with the corresponding period last year (%)	2010	2009	2008
Basic earnings per share (RMB/share)	(0.14)	0.10	(234.18)	0.34	0.41	0.65
Diluted earnings per share (RMB/share)	(0.14)	0.10	(234.18)	0.34	0.41	0.65
Basic earnings per share excluding extraordinary gains and losses (RMB/share)	(0.16)	0.10	(263.65)	0.32	0.36	0.59
Return on net assets (weighted average) (%)	(5.39)	3.93	Decreased by 9.32 percentage points	13.75	19.06	27.18
Return on net assets based on net profit excluding extraordinary gains and losses (weighted average) (%)	(6.25)	3.74	Decreased by 9.99 percentage points	12.98	19.25	24.64

# SUMMARY OF ACCOUNTING DATA AND FINANCIAL INDICATORS

## II. EXTRAORDINARY GAINS AND LOSSES AND AMOUNTS

<b>Extraordinary gains and losses</b>	<b>Amount 2012</b>	<b>Amount 2011</b>	<i>Unit: RMB</i> <b>Amount 2010</b>
Disposal of non-current assets	<b>(464,751.55)</b>	1,393,630.93	666,520.12
Government grants recognized through profit and loss (excluding those having close relationship with the Group's operation and enjoyed in fixed amount or quantity according to uniform national standard)	<b>15,369,410.00</b>	2,552,408.50	6,700,335.00
Debt restructuring	-	(905,350.26)	2,568,942.39
Other non-operating income and expenses besides items above	<b>(781,197.64)</b>	123,986.64	1,977,437.21
Effect of minority interests (after tax)	<b>(291,691.00)</b>	(19,918.60)	-
Effect of income tax	<b>(2,118,519.12)</b>	(475,562.62)	(1,335,565.91)
Total	<b><u>11,713,250.69</u></b>	<b><u>2,669,194.59</u></b>	<b><u>10,577,668.81</u></b>



# DIRECTORS' REPORT

## I. THE BOARD'S DISCUSSION AND ANALYSIS ON THE OPERATION OF THE COMPANY DURING THE REPORTING PERIOD

In 2012, being affected by the global financial crisis, investment in the manufacturing industry has been tightened, causing a decline in the profitability of the machine tools industry in the PRC. Meanwhile, the growth rate of the overall production and sales of the industry slowed down significantly. Facing an overall sluggish external economic environment and intensified market competition, coupled with insufficient intake of orders and increase in inventory, the Company experienced the worst time in recent years. In such circumstance, the Board of the Company adjusted the operation target for the year in a timely manner, while the management of the Company proactively initiated various measures to overcome the challenges, managed to ride out such a difficult time.

### 1. Analysis of principal activities

#### 1. Table of analysis of changes in relevant items of income statement and cash flow statement

Item	2012	2011	Unit: RMB
			Percentage of change (%)
Operating income	1,086,311,095.78	1,804,857,564.29	(39.81)
Operating costs	880,453,359.74	1,368,376,106.28	(35.66)
Selling and distribution expenses	96,628,154.07	134,188,688.09	(27.99)
General and administrative expenses	160,374,456.94	169,652,944.38	(5.47)
Financial expenses	1,797,725.19	3,409,201.42	(47.27)
Net cash flow from operating activities	7,571,011.30	654,756.70	1056.31
Net cash flow from investing activities	(80,688,471.77)	(164,733,792.62)	(51.02)
Net cash flow from financing activities	(12,822,306.62)	55,194,794.65	(123.23)
R&D expenses	43,099,929.64	42,960,137.36	0.33
Impairment losses	52,262,313.67	62,921,703.56	(16.94)
Investment income	2,996,374.90	7,334,821.80	(59.15)
Non-operating income	15,558,232.30	5,090,585.51	205.63
Income tax	(12,944,178.86)	16,568,488.10	(178.13)

- Notes: 1. The decrease in impairment losses was due to the decrease in provision for bad and doubtful debts for the period as compared with the previous period;
2. The decrease in investment income for the period was due to the recognition of income of RMB29.13 million from the profit distribution by General Machine in the previous period;
3. The increase in non-operating income was mainly attributable to the recognition of government grant of RMB8.14 million in the period;
4. The decrease in income tax was due to the negative profit recorded for the year and the recognition of income tax assets arising from the deductible temporary differences. The Company fulfilled the requirements set out on the Catalog of Guidance for Industrial Structure Adjustment (2011 version) issued by the National Development and Reform Commission and met the requirements for encouraged type enterprises stipulated on the Notice on Tax Policies in relation to Further Implementation of Western Development Strategy, and thus enjoyed a preferential corporate income tax rate of 15%. The applicable corporate income tax rate of the Company for 2012 was 15% (2011: 15%).

The Company's subsidiaries Xi'an Ser Turbo Machinery Co., Ltd and Changsha Ser Turbine Machinery Co., Ltd. enjoyed preferential tax treatment for high-tech enterprises. The applicable corporate income tax rate of these two subsidiaries for 2012 was 15% (2011: 15%). The Company's other subsidiaries are subject to 25% corporate income tax rate in 2012 (2011: 25%).

## DIRECTORS' REPORT

### 2. Revenue

- (1) Analysis of factors causing changes in operating income  
Affected by market factors, price factors and inventory factors, the changes in operating income of the Company were mainly attributable to the sales revenue of the machine tool products. Revenue from product services and machine processing businesses had insignificant impact on the overall revenue of the Company.
  - 1) Market factors: In 2012, continuous slowdown in market demands for machine tools due to sluggish market condition and reduced fixed assets investment causing a decrease in intake of orders, coupled with delayed or suspended pick-up of ordered machine tool products by certain customers who suffered from poor financial conditions and under-utilization of production capacity, resulted in an increase in inventory and decrease in sales revenue.
  - 2) Price factors: The unit selling price of machine tools was lowered from that of last year as the Company focused to capture market share and seize orders in light of intensified market competition. Meanwhile, being affected by the market environment, the Company also recorded a decrease in sales volume, resulting in a decrease in sales revenue.
  - 3) Inventory factors: Delayed or suspended pick-up of goods by customers resulted in an increase in machine tool products inventory, which led to increased inventory capital and affected re-investment in production and operation. In order to reduce inventory, some finished products were sold at a discounted price, resulting in a decrease in sales revenue.
- (2) Analysis of factors affecting the Company's product income mainly from physical sales  
The products of the Company were mainly sold through physical sales. Therefore, same with the operating income, the sales revenue of the Company was also affected by the above factors.
- (3) Analysis of orders  
The total contract amount of orders signed in 2012 amounted to RMB802 million, of which orders for CNC machine tools accounted for 66%. Floor-type boring machine tools orders accounted for 39% of all CNC product orders, constituting a majority of the CNC product orders. The amount and proportion of orders for floor-type boring machine tools decreased over last year due to the market and competition factors. The amount of orders for the gantry boring and milling machine tools also recorded a decrease as compared to that of last year, while the proportion of such orders in the total order amount remained the same with last year. The amount of digital display horizontal boring machine tools orders accounted for 30.05% of the total amount of orders, with a decrease in order amount but an increase in its proportion to the total order amount over last year, reflecting a more significant decrease in demand for CNC machine tools than demand for digital display machine tools due to the impact of the market factors in 2012.
- (4) Analysis of impacts of new products and new services  
Given that the new product – high precision horizontal products machining center was still at the marketing stage, and also affected by the market factors, the new product recorded a small sales volume and accounted for a tiny proportion of the overall sales volume, which had insignificant impact on the sales revenue of the year.
- (5) Information on the major customers  
Our customers include intermediate traders and end users. As at 31st December 2012, the total sales revenue of the top 5 customers (end users) amounted to RMB222 million.

Note: The top 5 customers accounted for 20.45% of the total sales revenue for the year.

## DIRECTORS' REPORT

### 3. Costs

#### (1) Changes in costs of principal activities

Unit: RMB'000

Item	Proportion (%)	2012	Proportion (%)	2011	Increase/Decrease (%)
Raw materials	63.71	560,910.18	49.71	680,203.59	(17.54)
Direct labor costs	15.44	135,968.59	5.86	80,145.82	69.65
Benefit expenses	4.54	39,965.96	3.02	41,287.24	(3.20)
Fuel and power	1.45	12,726.91	1.14	15,589.54	(18.36)
Manufacturing costs	5.18	45,570.19	19.32	264,431.89	(82.77)
External processing expenses	9.69	85,311.53	20.95	286,718.03	(70.25)
Total	100.00	880,453.36	100.00	1,368,376.11	(35.66)

The decrease in sales volume for the year resulted in a decrease in selling and distribution costs. Due to the decrease in production volume, the proportion of staff cost in unit product cost increased. Therefore, though the total wages for the year decreased, the proportion of staff costs in production costs increased. The decrease in manufacturing costs and the increase in direct labor costs was because that the salaries of the workshop assistants were transferred from manufacturing costs to production costs-direct labor costs. Furthermore, instead of outsourcing from external processing companies, all the products were manufactured by the Company, resulting in an increase in the proportion of raw materials in the production costs.

#### (2) Major suppliers

The total purchase from the top 5 suppliers for 2012 amounted to RMB210,258,000, representing 37.04% of the total purchase for the year. In particular, the largest supplier accounted for RMB74,850,000 or 13.19% of the total purchases (exceeding 5% of the total purchases), while the second largest supplier accounted for RMB52,083,000 or 9.17% of the total purchases.

### 4. Expenses

Item	2012	2011	Change	Percentage of change (%)
Selling and distribution expenses	96,628,154.07	134,188,688.09	(37,560,534.02)	(27.99)
General and administrative expenses	160,374,456.94	169,652,944.38	(9,278,487.44)	(5.47)
Financial expenses	1,797,725.19	3,409,201.42	(1,611,476.23)	(47.27)

The decrease in selling and distribution expenses was attributable to the decrease in the relevant freight expenses and provisions for warranty expenses due to declined sales revenue;

The decrease in general and administrative expenses was due to the Company's control over expenses. Except a slight increase in R&D expenses, all the other expenses such as wages, general and entertainment expenses decreased;

The decrease in financial expenses was due to the capitalization of interest expenses on the borrowings of the Company applied for the base construction project of the Company which was still in progress.

## DIRECTORS' REPORT

### 5. R&D expenses

#### (1) Table of R&D expenses

	<i>Unit: RMB</i>
R&D expenses expensed for the current period	43,099,929.64
R&D expenses capitalized for the current period	0
Total R&D expenses	43,099,929.64
Percentage of total R&D expenses to net assets (%)	3.16
Percentage of total R&D expenses to operating income (%)	3.97

#### (2) Detailed information

In 2012, the Company did not have any R&D projects with interest capitalization, all the R&D expenses of which incurred during the year were expensed, mainly including major national special projects, national "863 Program" and new products independently researched and developed by the Company.

### 6. Cash flow

Item	2012	2011	Amount increase/ decrease	Increase/ Decrease (%)
Net cash flow from operating activities	7,571,011.30	654,756.70	6,916,254.60	1056.31
Net cash flow from investing activities	(80,688,471.77)	(164,733,792.62)	84,045,320.85	(51.02)
Net cash flow from financing activities	(12,822,306.62)	55,194,794.65	(68,017,101.27)	(123.23)

Analysis:

- A. The increase in net cash flow from operating activities was mainly attributable to the increase in the government grant received for major special projects during the year;
- B. Net cash flow from investing activities increased as compared to that in the same period last year, mainly attributable to the decrease in the investment for construction projects of Yanglin Base;
- C. The decrease in net cash flow from financing activities was because the Group did not receive government grants relating to financing this year, which were received last year.

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

	<i>Unit: RMB</i>			
Item	Closing balance	Opening balance (same period last year)	Amount increase/ decrease	Increase/ Decrease (%)
Total assets	2,548,752,225.10	2,558,664,361.12	(9,912,136.02)	(0.39)
Operating profit	(109,363,734.67)	65,619,420.72	(174,983,155.39)	(266.66)
Net profit attributable to equity shareholders of the Company	(73,220,171.53)	54,567,125.16	(127,787,296.69)	(234.18)

# DIRECTORS' REPORT

## Analysis:

The decrease in operating profit over that in the same period last year was mainly attributable to the decrease in sales volume due to shrinking market demand for machine tool products as affected by macroeconomic control. Coupled with other factors such as surging costs for raw materials, energy and power and rising labor costs, the Company recorded a decrease in gross profit margin, resulting in loss for the year. The decrease in operating profit recorded for the period directly resulted in the decrease in the net profit attributable to equity shareholders of the Company.

## 8. Others

- (1) Explanation on progress of development strategies and operating plan
- In order to achieve the development strategies of the Company, the Company formulated operating plan for the year and made timely adjustment in accordance with the actual situation. In addition, the Company made significant adjustment to its organizational structure at the end of 2012 by establishing six functional management departments and three systems. The six functional management departments include administration department, investment operation department, marketing department, finance department, human resources department and production management department. The three systems include operation system, R&D system and operation supporting system. Based on the new organizational structure, the Company undertook supporting operational mechanism improvement and production process reengineering, and plans to implement the new operation management and control model in 2013 by adopting market-oriented business unit system to optimize and upgrade products, while the headquarters is responsible for operation management and performance assessment to optimize deployment of staff, funds and resources.

The Company will focus on the following eight aspects:

1. The Company will perfect its organizational reform to ensure smooth operation of the new organizational model;
2. The Company will innovate its operation model to steadily push forward its transformation toward industrial service provider;
3. The Company will vigorously reinforce its technology innovation capability and proactively explore new R&D system operation model, so as to step up product mix restructuring and updating;
4. The Company will continue to deepen the "quality control storm" to ensure consistent product quality and promote continuous improvement of product quality;
5. The Company will enhance the management of the ERP system covering production and finance and overall budget management, and carry out stringent assessment of their performance;
6. The Company will speed up the recruiting and training of talents, so as to enhance the core competitiveness of the Company;
7. The Company will enhance the establishment of corporate culture and strengthen implementation capability, so as to enhance the soft power and overall competitiveness of the Company;
8. The Company will complete the relocation plan of Yanglin Base.

# DIRECTORS' REPORT

## 2. Segment, product and regional operation

### 1. Analysis of principal activities by products

Unit: RMB

Analysis of principal activities by segments						
Business segments	Operating income	Operating costs	Gross profit margin (%)	Percentage change in operating income (%)	Percentage change in operating costs (%)	Percentage change in gross profit margin (%)
Machine tools	898,760,425.29	724,801,016.49	19.36	(41.95)	(36.93)	Decreased by 6.42 percentage points
Turbo machines	187,550,670.49	155,652,343.25	17.01	(26.95)	(29)	Increased by 2.40 percentage points

Analysis of principal activities by products						
Products	Operating income	Operating costs	Gross profit margin (%)	Percentage change in operating income (%)	Percentage change in operating costs (%)	Percentage change in gross profit margin (%)
Horizontal boring and milling machine tools	231,307,425.96	225,705,366.13	2	(61)	(58)	Decreased by 7 percentage points
Floor-type boring and milling machine tools	303,678,268.11	232,729,479.85	23	(51)	(43)	Decreased by 11 percentage points
Table-type boring and milling machine tools	137,361,463.73	106,486,098.04	22	26	51	Decreased by 13 percentage points
Horizontal products machining center	101,092,078.24	65,317,060.45	35	(33)	(20)	Decreased by 10 percentage points
Gantry boring and milling machine tools	82,380,341.88	68,808,263.02	16	36	(98)	Decreased by 26 percentage points
Turbo machines	187,550,670.49	155,652,343.25	17	(27)	(29)	Increased by 2.40 percentage points
Others	42,940,847.37	25,754,748.64	40	283	202	Increased by 16 percentage points

The gross profit margin of machine tool business decreased by 6.42 percentage points: the profit of the Company mainly derived from the sales of machine tool products. The decrease in sales volume for the year resulted in a decrease in production, led to an increase in the proportion of staff cost in the unit product cost. Therefore, though the total wages for the year decreased, the proportion of staff costs in production costs increased, resulting in a relatively significant decline in the gross profit margin of products.

# DIRECTORS' REPORT

## 3. Assets and liabilities

### 1. Table of assets and liabilities

*Unit: RMB*

Item	Closing balance for 2012	Percentage of total assets (%)	Closing balance for 2011	Percentage of total assets (%)	Percentage change in
					closing balance (%)
Cash at bank and on hand	98,887,040.73	3.88	192,200,330.65	7.51	(48.55)
Bills receivable	74,194,825.88	2.91	104,034,946.22	4.07	(28.68)
Accounts receivable	296,885,249.95	11.65	284,945,522.91	11.14	4.19
Prepayments	38,170,658.92	1.50	79,699,344.86	3.11	(52.11)
Inventories	1,011,927,770.40	39.70	983,679,390.52	38.45	2.87
Construction in progress	182,359,702.75	7.15	119,146,793.10	4.66	53.05
Intangible assets	69,000,264.01	2.71	35,378,639.17	1.38	95.03
Long-term deferred expenses	1,926,385.55	0.08	1,365,116.55	0.05	41.12
Deferred tax	62,869,275.31	2.47	46,245,088.62	1.81	35.95

Item	Closing balance for 2012	Percentage of total liabilities (%)	Closing balance for 2011	Percentage of total liabilities (%)	Percentage change in
					closing balance (%)
Accounts payable	506,762,578.19	42.76	363,932,002.93	33.03	39.25
Advances from customers	339,341,062.27	28.63	433,353,771.35	39.33	(21.69)
Other non-current liabilities	66,773,920.91	5.63	41,490,702.91	3.77	60.94

- A. The decrease in cash at bank and on hand was due to the decrease in the sales of the Company's products for the period, resulting in the decrease in receiving payments from sales and the decline in the proportion of total assets;
- B. The decrease in bills receivable was due to the decrease in receiving payments from sales and extensive use of acceptance notes endorsement to pay for materials during the period, resulting in the decline in the proportion of total assets of bills receivable;
- C. The increase in accounts receivable was due to difficulties in recovering amounts due from customers for the period, representing a slight increase in the proportion of total assets over the same period last year;

Currently, the Company has assigned certain individual to sort out the accounts receivable which required cooperation from the finance department and the sales and marketing department and communication with the customers, so as to formulate policy and step up efforts to collect these money. Meanwhile, the Company enhanced and improved after-sale services, so as to effectively uplift customer satisfaction.

- D. The decrease in prepayments was due to the decrease in prepayments for materials for the period, representing a decrease in the proportion of total assets over the same period last year;
- E. The increase in inventories was due to the decrease in sales of the Company for the period, resulting in slight increase in inventories, representing a slight increase in the proportion of total assets over the same period last year;
- F. The increase in construction in progress was due to the heavy casting base of the Company being under construction for the period, representing a significant increase in the proportion of total assets over the same period last year;

## DIRECTORS' REPORT

- G. The increase in intangible assets was due to the acquirement of land use rights for a land of 200 mu at Yanglin Base for the period, representing an increase in the proportion of total assets;
- H. The increase in long-term deferred expenses was due to the reconstruction of sheet metal workshop, representing a slight increase in the proportion of total assets over the same period last year;
- I. The increase in deferred tax assets was due to the increase in deductible temporary difference as a result of provision for bad and doubtful debt, government grants and deductible losses, representing a slight increase in the proportion of total assets over the same period last year;
- J. The increase in accounts payable was due to the extension of payment term for purchased materials for the period, representing a slight increase in the proportion of total liabilities over the same period last year;
- K. The decrease in advances from customers was due to the decrease in prepayments received from customers as a result of the decrease in contracted sales for the period over the same period last year, representing a decrease in the proportion of total liabilities;
- L. The increase in other non-current liabilities was due to the receipt of specific grants for the infrastructure of Yanglin Base and specific appropriation from the government for major national projects, representing an increase in the proportion of total liabilities.

#### 4. Analysis of core competitiveness

1. Technical advantages of products: horizontal boring and milling machine tool and CNC floor-type boring and milling machine tool series products are the main flagship and core products of the Company. Horizontal boring and milling machine tools, being complicated in structure and difficult to manufacture, represent the Company's traditional strengths. CNC floor-type boring and milling machine tool series products are heavy machine tools successfully developed by the Company, which are the first in China to apply home-made simple numerical control system to control the coordinates of motion of machine tools. The technology was commercialized soon after its successful R&D. Through years of continuous improvement to enhance the technical level and technology content of the products, especially the breakthrough in simultaneous motion of five axes, the overall level of this series ranked top in China. Meanwhile, the continuous diversification of specifications and varieties of this series made it one of the most competitive leading products of the Company. The Company is the only manufacturer in the PRC that has the capability to design and manufacture the jig boring machine tools, targeting at the high-end customers, which represented the Company's special status and influence in the machine tool industry.
2. Strength in technology platform: the Company has a national level enterprise technology center, representing the Company's competitive strength and important position in the precision machine tools area in China, which will play an important role in further enhancement of the Company's technological innovation, improvement of R&D capability and market competitiveness of products, and achieving sustainable development. The Company's applications for listing the "THM- $\mu$  series precision horizontal products machining center" and "technology innovation platform for precision horizontal and vertical products machining center" as major national special science and technology projects on technology of "high-end CNC machine tool and fundamental manufacturing machinery", the "key technology in designing and manufacturing precision CNC jig boring machine tools" as a project under the National High-tech Research and Development Program (863 Program), and the "research and development of XK2850 CNC gantry boring and milling machine tools" as a project under the development program of key and new products of Yunnan Province were all approved.



## DIRECTORS' REPORT

3. Strength in precision manufacturing: the Company carried forward its tradition of precision manufacturing in recent years, researched and developed multiple precision products. The Company undertook 2009 special project of "THM series 46100/65160 precision horizontal products machining center" and 2010 special project of "TGK46100 high precision CNC horizontal jig boring machine tools" among the major national special science and technology projects on technology of "high-end CNC machine tool and fundamental manufacturing machinery". For example, the THM46100 high precision horizontal products machining center is a latest researched and developed product with high torque, high precision and high speed, which is highly automatic and enjoys fully independent intellectual property rights. Most of the precision parameters of this product have reached the advanced world levels, while some were close to those. The product is capable to process high precision products at high speed in the case of heavy load and high torque. The latest research results of the generic technology such as structure optimization, heat distortion, vibration control etc. obtained through the collaboration among enterprises, colleges and research institutes provide powerful technology support to the outstanding performance indicators and high reliability of the machine tools.

### 5. Investing activities

#### 1. Entrusted investment of non-financial entities and investment in derivatives

- (1) Entrusted investment  
There was no entrusted investment of the Company during the year.
- (2) Entrusted loan  
There was no entrusted loan of the Company during the year.

#### 2. Information of major subsidiaries and invested companies

Name	Place of registration	Scope of business	Registered capital RMB ten thousand	Investment Proportion	Nature	Date of investment	Relationship with the Company
Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. ("Xi'an Ser")	Xi'an city	Design, development and sales of turbo machines, energy saving sintering fans, compressor equipment, research and re-modification of imported equipment and its parts, automated control system engineering, CNC engineering, mechanical and chemical equipment, meter technology development, whole machine production and sales	5,000	45.00%	Limited liability	2001.12	Subsidiary
Kunming Kunji General Machine Co., Ltd.	Kunming city	Development, design and sales of machine tool products and accessories	300	100.00%	Limited liability (wholly owned by legal person)	2007.10	Subsidiary
Kunming TOS Machine Tool Manufacturing Co., Ltd. ("Kunming TOS")	Kunming city	Development, design, production and sales of self-produced machine tool series products and accessories; development of high-tech products, transfer of self-developed technology, provision of technical services and technical advisory; provision of repairs and processing of machine tool products for third parties	5,000,000 Euros	50.00%	Limited liability	2005.4	jointly controlled enterprise
Changsha Ser Turbine Machinery Co., Ltd. ("Changsha Ser") (note 1)	Changsha city	Production and sales of centrifugal compressors, centrifugal blowers, sintering fans and its accessories	1,000	100%	Limited liability	2004.01	Subsidiary of Xi'an Ser

# DIRECTORS' REPORT

Name	Place of registration	Scope of business	Registered capital RMB ten thousand	Investment Proportion	Nature	Date of investment	Relationship with the Company
Hangzhou Ser Gas Engineering Co., Ltd. ("Hangzhou Ser") (note 2)	Hanzhou city	Contracting: design, development, sales and technology support of gas equipment engineering, compressors, sintering fans, whole sintering fan equipment, low-temperature machines, automated control system equipment and its parts; wholesale and retail: mechanical and electrical products, building materials, hardware tools, metal materials; operation of import/export businesses; all legally valid projects not subject to review and approval	120	11.45%	Limited liability	2004.04	Subsidiary of Xi'an Ser
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite")	Xi'an city	Laser prototyping machine	6,000	23.34%	Limited liability	2006	Associate
Fujian Kunji Conventional Machine Tool Co., Ltd. (note 3)	Nanan city	Development, design, production and sales of self-produced machine tool series products and accessories	500	50.00%	Limited liability	2008	Subsidiary

## Notes:

1. With approval from the Administration for Industry and Commerce of Changsha City, Hunan Province, Changsha Ser Turbo Equipment Co., Ltd. was renamed as Changsha Ser Turbine Machinery Co., Ltd. ("Changsha Ser") and obtained the renewed enterprise legal person business license (No. 430194000001977) on 16th May 2012.
  2. Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. ("Xi'an Ser"), a subsidiary of the Company, originally held 51% equity interest in Hangzhou Ser Turbo Equipment Co., Ltd. ("Hangzhou Ser"). The original registered capital of Hangzhou Ser was RMB1,200,000. In May 2012, the Group decided not to participate in the proposal on increase capital investment by other shareholders of Hangzhou Ser. According to a resolution passed by the shareholders at the general meeting and the amended articles of association of Hangzhou Ser, its two shareholders who are natural persons made additional contribution to the company in an aggregate amount of RMB8,800,000, increasing their respective shareholding in Hangzhou Ser to 46.55% and 42% upon such additional contribution. The original capital investment of RMB612,000 by Xi'an Ser which accounted for 51% of the share capital would represent 11.45% of the shareholdings in Hangzhou Ser after the increase capital investment. After the completion of the increase capital investment, Hangzhou Ser would cease to be a subsidiary of the Group and would not be consolidated in the financial statements.
  3. The Company transferred its 50% equity interest of Fujian Kunji Conventional Machine Tool Company Limited by putting it to open tender on Yunnan Equity Exchange Co., Ltd. at a transferring price of RMB1,000,000 with reference to the asset evaluation. The transferee of this equity interest transaction was Fujian Chenggong Machine Tool Company Limited. The base date of the transaction was 28th December 2012 and the transferring price was RMB1,000,000. After completion of the transaction on 28th December 2012, the Company no longer held any equity interest of Fujian Kunji Conventional Machine Tool Company Limited.
3. *Use of proceeds from non-raised fund*
- During the reporting period, there were no proceeds from non-raised funds.

# DIRECTORS' REPORT

## II. DISCUSSION AND ANALYSIS OF THE BOARD ON THE COMPANY'S FUTURE DEVELOPMENT

### 1. Landscape of competition and development trend of the industry

In 2012, the production volume of metal cutting machine tools of China was 600,000 sets, representing a decrease of 15.7% over the same period last year. In 2011, the production volume of metal cutting machine tools of China was 860,000 sets.

Since 2012, the imports amount and volume of metal cutting machine tools of China had recorded a month-on-month increase, but the average unit price gradually decreased. From January to November 2012, China imported 101,608 sets of metal cutting machine tools, representing a decrease of 3.7% over the same period last year; and the amount of imports was approximately US\$12.57 billion, representing a year-on-year increase of 5.0%; while the average unit price of imports was US\$124,000 per set.

### 2. Development strategies of the Company

Based on its development strategies and in order to cope with the changes in market demand, the Company sets the target of "precise, large-scale, complex and full-spectrum" as its future technology positioning for its products while focusing on precision manufacturing. The Company seeks to "integrate precision into high-end products and excellence into low-end products" in the principle of "being the best instead of the largest" according to its business development strategy focusing on "uniqueness, brand, profitability".

In the mean time, the Company will leverage on its technical advantages of products and strengths in technology platform and precision manufacturing to speed up the adjustment of product structure and narrow the gap with international advanced level. KMTCL has reached an agreement with SCHIESS GmbH, a world-famous machine tool enterprise, to introduce its proprietary technology for large and heavy-duty, high-precision CNC gantry boring and milling machine tools, CNC vertical lathes and components (milling head), so as to lay the technology and product bases for the future strategic development of KMTCL.

### 3. Operating plan

The business targets for 2013: to achieve a revenue of RMB1.45 billion and an aggregate profit of RMB25 million.

In light of the market condition in 2012 and based on its analysis on the economic and market prospect of 2013, the Company formulated its development plan for 2013, which will be achieved mainly by innovating its operation model and steadily promoting its transformation into an industrial service provider. Upholding the annual operating guideline focusing on "seizing contracts and orders and ensuring collection of accounts receivable", the Company will implement the following measures to ensure fulfillment of the business targets:

- 1) To focus on the market and proactively cooperate with the business departments to seize orders and undertake business from external customers;
- 2) To consolidate and further expand the market share of its major horizontal and floor-type products by focusing on middle and high-end customers, refining industry segments and studying the needs of customers, with an aim to exploring new market for its CNC products and seeking for new breakthrough in the international market;
- 3) To promote the consolidation of production and services, so as to improve the timeliness and effectiveness of post-sale services;
- 4) To enhance the development of major marketing channels and steadily promote the establishment of flagship stores and franchise shops;

## DIRECTORS' REPORT

- 5) Leveraging on the capacity of the processing, casting and general business departments to provide complementary services, to actively explore the external markets to increase income;
- 6) To sort out and collect the accounts receivable, which will be included in the assessment of performance of the staff for the year, while implementing strict control over the costs and expenses.

#### **4. Liquidity requirements of the Company for maintaining current operation and completing an investment project under construction**

The completion of an investment project under construction requires RMB400 million. The project mainly comprises the construction of test platform and infrastructure in relation to the introduction of SCHIESS project at the precision machine tools heavy casting base in Yanglin, which is to provide support to facilitate the implementation of the project and for the introduction, digestion and absorption of technology. In consideration of the internal and external environments and operating conditions, the Company intends to implement the project investment in phases and stages. The main reason for maintaining this investment plan is that the project is in line with the Company's strategic development priorities, and the main source of funds to be invested is the Company's own funds.

#### **5. Potential risks**

In the development process of the industry over the past decade, we mainly relied on the domestic policy guidance, the strong driving force of market demand, the power of development released from the reform of enterprises' institutional mechanisms, the comparative advantage in labor costs and the strong support of the national industrial policy. In contrast, the role of technical progress and management innovation is secondary. In a sense, the continued strong demand of domestic market for medium to low-end products objectively retarded the process of technological progress of industry, management upgrade and improvement of the quality of workforce. As a result, the enterprises will face more challenging market environment and operation and management challenges after the transformation of China's economic growth model and adjustment of macro-economic policies.

### **III. EXPLANATION OF THE BOARD ON THE "NON-STANDARD AUDIT REPORT" ISSUED BY THE AUDITOR**

#### **1. Explanation of the Board and the Supervisory Committee on the "non-standard audit report" issued by the auditor**

✓ Not applicable

#### **2. Analysis and explanation of the Board on the reasons for and impacts of the changes in accounting policies, accounting estimates and auditing methods**

✓ Not applicable

#### **3. Analysis and explanation of the Board on the reasons for and impacts of corrections of material accounting errors of prior periods**

✓ Not applicable

## DIRECTORS' REPORT

### IV. PROPOSAL ON PROFIT DISTRIBUTION OR CAPITALIZATION OF CAPITAL RESERVE TO INCREASE SHARE CAPITAL

#### 1. Formulation, implementation and adjustment of cash dividends policy

The second amendment of 2012 to the Articles of Association of the Company – policy of cash dividend was approved by the shareholders at the second extraordinary general meeting of 2012 which was held on 16th October 2012. The amendment clarifies the proportion of cash dividend as set out in the main terms of Article 233 profit distribution of the Company: “under the circumstance of having positive undistributed profit, the profit distributed by cash by the Company for three consecutive years in aggregate shall not be less than 30% of the distributable profit for the three years. Should the above proportion could not be achieved by exceptional circumstances, the board of directors shall make specific explanation to the shareholders’ meeting.”

2. If the Company records profits and the parent company records positive undistributed profits but there is no proposal for cash dividends during the reporting period, the Company shall specify the reasons for doing so and the usage of the undistributed profits and disclose the usage plan in detail

✓ Not applicable

#### 3. Profit distribution or capitalization of capital reserve to increase share capital and distribution of dividends of the Company for the preceding three years:

Unit: RMB'000

Year	Number of bonus shares for every 10 shares (share)	Amount of dividends for every 10 shares (Yuan) (tax inclusive)	Number of shares converted for every 10 shares (share)	Amount of cash dividends (tax inclusive)	Net profits attributable to the shareholders of the listed Company in the consolidated financial statement for the year of distribution	Percentage of the net profits attributable to the shareholders of the listed Company in the consolidated financial statement (%)
2012	–	–	–	–	–	–
2011	–	0.20	–	10,621	54,567	19.46
2010	–	0.50	–	26,554	178,325	14.89

### V. ACTIVE FULFILLMENT OF SOCIAL RESPONSIBILITY

#### 1. Fulfillment of social responsibility

(See the report on social responsibilities of the Company published on the website of the Company ([www.kmtcl.com.cn](http://www.kmtcl.com.cn)) and the website of Shanghai Stock Exchange ([www.sse.com.cn](http://www.sse.com.cn)) on 28th March 2013 for details).

## SIGNIFICANT EVENTS

### I. PRE-EMPTIVE RIGHTS

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

### II. WARRANTS AND OTHERS

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

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

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

### IV. BANK LOANS, OVERDRAFT AND OTHER BORROWINGS

Details of bank loans, overdrafts and other borrowings as at 31st December 2012 are set out in the notes to the financial statements.

### V. FINANCIAL RESOURCES AND CAPITAL STRUCTURE OF THE GROUP

For the year ended 31st December 2012, the Group had no long-term borrowings and the Group had borrowing due within one year of RMB10,500,000. The Group maintains a sound credit condition with a high margin product mix and has sufficient cash flow for future repayment of liabilities due.

As at the end of 2012, the shareholders' equity of the Group was RMB1,363,590,000, compared to RMB1,456,685,000 as at the end of 2011.

### VI. GEARING RATIO

The shareholders' equity to debt ratio of the Group for 2012 was 1.16, compared to 1.32 in 2011.

### VII. CONTINGENT LIABILITIES

Details of contingent liabilities of the Company as at 31st December 2012 are set out in the notes to the financial statements.

### VIII. MAJOR LITIGATION, ARBITRATION AND MATTERS COMMONLY QUESTIONED BY MEDIA

The Company was not involved in any major litigation and arbitration and did not have matters commonly questioned by media during the year.

### IX. EMBEZZLEMENT OF FUNDS AND REPAYMENT OF DEBT DURING THE REPORTING PERIOD

✓ Not applicable

### X. BANKRUPTCY AND RESTRUCTURING RELATED MATTERS

None

# SIGNIFICANT EVENTS

## XI. ASSETS TRANSACTIONS AND MERGER OF COMPANIES

✓ Not applicable

## XII. EQUITY INCENTIVES OF THE COMPANY AND ITS EFFECT

✓ Not applicable

## XIII. RELATED PARTY TRANSACTIONS OF THE COMPANY DURING THE REPORTING PERIOD

1. Kunming Kunji Group Co., Ltd. was authorized by the People's Government of Yunnan Province to succeed the rights and obligations of the "The Land Use Rights Rental Agreement" and "The Premise Rental Agreement" signed between the People's Government of Yunnan Province and the Company on 12th November 2001. On 31st January 2011, the Company entered into an agreement for rental adjustment with Kunming Kunji Group Co., Ltd.. The annual rent of land use rights was adjusted to RMB4,457,340.00, and the annual rent of premises was adjusted to RMB792,660.00. The adjusted annual rent was effective from 12th November 2010 to 11th November 2013.

Under the agreement for rental adjustment above, the Company incurred a rental totalling RMB5,250,000 in respect of the land and premises leased from Kunming Kunji Group Co., Ltd. for 2012.

2. As approved by the first extraordinary general meeting for 2011 held on 18th July 2011, the Company entered into Technologies License Contract with Schiess GmbH, under which the Company introduced from Schiess GmbH the design, manufacture and installation technical know-how of the double column portals for cross rail profile of 2000 mm ("contract products"), together with an exclusive and non-transferable license right to use the technical know-how to manufacture in China and sell the contract products in Asia. The contract expenses consist of 6,600,000 Euros of one-off license fee, 700,000 Euros of staff training fee and 200,000 Euros paid for technical services of two prototype machines with Machine Models VMG6 and VM8, and the maximum budget for the purchase of assembly parts of VMG6 and VM8 prototype machines of 7,360,651 Euros.

According to the terms and conditions of the contract, the Company paid 2,261,256.83 Euros (equivalent to RMB18,844,219.15) of sample fee for VMG6 to Schiess GmbH in 2012.

The Company paid 20% of one-off license fee (i.e. 1,320,000 Euros, equivalent to RMB10,575,351.60) to Schiess GmbH in 2012.

3. On 4th August 2011, the Company entered into (1) Lathes Supply Framework Agreement with Yunnan CY Group; (2) Packaging Materials Supply Framework Agreement with Yunnan CY Group Jinhui Coating Factory; and (3) Vertical Lathes and Radial Drilling Lathes Supply Framework Agreement with Shenyang Machine Tool Holding Company Limited. The term of the agreements was effective from the date approved at the general meeting to 31st December 2013 (the Framework Agreement signed with Shenyang Machine Tool Holdings Limited should also be subject to the approval at the general meeting of the company) and the annual caps of purchasing are listed as follows:

*Unit: RMB ten thousand*

Related party	Yunnan CY Group Co., Ltd.	Yunnan CY Group Jinhui Coating Factory	Shenyang Machine Tool Holding Company Limited	Total
As at 31st December 2011	400	400	1600	2400
As at 31st December 2012	500	500	1800	2800
As at 31st December 2013	600	600	2000	3200
Total	1500	1500	5400	8400

## SIGNIFICANT EVENTS

4. The Company entered into the leasing contract with Yunnan State-owned Assets Property Management Company Limited (“Property Management Co.”), which is the subsidiary of the Company’s shareholder – Yunnan Industrial Investment Holding Group Co., Ltd., to lease the man-made cavern, originally used as the fleet repair workshop and place of the Company. The total leasing area is 10,465.96 square meters. The Property Management Co. requested to adjust the rental referring to the fair market value. After negotiation, the following terms have been achieved: a. the rental of the first year will be RMB989,150; b. the rental of the next year will be increased by 10% based on that of the previous year, i.e. the rental of the second year will be RMB1,088,065 and the rental of the third year will be RMB1,196,871; c. the rental is effective for a period of three years from 1st January 2011 to 31st December 2013.

The independent non-executive directors of the Company had issued independent opinions on the above connected transactions: the above connected transactions were entered into in the ordinary and usual course of business on normal commercial terms through arm’s length negotiations and were in the interests of the Company and the shareholders in a whole. These transactions were made without prejudice to the interests of the Company and its other shareholders, especially minority shareholders and non-connected shareholders.

The auditor of the Company was engaged to report on the continuing connected transactions of the Company as defined under the Hong Kong Listing Rules (ie. those set out above in items 1 and 3) in accordance with Hong Kong Standard on Assurance Engagements 3000 “Assurance Engagements Other Than Audits or Reviews of Historical Financial Information” and with reference to Practice Note 740 “Auditor’s Letter on Continuing Connected Transactions under the Hong Kong Listing Rules” issued by the Hong Kong Institute of Certified Public Accountants, indicating that:

- (a) nothing has come to their attention that causes them to believe that the disclosed continuing connected transactions have not been approved by the Board.
  - (b) for continuing connected transactions involving the provision of goods or services by the Group, nothing has come to their attention that causes them to believe that the transactions were not, in all material respects, in accordance with the pricing policies of the Group.
  - (c) nothing has come to their attention that causes them to believe that the continuing connected transactions were not entered into, in all material respects, in accordance with the relevant agreements governing such transactions.
  - (d) with respect to the aggregate amount of each of the above continuing connected transactions, nothing has come to their attention that causes them to believe that the disclosed continuing connected transactions have exceeded the respective annual caps disclosed in the previous announcements made by the Company in respect of each of the disclosed continuing connected transactions.
5. On 4th February 2013, the Board approved the daily connected transaction between the Company and Kunming TOS Machine Tool Manufacturing Co., Ltd. (a related party) during the year 2012 in relation to purchase of goods, receipt of services, sales of goods and provision of services. The connected transaction was approved at the first extraordinary general meeting of 2013 held on 22nd March 2013.

## XIV. MATERIAL CONTRACTS AND THEIR PERFORMANCE

### 1. Escrow agency, contracting and lease matters

✓ Not applicable

### 2. Guarantee

✓ Not applicable

### 3. Other material contracts

None



# SIGNIFICANT EVENTS

## XV. PERFORMANCE OF COMMITMENTS

### 1. Commitments of the Company, shareholders holding over 5% shares of the Company, controlling shareholder and beneficial controller made or subsisting during the reporting period

Background of commitment	Type of commitment	Commitment making party	Content of commitment	Date of commitment and duration	Is there a fulfillment time limit	Whether duly and timely fulfilled	Specify reasons for failure in fulfillment in time	Specify further steps in case of failure in fulfillment in time
Commitment in relation to share reform	Other	Shenyang Machine Tool (Group) Co., Ltd.	It would provide full support to the business development of the Company in terms of technology, business and resources and would consolidate the relevant resources and markets by leveraging on its own unique strengths based on the principles and models favorable to accelerating the growth of the Company within two years after the completion of the share transfer and share reform with a view to developing Kunming Machine Tool as an important platform for technological upgrade, business expansion and sector growth to provide comprehensive support and facilitate the sustainable and healthy development of the Company. Currently, Shenyang Machine Tool (Group) Co., Ltd. has introduced production management officers to the Company in order to facilitate the enhancement of the production management capabilities and provide convenience for the exports of the Company in terms of market expansion.		No	Yes		

## XVI. APPOINTMENT AND REMOVAL OF AUDITORS

Any change of auditor:	No
Domestic auditor	Currently engaged KPMG Huazhen (Special General Partnership)
Term of domestic auditor	2 years
Internal control auditor	<b>Name</b> KPMG Huazhen (Special General Partnership)

KPMG Huazhen is a Mainland audit firm approved by the Ministry of Finance and the CSRC who is eligible to act as auditor for Mainland incorporated companies listed in Hong Kong. Therefore, the board of directors of the Company considered to re-appoint KPMG Huazhen as the Company's auditor and internal control auditor for the year 2012. The issue regarding re-appointing auditor has been approved at the annual general meeting of 2011.

In August 2012, the Company was notified in written by KPMG Huazhen that it had recently completed the conversion into the special general partnership in accordance with the "Notice on the 'Sino-foreign Joint Venture Accounting Firms Localisation Conversion Program'" (Cai Kuai [2012] No.8) and obtained its business license in July 2012. Following the conversion, the full name of KPMG Huazhen has been changed to "KPMG Huazhen (Special General Partnership)". KPMG Huazhen (Special General Partnership) has been approved to count its qualifying operating period and results to include those of the former entity, KPMG Huazhen. Its professional certifications (including its securities and futures certification) have also been extended.

## SIGNIFICANT EVENTS

### XVII. PENALTIES ON THE COMPANY, ITS DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS, SHAREHOLDERS HOLDING OVER 5% SHARES OF THE COMPANY, BENEFICIAL CONTROLLER AND ACQUIRER, AND RECTIFICATION ISSUES

None

### XVIII. OTHER SIGNIFICANT EVENTS

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

A liquidation team has been established. Presently, the liquidation team is processing the liquidation in accordance with the relevant laws and statutory procedures. And the liquidation is substantially completed by now. However, the Company considered continuing its business expansion via that company subsequently. As such, the cancellation is suspended.

2. On 10th August 2012, the Company transferred its 50% equity interest of Fujian Kunji Conventional Machine Tool Company Limited by putting it to open tender on Yunnan Equity Exchange Co., Ltd. at a transferring price of RMB1,000,000 with reference to the asset evaluation. The Board considered that the transfer was in the interest of the Company and its shareholders as a whole and was beneficial to the development of the Company in the future. Subsequently the Company received a notice from Yunnan Equity Exchange Co., Ltd. which confirmed that the transferee of this equity interest transfer transaction was Fujian Chenggong Machine Tool Company Limited. The base date of the transaction was 28th December 2012 and the transferring price was RMB1,000,000. After completion of the transaction, the Company no longer held any share of Fujian Kunji Conventional Machine Tool Company Limited. According to the agreement, after the transferring, the liabilities and obligations of the transferee shall be:

- 1) handling industrial and commercial registration changes in company name, legal representative, equity interest etc., no longer using the original company name;
- 2) no longer using the original trademark "Kunji".

3. Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. ("Xi'an Ser"), a subsidiary of the Company, originally held 51% equity interest in Hangzhou Ser Turbo Equipment Co., Ltd. ("Hangzhou Ser"). The original registered capital of Hangzhou Ser was RMB1,200,000. In May 2012, the Group decided not to participate in the proposal on increasing capital investment by other shareholders of Hangzhou Ser. According to a resolution passed by the shareholders at the general meeting and the amended articles of association of Hangzhou Ser, its two shareholders who are natural persons made additional contribution to the company in an aggregate amount of RMB8,800,000, increasing their respective shareholding in Hangzhou Ser to 46.55% and 42% upon such additional contribution. The original capital investment of RMB612,000 by Xi'an Ser which accounted for 51% of the share capital would represent 11.45% of the shareholdings in Hangzhou Ser after the increase of capital investment. After the completion of the increase of capital investment, Hangzhou Ser would cease to be a subsidiary of the Group and would not be consolidated in the financial statements.

4. Impact of the construction of Yanglin Base on the results of the Company

At the second extraordinary general meeting of 2009 held on 29th September 2009, the proposal on land acquisition for building Yanglin Heavy Casting Base was approved, and the investment and construction of the new base commenced. At the 2009 annual general meeting held on 23rd June 2010, the proposal on implementing the first stage construction under the phase one of Yanglin Heavy Casting Base project by investing RMB315 million was approved. At the second extraordinary general meeting of 2011 held on 21st September 2011, the proposal on kicking off the first stage construction of the 60 thousand tons heavy casting workshop under the phase two of Yanglin Base with an investment amount of RMB415 million was approved.

## SIGNIFICANT EVENTS

Item	Approved budget	Investment percentage to total budget	Project progress	Source of the fund	Closing balance
Heavy casting base	RMB730 million	23.84%	36%	Self-financing and budgetary investment of central government	RMB174 million

As at the end of 2012, the Company mainly invested in and constructed the first stage of heavy equipment plant under the phase one of Yanglin Base project which has not been put into operation, and the construction of the first stage of heavy casting workshop under the phase two project has not commenced due to adjustment to the overall planning. According to the progress of the investment and construction of the base at this stage, the project is not able to support the Company in terms of results.

The economic and market environment was favorable when the whole project kicked off in 2009. Due to the large amount of overall investment and long term construction, the Company planned to gradually implement the project by self-financing and budgetary investment of central government during a certain period. Given the potential change of economy and industry during the investment and construction cycle, the Company had specified in the original overall planning that the project should be constructed in stages and phases. Along with the gradual downturn of market condition after 2010, the operation of the Company slowed down. Therefore, the Company adjusted the amount and intensity of investment and construction of Yanglin Base project in a timely manner, so as to gradually reduce and slow down its investment and construction. Such adjustments were made in line with the macro environment and the actual situation of the Company, which is an effective strategy to prevent excessive investments and avoid risks.

The purpose of building Yanglin Base is to enable the Company to manufacture precision heavy and large-scale CNC products. Upon the completion of the construction of this Base, the Company's production capacity will be enhanced, the plants, facilities and equipments will be improved, and the Base will have the capability to become a product experimental and manufacturing platform for the major national special science and technology projects or the introduction of advanced foreign technologies, which will ensure the smooth implementation of medium to long term strategic development planning of the Company.

The Company intends to effectively maintain rational investment and construction in light of the future development of economy and market, make sure to focus on key aspects of the project taking into account the internal and external conditions, and consider the impact of construction of the Base on the Company from a comprehensive point of view.

# CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

## I. CHANGES IN SHARE CAPITAL

### 1. Table of changes in share capital of the Company

	Before the change		Increase/Decrease (+/-)				Unite: share After the change		
	Number of shares	Proportion (%)	Issue of new shares	Issue of bonus shares	Transfer from capital reserve	Other	Subtotal	Number of shares	Proportion (%)
I. Shares subject to selling restrictions									
1. State-owned shares	-	-	-	-	-	-	-	-	-
2. State-owned legal person shares	-	-	-	-	-	-	-	-	-
3. Other domestic shares									
Including:									
Shares owned by domestic non-state- owned legal person	-	-	-	-	-	-	-	-	-
Shares owned by domestic natural person	-	-	-	-	-	-	-	-	-
4. Foreign owned shares									
Including:									
Shares owned by foreign legal person	-	-	-	-	-	-	-	-	-
Shares owned by foreign natural person	-	-	-	-	-	-	-	-	-
II. Circulating shares not subject to selling restrictions	531,081,103	100	-	-	-	-	-	531,081,103	100
1. RMB ordinary shares	390,186,291	73.47	-	-	-	-	-	390,186,291	73.47
2. Domestic listed foreign shares	-	-	-	-	-	-	-	-	-
3. Overseas listed foreign shares	140,894,812	26.53	-	-	-	-	-	140,894,812	26.53
4. Others	-	-	-	-	-	-	-	-	-
III. Total number of shares	<u>531,081,103</u>	<u>100</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>531,081,103</u>	<u>100</u>

### 2. Changes in selling restricted shares

During the reporting period, the Company did not have any selling restricted shares.

## II. ISSUANCE AND LISTING OF SECURITIES

### 1. Issuance of securities in the past three years as at the end of the reporting period

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

### 2. Changes in total share capital and share structure and changes in assets and liabilities of the Company

During the reporting period, there were no changes in the total share capital and share structure of the Company resulting from issue of bonus shares and placement.

### 3. Information of existing employee shares

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

# CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

## III. SHAREHOLDERS AND BENEFICIAL CONTROLLERS

### 1. Number of shareholders and shareholdings

Total number of shareholders as at the end of the reporting period 47,748

#### Shareholdings of the top ten shareholders

Unit: Share

Name of shareholders	Nature of shareholders	Percentage (%)	Total number of shares held	Increase/Decrease during the reporting period	Number of selling restricted shares held	Number of shares pledged or frozen
HKSCC NOMINEES LIMITED	Unknown	25.27	133,976,900	-	-	Unknown
Shenyang Machine Tool (Group) Co., Ltd.	State-owned legal person	25.08	133,222,774	-	-	No
Yunnan Industrial Investment Holding Group Co., Ltd.	State-owned legal person	11.07	58,772,913	-	-	No
CHAN KWOK TAI EDDIE	Unknown	0.53	2,800,000	-	-	Unknown
Kunming Jinghua Co.	Domestic non-state-owned legal person	0.49	2,609,825	-	-	Unknown
Essence Securities Co., Ltd. – client credit trading guarantee securities account	Unknown	0.47	2,489,700	-	-	Unknown
Wu Runhuan	Unknown	0.31	1,628,700	-	-	Unknown
Beijing Haifeng Media Co., Ltd.	Unknown	0.30	1,587,300	-	-	Unknown
CAI QINGSHAN	Unknown	0.20	1,083,806	-	-	Unknown
LIN JIANMING	Unknown	0.13	702,306	-	-	Unknown

#### Selling unrestricted shares held by the top ten shareholders

Name of shareholders	Number of selling unrestricted shares	Type of shares
HKSCC NOMINEES LIMITED	133,976,900	Overseas listed foreign shares
Shenyang Machine Tool (Group) Co., Ltd.	133,222,774	RMB ordinary shares
Yunnan Industrial Investment Holding Group Co., Ltd.	58,772,913	RMB ordinary shares
CHAN KWOK TAI EDDIE	2,800,000	Overseas listed foreign shares
Kunming Jinghua Co.	2,609,825	RMB ordinary shares
Essence Securities Co., Ltd. – client credit trading guarantee securities account	2,489,700	RMB ordinary shares
Wu Runhuan	1,628,700	RMB ordinary shares
Beijing Haifeng Media Co., Ltd.	1,587,300	RMB ordinary shares
CAI QINGSHAN	1,083,806	Overseas listed foreign shares
LIN JIANMING	702,306	Overseas listed foreign shares

## CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

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

The Company was not notified of any connected relationship or acting in concert relationship regulated by "Information Disclosure Management Procedure to Changes of Shareholding of Listed Company" among the above shareholders of the Company.

Other than the substantial shareholders disclosed above, as at 31st December 2012, there were no other shareholders whose shareholdings exceeded the amount required to be disclosed under Article 60 of "Administration of the Issuing and Trading of Shares Provisional Regulations" of the PRC and Issue No.2 of "The Content and Format of Disclosure of Information of the Listed Companies" (amended in 2005); and under Section 16(1) of the Securities and Futures Ordinance under the Hong Kong Exchanges and Clearing Limited, the Company was not notified of any interests representing 10% or more of the issued share capital of the Company.

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

#### *Notes:*

- 1) HKSCC Nominees Limited holds shares on behalf of clients. The Company did not receive any notification that any holder of H Shares held more than 10% of total share capital of the Company. Holders of H Shares who held more than 5% of total share capital of H Shares were as follows: nil.
- 2) Save as disclosed above, the Directors were not notified that any person (who is not a Director or a chief executive officer) owns the interest or short position in the shares or underlying shares of the Company that shall be disclosed to the Company in compliance with the requirements contained in Divisions 2 and 3 of Part XV of Securities and Future Ordinance ("SFO"), or the interest or short position that shall be included in the prescribed register in accordance with Section 336 of SFO.
- 3) As at 31st December 2012, none of the Directors and the Supervisors had any interests or short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which shall be notified to the Company and the Hong Kong Stock Exchange pursuant to Division 7 and 8 of Part XV of the SFO, including interests or short positions which the Directors or the Supervisors are taken or deemed to have under such provisions of the SFO, or which are required to be recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code.

This issue was announced in accordance with the regulation – Notice of Supervising the Shareholders of Listed Companies Implementing the Rules on Lessening Terminated Selling Restricted Shareholding issued by Shanghai Stock Exchange.

# CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

## IV. CONTROLLING SHAREHOLDER AND BENEFICIAL CONTROLLER

### 1. Beneficial controller

#### 1. Legal person

Unit: RMB'000

Name	Shenyang Machine Tool (Group) Co., Ltd.
Person in charge or legal representative	Guan Xiyou
Date of incorporation	18th December 1995
Organization Code	24338125-8
Registered capital	1,556,480
Principal activities	Manufacturing of metal cutting machines, CNC machines and mechanical equipment; general commercial trading, technology trading, property leasing within the PRC, economic information consulting services.
Equity interests in other domestic and overseas listed controlling and invested companies during the reporting period	Shenyang Machine Tool (Group) Co., Ltd. holds 42.6% equity interest in Shenyang Machine Tool Co., Ltd., whose beneficial controller is Shenyang State-owned Assets Supervision and Administration Commission

## V. OTHER LEGAL PERSON SHAREHOLDERS HOLDING OVER 10% SHARES OF THE COMPANY

Unit: RMB'000

Name of legal person shareholder	Person in charge or legal representative	Date of incorporation	Organization code	Registered capital	Principal operating or managing activities
Yunnan Industrial Investment Holding Group Co., Ltd.	Gong Lidong	12th May 2008	67363734-8	6,000,000	Investment and financing, assets operation, merger and acquisition of enterprises, equity trading, state-owned assets trusted investment and trusted disposal in various industries and different business subject to the laws and regulations; domestic and international trade; other businesses approved by the Yunnan Provincial Government

# DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

## I. MOVEMENT IN SHAREHOLDING AND EMOLUMENTS

### 1. Movement in shareholding and emoluments of existing and resigned directors, supervisors and senior management during the reporting period

Name	Title	Gender	Age	Date of appointment	End date of appointment	Number of shares held at the beginning of the year	Number of shares held at the end of the year	Change in the number of shares held during the year	Reason for the change	Total emoluments received from the Company during the reporting period (RMB ten thousand) (before tax)
Wang Xing	Chairman, Executive director	Male	47	28th July 2011	31st October 2014	-	-	-	-	57.18
Li Zhenxiong	Vice chairman	Male	50	23rd March 2007	31st October 2014	-	-	-	-	0
Zhang Xiaoyi	Vice chairman, Executive director General manager	Male	48	31st October 2008 29th April 2008	31st October 2014 31st October 2014	- -	- -	- -	- -	53.58
Ye Nong	Executive director Vice general manager	Male	52	23rd June 2010 30th December 2006	31st October 2014 31st October 2014	- -	- -	- -	- -	47.69
Li Shunzhen	Executive director Financial controller	Female	40	31st October 2011 31st October 2011	31st October 2014 31st October 2014	- -	- -	- -	- -	46.84
Guan Xin	Non-executive director	Male	44	23rd June 2010	31st October 2014	-	-	-	-	5.71
Gao Minghui	Non-executive director	Male	49	28th July 2011	31st October 2014	-	-	-	-	47.18
Zhang Tao	Non-executive director	Male	42	31st October 2008	31st October 2014	-	-	-	-	0
Liu Minghui	Independent non-executive director	Male	48	23rd March 2007	22nd March 2013	-	-	-	-	14.29
Li Dongru	Independent non-executive director	Female	57	29th June 2007	29th June 2013	-	-	-	-	14.29
Chen Fusheng	Independent non-executive director	Male	48	16th June 2011	31st October 2014	-	-	-	-	20
Xiao Jianming	Independent non-executive director	Male	66	31st October 2011	31st October 2014	-	-	-	-	14.29
Shao Li	Chairman of the Supervisory Committee	Male	54	31st October 2008	31st October 2014	-	-	-	-	46.13
Fan Hong	Supervisor	Male	49	31st October 2008	31st October 2014	-	-	-	-	0
Tang Hua	Supervisor	Female	55	10th May 2011	18th March 2013	-	-	-	-	4.26
Cai Zhemin	Supervisor	Male	50	10th May 2011	31st October 2014	-	-	-	-	4.26
Qin Jianzhong	Supervisor elected by staff	Male	59	31st October 2011	31st October 2014	-	-	-	-	33.72
Zhu Xiang	Vice general manager	Male	47	20th August 2007	31st October 2014	-	-	-	-	39.64
Zhou Guoxing	Vice general manager	Male	50	10th April 2006	31st October 2014	-	-	-	-	38.23
Xu Kunping	Vice general manager	Male	43	10th February 2009	31st October 2014	-	-	-	-	39.85
Luo Tao	Secretary to the Board	Male	37	28th May 2008	31st October 2014	-	-	-	-	33.83



## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

**Wang Xing**, male, born in 1965. He graduated from Harbin University of Science and Technology majoring in auditing in 1989. He is currently an undergraduate of the MPACC at Dongbei University of Finance and Economics. In 1989, he worked for the Auditing Department of Shenyang First Machine Tool Factory. In early 1996, he worked for the Finance Department of Shenyang Machine Tool (Group) Co., Ltd. Later that year he joined the liquidation team of Shenyang Third Machine Tool Factory. In January 2001, he acted as the vice general manager and the head of Finance Department of Zhong Jie Machine Tool Co., Ltd. At the end of 2003, he worked as the vice general manager and the head of Finance Department of Shenyang CNC Machine Tool Co., Ltd. From 2006, he was the director and the head of Finance Department of Shenyang Machine Tool (Group) Kunming Co., Ltd. Since March 2007, he has held the positions of vice general manager and the head of Finance Department of Yunnan CY (Group) Co., Ltd. On 23rd March 2007, he was appointed as the director of the Company. On 28th July 2011, he was appointed as the chairman of the Company. His tenure of appointment will expire on 31st October 2014.

**Li Zhenxiang**, male, born in May 1962, holding master postgraduate qualification and is an assistant economist. He is currently the vice-chairman of the Company. Mr. Li joined Kunming Machine Tool Factory in 1985 and worked as the technician for construction and the head of construction team. During October 1993 to July 2002, he was the general manager and secretary to the committee of CPC of Kunming Kunji Group Construction Company. Since August 2002, he has acted as the general manager assistant, member of party committee, vice general manager and general manager of Kunming Kunji Group Company. He is now the general manager assistant of Yunnan Industrial Investment Holding Group Co., Ltd. His tenure of appointment will expire on 31st October 2014.

**Zhang Xiaoyi**, male, born in April 1964, holding master postgraduate qualification and a bachelor degree of engineering and is a senior engineer. He is currently the vice-chairman, executive director, general manager and deputy secretary to the Committee of Communist Party of China ("CPC") of the Company. Mr. Zhang joined Kunming Machine Tool Factory in 1985. He has extensive experience in machinery design and technology management. He worked as the deputy manager, manager of the technical center of the Company, general manager assistant and chief engineer, vice general manager and general manager of the Company. From 29th April 2008 till now, he has been the general manager of the Company. His tenure of appointment will expire on 31st October 2014.

**Ye Nong**, male, born in November 1960, holding postgraduate qualification and is an engineer. Mr. Ye currently is the vice general manager of the Company. During February 2000 to May 2002, he was the manager of the Technology Department of Shenyang Machine Tool (Group) and the vice president of Shenyang Machine Tool Design Institute. During May 2002 to December 2003, he was the manager of the Quality Control Department of Zhongjie Machine Tool Co., Ltd. He was the manager of Production Department of Zhongjie Machine Tool Co., Ltd. from December 2003 to June 2006. Since June 2006, he has worked for the Company as general manager assistant and vice general manager. On 23rd June 2010, he was appointed as the director of the Company. His tenure of appointment will expire on 31st October 2014.

**Li Shunzhen**, female, born in April 1972, holding a bachelor degree, certified public accountant, senior accountant. Ms. Li graduated at Jiangxi University of Finance and Economics in 1995 in the major of investment and economic management. From July 1995 to March 1998, she worked at the First Engineering Company under Yunnan Railway Construction handling project budget and as an accountant. From March 1998 to July 2002, she worked at Yunnan Guang Da Railway Maintenance Company as an accountant. From July 2002 to August 2008, she worked at Yunnan State-owned Assets Operation Company Limited as an accountant in finance department. From August 2008 to June 2011, she worked at Yunnan Industrial Investment Holding Group Company Limited as an accountant in finance department. Since June 2011, she has worked at Shaoyang Industrial Development Co., Ltd. under Yunnan Industrial Investment Holding Group Company Limited as a chief financial officer. Her tenure of appointment will expire on 31st October 2014.

**Guan Xin**, male, born in May 1968, holding a master post-graduate diploma, senior economist. Mr. Guan started his career in August 1990. From February 2005 to August 2009, Mr. Guan was the director of securities unit, general manager assistant, head of financial department, secretary to the board, vice general manager of Shenyang Machine Tool Co., Ltd. Meanwhile, he was the director of the Strategic Investment Unit of Shenyang Machine Tool (Group) Co., Ltd. From August 2009 to November 2009, he was the general

## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

manager assistant and the head of finance and investment unit of Shenyang Machine Tool (Group) Co., Ltd. Since November 2009, he has been the vice general manager of Shenyang Machine Tool (Group) Co., Ltd. On 23rd June 2010, he was appointed as the director of the Company. His tenure of appointment will expire on 31st October 2014.

**Gao Minghui**, male, born in 1963, holding a bachelor degree and postgraduate qualification. He is currently the non-executive director and secretary to the Committee of CPC of the Company. He graduated from the Northeastern University majoring in engineering in 1988. Mr. Gao was a researcher, deputy manager and manager of the Research and Development Department of Shenyang First Machine Tool Factory. Then he was the deputy chief engineer, assistant to general manager, deputy general manager, and general manager of Shenyang First Machine Tool Factory. Starting from January 2002, he had also been as the deputy general manager of Shenyang Machine Tool Co., Ltd. He had been the chairman of the board of directors of Yunnan Machine Tool Factory (now known as Yunnan CY Group Co., Ltd. since the change of name in 2006) from August 2004. Since 2006, he had been the chairman of Shenyang Machine Tool (Group) Co., Limited. He was appointed as the director of the Company on 30th October 2006. During 23rd October 2007 to 29th April 2008, he was also the general manager of the Company. During 30th December 2006 to 28th July 2011 he was the chairman of the Company. His tenure of appointment will expire on 31st October 2014.

**Zhang Tao**, male, born in June 1970, holding a bachelor degree and is an engineer. Mr. Zhang graduated from the Department of Architecture of Yunnan Industrial University majoring in city roads and bridges in 1991. During July 1991 to December 1993, he worked as the technician and subsequently the assistant engineer for the Kunming railroad second maintenance team under Chengdu Railroad Bureau. During December 1993 to May 1996, he was the secretary to the office of Kunming Railroad Bureau. During May 1996 to June 2004, he worked as the vice manager, manager and the vice chairman of the labor union of Yunnan Guangda Railroad Co., Ltd. During June 2004 to March 2008, he held the positions of office manager, secretary to the board, general manager assistant and vice chief engineer at Dianxi Railroad Co., Ltd. Since March 2008, he has been the deputy manager of Investment Department of Yunnan Industrial Investment Holding Group Co., Ltd. His tenure of appointment will expire on 31st October 2014.

**Liu Minghui**, male, born in 1964, is a professor and tutor of doctoral students and certified public accountant. During August 1987 to May 2000, he was an assistant lecturer, lecturer, associate professor and professor in Dongbei University of Finance and Economics. Since May 2000, he has been a tutor of doctoral students. During March 2001 to January 2004, he was the head of Jinqiao Faculty of Business at Dongbei University of Finance and Economics. During January 2004 to October 2004, he was the general manager of Dongbei University of Finance and Economics Magazine Company. From October 2004, he has held the positions of vice president of Dalian Newspaper Group and president of Dalian Publisher. He is also the director, vice-secretary general of China Accounting Association, a president of a branch of Cost Accounting Association, a president of a branch of Cost Accounting Association, director of China Auditing Association etc. His tenure of appointment expired on 22nd March 2013.

**Li Dongru**, female, born in 1955, Han nationality, member of the CPC, professor level senior engineer, holding postgraduate qualification. Ms. Li is working at the China Machinery Industry Federation (the "Federation"). Starting from January 2001, she has been the manager of the Science and Technology Department of the Federation and is responsible for the management of the machinery industry. During the periods of the Ninth and Tenth Five-year plans, she organized or managed the implementation of "Research and Development in Engineering of CNC Technology and Equipment (數控技術與裝備工程化的研究與開發)", a key project for the state-level science and technology development plan of the Ninth Five-year plan and "Development and Studies of New Generation CNC System Platform(新一代數控系統平台的開發研究)", a the key project for the national technological innovation plan of the Ninth Five-year plan. She organized the feasibility evaluation and implementation of key projects for the state-level science and technology development plan of the Tenth Five-year plan, namely "Research and Practical Demonstration of Precision Manufacturing and Key CNC Technology (精密製造與數控關鍵技術研究和應用示範)" and "Research and Development of Advanced Production Technique for Basic Components and Its Application (先進製造基礎件技術研究開發與應用)". She also participated in the feasibility evaluation and annual implementation of "Key CNC Technology and Supporting Technology for Equipment Industrialization and Their Applications (數控關鍵技術與裝備產業化支持技術及應用)", a project focused on the subject field of technologies on robots under the area of advanced manufacturing and automation technology of 863 Program. Her tenure of appointment will expire on 29th June 2013.

## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

**Chen Fusheng**, male, born in 1965, doctor of accountancy, master of economics, member of American Accounting Association, member of Hong Kong Academic Accounting Association. During 1996 to 1998, he was a part-time demonstrator of the Faculty of Business at University of Alberta in Canada. In 2006, he was a visiting professor at Tsinghua University. He is now an associate professor in accounting of the Faculty of Business at the Hong Kong University of Science and Technology, editor of "International Accounting Research Journal", specialized professor of the Faculty of Business at Nanjing University and the Faculty of Accounting at Shanghai University of Finance and Economics. His tenure of appointment will expire on 31st October 2014.

**Xiao Jianming**, male, born in November 1947, holding a bachelor degree, senior political officer, part-time professor of Kunming Polytechnic University Management College. From September 1968 to May 1971, he worked for a construction brigade under the fourteen metallurgy construction group second construction company. From May 1971 to August 1978, he worked at the material supply department of the fourteen metallurgy construction group. From September 1982 to February 1984, he was vice division chief of secretary department under the office of committee of CPC of the fourteen metallurgy construction group. From February 1984 to July 1987, he was the vice section chief of publicity section of the fourteen metallurgy construction group. From July 1987 to January 1993, he was the secretary to the committee of CPC of the equipment and materials company under the fourteen metallurgy construction group. From January 1993 to December 1997, he was the secretary to the committee of CPC of Kunming Prospecting Design Institute of China Nonferrous Metal Industry. From December 1997 to November 1998, he was the secretary to the committee of CPC of Yunnan Stannum Industry Company. From November 1998 to September 2001, he was the secretary to the committee of CPC and manager of Yunnan Stannum Industry Company. From September 2001 to December 2007, he was the secretary to the committee of CPC and chairman of Yunnan Stannum Industry Group. From December 2007 to February 2011, he was the vice section chief of the finance and economic committee under the people's congress of Yunnan province. He retired in March 2011. His tenure of appointment will expire on 31st October 2014.

**Shao Li**, male, Han nationality, born in 1958, holding a master degree and is a deputy researcher. He is currently the deputy secretary to the Committee of CPC of the Company and chairman of the Supervisory Committee. Mr. Shao joined the Second Light Industry Bureau of Kunming City in February 1984 as a deputy office manager. In May 1987, he worked for Publicity Department under the Committee of CPC in Kunming City as the office manager, and subsequently the assistant to the director of the department. In December 1992, he worked for Research Center of Kunming City Government as a deputy director. In August 2000, he worked for the Enterprises Union Department under the Committee of CPC in Yunnan Province as the deputy office manager and subsequently the director of the research center. In February 2003, he worked for Yunnan State-owned Assets Supervision and Administration Commission as the director of Policy and Statute Department. Since October 2007, Mr. Shao has been the deputy secretary to the Committee of CPC of the Company. His tenure of appointment will expire on 31st October 2014.

**Fan Hong**, male, born in June 1963, holding a bachelor degree and is an economics. Mr. Fan graduated from Jiangxi University of Finance & Economics majoring in finance in 1987. During July 1987 to September 1992, he worked for the Provincial Department of Finance of Yunnan. During August 1992 to February 2005, he worked as the department manager for Yunnan International Trust and Investment Company. Since February 2005, he has held the positions of trust department manager, risk control department manager and policy and statute department manager and general manager assistant of Yunnan State-owned Assets Operation Co., Ltd. In August 2011, he was appointed as chairman of Yunnan Equity Exchange Co. Ltd.. His tenure of appointment will expire on 31st October 2014.

**Tang Hua**, female, born in 1957, member of the CPC, holding postgraduate qualification, senior engineer, senior political officer, now is the chairman of the labor union of Shenyang Machine Tool (Group) Company Limited. Ms. Tang went into workforce in 1975. In 1994, she joined Shenyang Machine Tool (Group) Company Limited and has successively held the posts of sales person, executive officer in overseas business unit. From 1997 to 2007, she was the office manager of the union and vice chairman of the union. From 2007 to 2008, she was the secretary to the Third Committee of CPC, secretary of Discipline Inspection Commission and the Chairman of the labor union. She has been the vice chairman and chairman of the labor union of the Company since 2008. Her tenure of appointment expired on 18th March 2013.

## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

**Cai Zhemin**, male, born in 1962, member of the CPC, holding college diploma, engineer, now is the head of the strategy planning department of Shenyang Machine Tool (Group) Company Limited. Mr. Cai went into workforce in 1981. In 1996, he joined Shenyang Machine Tool (Group) Company Limited and was successively the official of technology department, production department, planning department. From 2007 to 2008, he was the manager of the planning department. From 2008 to 2009, he was the manager of engineering planning department of Shenyang Machine Tool Company Limited. From 2009, he has been the head of the strategy planning department of Shenyang Machine Tool (Group) Company Limited. His tenure of appointment will expire on 31st October 2014.

**Qin Jianzhong**, male, born in September 1954, holding a postgraduate qualification, senior economist. He is currently the chairman of the labor union and the supervisor elected by staff of the Company. He joined Kunming Machine Tool Factory in 1982 and has held the positions of technician, deputy director and the director of Workshop, deputy head and head of the Labour and Personnel Section, Supervisor of the Supervisory Committee of the Company, director of the Board, vice general manager and secretary to the Committee of CPC of the Company. His tenure of appointment will expire on 31st October 2014.

**Zhu Xiang**, male, born in April 1966, holding master postgraduate qualification and is a senior engineer. He is currently the vice general manager of the Company. He joined Kunming Machine Tool Factory in 1988. He has extensive experience in machine tool products design and sales management. He has held the positions of vice director of Assembly Sub-Plant of Kunming Machine Tool Factory, deputy director of the Technology Centre, vice manager of the Sales Department, manager of Sales Company, general manager assistant, and from 20th August 2007, the vice general manager of the Company. His tenure of appointment will expire on 31st October 2014.

**Zhou Guoxing**, male, born in November 1962, holding a master degree and is a senior engineer. He is currently the vice general manager of the Company. Mr. Zhou joined Kunming Machine Tool Factory in 1987 and has extensive experience in machine tool design and production management. He was the manager of the Laboratory of the Company; vice manager and manager of the Technical Center; deputy chief engineer; manager of the Manufacture Center; general manager assistant and the head of the assembly sub-plant; chief engineer and from 10th April 2006, the vice general manager of the Company. His tenure of appointment will expire on 31st October 2014.

**Xu Kunping**, male, born in November 1969, holding a bachelor degree and currently engaged in postgraduate study for a master degree, a senior engineer. He is currently the vice general manager of the Company. Mr. Xu joined Kunming Machine Tool Factory in 1991 and has extensive experience in machine tool R&D and design, technical management and sales management. From 1993, he was the designer, machine room manager, vice director and director of the Technical Center and general manager assistant. Since 24th March 2010, he has been the vice general manager of the Company, responsible for the marketing efforts. His tenure of appointment will expire on 31st October 2014.

**Luo Tao**, male, born in July 1975, holding a master degree and postgraduate qualification. He is currently the secretary to the Board of the Company (joint company secretary) and affiliate member of the Hong Kong Institute of Chartered Secretaries. Starting from October 2005, he has held the positions of assistant secretary to the Board and the manager of the office of the Board of the Company, manager of the office of general manager and securities affairs representative. Since May 2008, he has been the secretary to the Board of the Company. His tenure of appointment will expire on 31st October 2014.

# DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

## II. POSITIONS HELD BY EACH OF EXISTING AND RESIGNED DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT DURING THE REPORTING PERIOD

### 1. Positions in shareholder's business unit

Name	Shareholder's business unit	Position	Date of appointment	End date of appointment
Li Zhenxiong	Yunnan Industrial Investment Holding Group Co., Ltd.	General manager assistant		
Guan Xin	Shenyang Machine Tool (Group) Co., Ltd.	Vice general manager		
Zhang Tao	Yunnan Industrial Investment Holding Group Co., Ltd.	Vice manager of Investment Department		
Tang Hua	Shenyang Machine Tool (Group) Co., Ltd.	Chairman of the labor union		
Cai Zheming	Shenyang Machine Tool (Group) Co., Ltd.	Head of the Strategy Planning department		

### 2. Positions in other companies

Name	Other Companies	Position	Date of appointment	End date of appointment
Wang Xing	Yunnan CY Group Co., Ltd.	Vice general manager		
	Shenyang Machine Tool (Group) Kunming Co., Ltd.	Vice general manager		
	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Director		
	Kunming Kunji General Machine Co., Ltd.	Chairman		
Gao Minghui	Shenyang Machine Tool (Group) Kunming Co., Ltd.	Chairman		
	Yunnan CY Group Co., Ltd.	Chairman		
Zhang Xiaoyi	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Vice chairman		
	Kunming TOS Machine Tool Manufacturing Co., Ltd.	Vice chairman		
Ye Nong	Kunming TOS Machine Tool Manufacturing Co., Ltd.	Director		
Liu Minghui	Dalian Newspaper Group	Vice president		
	Dalian Publisher	President		
Li Dongru	China Machinery Industry Federation	Vice secretary-general		
Chen Fusheng	"International Accounting Research Journal" of the Accounting Department of the Faculty of Business at the Hong Kong University of Science and Technology	Associate professor editor		
Fan Hong	Yunnan Equity Exchange Co. Ltd.	Chairman		
Zhou Guoxing	Kunming TOS Machine Tool Manufacturing Co., Ltd.	Member of controlling committee		
Zhu Xiang	Kunming Kunji General Machine Co., Ltd.	Director and general manager		
	Xi'an Ser Turbo Machinery Manufacturing Co., Ltd.	Director		
	Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Director		
Luo Tao	Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd.	Director		

## III. EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

### The procedures for the determination of directors, supervisors and senior management's Emoluments

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

## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

### Basis for emoluments of directors, supervisors and senior management officers

- (1) general information of the emoluments of domestic directors and supervisors;
- (2) general information of the emoluments of Hong Kong directors and supervisors;
- (3) emoluments of senior management officers are based on the domestic industry practice and emoluments of the comparable listed companies in the region;

## IV. CHANGE OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

During the reporting period, there is no change in the directors, supervisors and senior management officers of the Company.

## V. STAFF OF THE PARENT AND MAJOR SUBSIDIARIES

### 1. Staff

No. of existing staff of the parent	2,386
No. of retired staff whose retirement expenses undertaken by the parent and its major subsidiaries	204

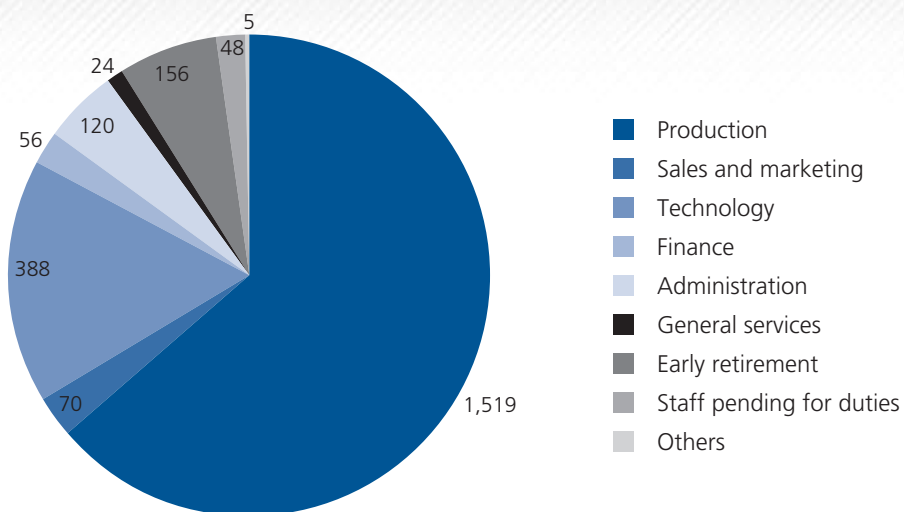
Areas of specialization	Number of employees
Production	1,519
Sales and marketing	70
Technology	388
Finance	56
Administration	120
General services	24
Early retirement	156
Staff pending for duties	48
Others	5
Total	2,386

Education level	Number of Employees
Postgraduate or above	23
University graduate	393
College diploma	411
Diploma	343
High school or vocational school	680
Junior high school or below	536
Total	2,386

# DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

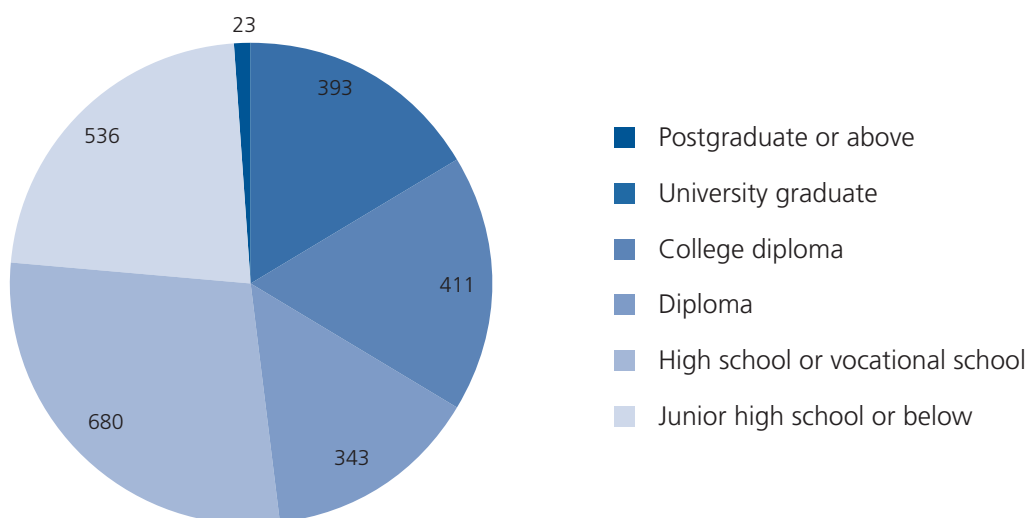
## (1) Chart of Specialization:

Areas of Specialization



## (2) Chart of Education Level:

Education Level (Number of employees)



# CORPORATE GOVERNANCE

## I. DESCRIPTION OF CORPORATE GOVERNANCE AND INSIDER REGISTRATION MANAGEMENT

The Company strictly complies with the Company Law, the Securities Law and relevant regulations issued by the CSRC and the Shanghai Stock Exchange to establish a modern enterprise system, continuously improve its corporate governance and regulate the operations of the Company. Various systems of the Company are substantially in compliance with the requirements of the “Corporate Governance Standards of Listed Company” promulgated by the CSRC and the State Economic and Trade Commission. In the future, the Company will continue to improve and strengthen the internal control system in the ordinary course of operation so as to strive for the highest standards of corporate governance.

To further improve the corporate governance, the Company formulated the Registration and Management System of Persons with Inside Information in accordance with the requirements of the relevant documents issued by the Shanghai Stock Exchange. To step up promotion on prevention of inside trading, the Discipline Inspection Committee of the CSRC, with the assistants of the Yunnan Securities Regulatory Bureau and Shenzhen Stock Exchange, held the “Exhibitions for Education on being Alert to Inside Trading” in November 2012. Through such studies, the Company has a more profound understanding on the importance of inside information management and will continue to enhance the Registration and Management System of Persons with Inside Information, continuously improve the internal control system and strengthen self-discipline awareness, so as to secure confidentiality of the inside information and increase the compliance awareness of insiders, further improving the compliant operation of the Company and effectively preventing and combating inside trading and other illegal securities trading conducts, with an aim to uphold the principle of “openness, equality and fairness” in the securities market and safeguard the legal interests of all shareholders of the Company.



# CORPORATE GOVERNANCE

## II. SHAREHOLDERS' MEETING

Meeting session	Meeting Date	Name of resolutions of the meeting	Results of resolutions	Designated websites for publishing the resolutions	Publishing date resolved for disclosure
The first extraordinary general meeting of 2012	6th March 2012	<ol style="list-style-type: none"> <li>2011 Amendments to articles of association of the Company;</li> <li>2012 Amendments to articles of association of the Company;</li> <li>To consider and approve the resolution authoring the management of the Company to deal with bank financing not exceeding RMB500,000,000.</li> </ol>	All were considered and passed	www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn	7th March 2012
2011 annual general meeting	15th May 2012	<ol style="list-style-type: none"> <li>To consider and approve the 2012 Amendments to the Rules of Procedure of the Board of the Company;</li> <li>To consider and approve the report of the board of directors of the Company for the year 2011;</li> <li>To consider and approve the report of the supervisory committee of the Company for the year 2011;</li> <li>To consider and approve the annual report of the Company for the year 2011;</li> <li>To consider and approve the proposal of profit distribution of the Company for the year ended 31st December 2011;</li> <li>To consider and approve the financial budget for the year ended 31st December 2012; operating income objective for 2012 is RMB2 billion and the objective of net profit for 2012 is RMB180 million;</li> <li>To consider and approve the proposal on using RMB58,935,900 for the general technological renovation projects for the year 2012;</li> <li>To consider and approve the motion regarding changing of the member of the 7th audit committee of the Company to elect Mr. Guan Xin as the member of the audit committee to replace Mr. Wang Xing;</li> <li>To consider and approve re-appointing KPMG Huazhen as the auditor of the Company for the year 2012 and authorize the Board to fix the auditor's remuneration;</li> <li>To consider and approve the independent non-executive directors' work report for the year 2011.</li> </ol>	All were considered and passed	www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn	16th May 2012
The second extraordinary general meeting of 2012	16th October 2012	<ol style="list-style-type: none"> <li>The second amendment of 2012 to the articles of association of the Company – the policy of cash dividend;</li> <li>Adjusting the business objective of the Company for 2012 as: operating revenue will be RMB1.5 billion and the net profit attributable to the parent company will be RMB20 million.</li> </ol>	Both were considered and passed	www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn	17th October 2012
The third extraordinary general meeting of 2012	28th December 2012	To consider and approve the proposal on issuance of medium-term notes and authorize the Board of the Company to handle the issuance	Considered and passed	www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn	29th December 2012

# CORPORATE GOVERNANCE

## III. DIRECTORS AND THEIR DUTIES

### 1. Attendance of Directors at the board meetings and general meetings

No. of board meetings held during 2012	8
Including: No. of meetings held on-site	2
No. of meetings held via electronic communication	6
No. of meetings held on-site with electronic communication	0

### 2. Objections raised by Independent Directors

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

## IV. EXPLANATION ON DISCOVERY OF COMPANY RISKS BY THE SUPERVISORY COMMITTEE

The Supervisory Committee has no objection to matters under supervision during the reporting period.

# INTERNAL CONTROL

## I. RESPONSIBILITY STATEMENT AND INSTITUTIONAL IMPROVEMENT ON INTERNAL CONTROL

### The establishment and improvement of the Company's internal control system

General plan for the establishment of internal control system	In accordance with the regulatory requirements on the listed companies under the Company Law, the Securities Law, the Listing Rules of Shanghai Stock Exchange, Supplementary Guidelines of Corporate Internal Control and Internal Control Guidelines for Companies Listed in the Shanghai Stock Exchange, the Company has established and put in place a sound and effective internal control system. In establishing and implementing the internal control system, the Company has taken into account the fundamental factors as follows: objective setting; internal environment; risk assessment; regulatory activities; information & communication; internal supervision. Based on the fundamental system, the Company's internal control system involves the formulation of corporate governance structure, rules of procedures, organizational structure and terms of reference of each department, fundamental management system, duties, workflow procedures and quality manual, covering all aspects from daily and usual production, operation and management. The internal control system is comprehensive with well-defined structure.
Establishment of a sound work plan in the internal control system and its implementation	The Company has conducted tests and assessments on the present status of the internal control. Based on the features of the corporate structure and business procedures, the Company can also identify the major risks of internal control and set up objectives of internal control, rationalize internal procedures, spot defects and make improvement. The Company has outlined the annual work plan based on the key issues and accomplished them. In addition, the Company continues to strive for excellence for internal control system according to the development of the Company.
Establishment of the inspection and supervision department for internal control	The Board office of the Company is the daily operation office of the Audit Committee. In addition, the Company has also established the audit department, which is responsible for special audit work on the Company; and assessment and random inspection of the implementation of the internal control system.
Internal supervision and self-assessment on internal control	The Articles of Association of the Company sets out the provisions on internal audit and the Implementation Rules of Audit Committee and Internal Audit System are formulated. The audit department will conduct special audit work on the Company. In the fourth quarter of 2012, the audit department commenced self-assessment for internal control system.
The Board's work arrangement on internal control	The Board of the Company reviews the internal control assessment report and makes advice for improvement. The Company has also engaged an audit firm to make assessment on the internal control in respect of financial reports of the Company.
Improvement of internal control system associated with financial audit	In accordance with the relevant laws and regulations under the Accounting Law, the General Rules Governing Enterprise Financial Affairs and Enterprise Accounting System, the Company has established an accounting and audit mechanism and set up a more reasonable and regulated audit system through ERP software. The Company has complied with the relevant financial management requirements and formulated the relevant systems, which set out strict requirements on internal control procedures relating to finance, and the system has been put in place effectively.

# INTERNAL CONTROL

## II. RELEVANT INFORMATION ABOUT AUDIT REPORT ON INTERNAL CONTROL

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

The Board of the Company conducted the self-assessment on the internal control during 2012 and no material defects were discovered in terms of the design or implementation of the internal control system. As of 31st December 2012, the Company maintained effective internal control in all material aspects pursuant to the "Basic Standard for Enterprise Internal Control" and relevant requirements. (See the appendix to the annual report published on the website of the Company ([www.kmtcl.com.cn](http://www.kmtcl.com.cn)) and the website of Shanghai Stock Exchange ([www.sse.com.cn](http://www.sse.com.cn)) on 28th March 2013 for details).

### 2. The auditor issued the audit opinions on the internal controls in respect of financial reporting of the Company.

The Company engaged the auditor to audit the effectiveness of internal control in relation to the financial report as at 31st December 2012, and the auditor has issued the audit report on the internal controls in relation to the financial report as at 31st December 2012 according to the requirements. (See the appendix to the annual report published on the website of the Company ([www.kmtcl.com.cn](http://www.kmtcl.com.cn)) and the website of Shanghai Stock Exchange ([www.sse.com.cn](http://www.sse.com.cn)) on 28th March 2013 for details).

## III. INFORMATION ABOUT LIABILITY INVESTIGATION SYSTEM ON MAJOR ERRORS IN DISCLOSURE OF ANNUAL REPORTS AND RELEVANT IMPLEMENTATION

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

# CORPORATE GOVERNANCE REPORT

## 1. CORPORATE GOVERNANCE PRACTICE

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

### A. Directors

#### A.1 Board Meetings

The Company holds at least one board meeting each quarter. 8 board meetings were held during 2012 and 6 of them were in written resolutions, please refer to page 47 for details of directors’ attendance. The secretary to the Board would consult each director for discussion issues and include them in the agenda for every board meeting to be held. During the reporting period, the notice and preliminary agenda were distributed to the directors at least 14 days before the date of meeting.

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

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

#### A.2 Chairman and Chief Executive Officer

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

#### A.3 Composition of the Board

The Company discloses the composition of members of Board in its communications by the director category including Chairman, Executive Directors, Independent Non-Executive Directors and Non-Executive Directors. The Board currently comprises 4 independent non-executive directors, representing 1/3 of the total number of directors. During 2012, 4 directors took up the role of management, representing more than 1/3 of the total number of directors. This enabled the Board to strictly review and monitor the management procedures of the Company. In order to enrich the shareholders’ understanding of the directors and the composition of the Board of the Company, the Company has published the role of directors and their responsibilities in related media.

#### A.4 Appointment, Election and Removal

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

#### A.5 Directors’ Responsibilities

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

# CORPORATE GOVERNANCE REPORT

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

## A.6 *Provision and Usage of Information*

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

## B.1 **Remuneration of Director and Senior Management Officers**

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

## C. **Accountability and Auditing**

### C.1 *Financial Reporting*

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

### C.2 *Internal Control*

The Supervisory Committee of the Company exercises its supervisory rights independently in accordance with laws and regulations to safeguard the legal rights of shareholders, the Company and employees. The number of members and composition of the Supervisory Committee shall comply with the laws and regulations. During 2012, 2 meetings were held and full attendances were recorded in every meeting where the supervisors supervised on behalf of the shareholders the financial conditions of the Company and the performance of obligations of directors and senior management officers and their compliance, and sat in on the board meetings to perform the duties of the Supervisory Committee in a diligent manner.

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

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

### C.3 *Audit Committee*

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

# CORPORATE GOVERNANCE REPORT

## **D. Transfer of Right of the Board**

### *D.1 Management Function*

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

### *D.2 Committees under the Board*

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

## **E. Communication with Shareholders**

### *E.1 Effective Communication*

The Board endeavors to maintain communications with its shareholders. During the 2011 Annual General Meeting and the extraordinary general meetings of 2012, all Executive Directors, and part of the Non-Executive Directors and senior management officers attended the meeting to communicate with its shareholders.

### *E.2 Voting by poll*

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

## **2. SECURITIES TRANSACTION OF DIRECTORS**

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

# CORPORATE GOVERNANCE REPORT

## 3. BOARD OF DIRECTORS

### (1) Composition of the Board

Currently, there are 12 directors in the Company and 4 of them are independent directors. This is the seventh session of Board of Directors since the establishment of the Company. The term of directors begins from 1st November 2011 or the date of appointment to the date of next election of directors.

Name	Position	Required attendance	Attended in person	Attended via electronic communication	Attended by representative	Absence	Failed to be present at two meetings in a row
Wang Xing	Chairman and executive director	8	2	6	0	0	No
Li Zhenxiong	Vice chairman and non-executive director	8	2	6	0	0	No
Zhang Xiaoyi	Vice chairman and executive director	8	2	6	0	0	No
Guan Xin	Non-executive director	8	2	6	0	0	No
Gao Minghui	Non-executive director	8	1	6	1	0	No
Ye Nong	Executive director	8	2	6	0	0	No
Li Shunzhen	Executive director	8	2	6	0	0	No
Zhang Tao	Non-executive director	8	2	6	0	0	No
Liu Minghui	Independent non-executive director	8	2	6	0	0	No
Li Dongru	Independent non-executive director	8	2	6	0	0	No
Chen Fusheng	Independent non-executive director	8	2	6	0	0	No
Xiao Jianming	Independent non-executive director	8	1	6	1	0	No

No. of board meetings held during 2012	8
Including: No. of meetings held on-site	2
No. of meetings held via electronic communication	6
No. of meetings held on-site with electronic communication	0

8 board meetings (6 of them were in written resolutions) were held during the year, and the members and the board meetings are as follows:

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

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

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

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



# CORPORATE GOVERNANCE REPORT

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

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

## **(2) Appointment of Directors**

Each director of the Company is elected for a term of three years, subject to re-election upon expiry. The term of appointment of the independent non-executive directors shall not exceed six years. The Company shall enter into a Directors' Service Contract with the directors for a term of three years where the term of appointment of any additional directors during the term is less than three years. The appointment or removal of directors shall be approved at the shareholders' meeting. There is no appointment or removal of directors during 2012.

## **(3) Duties of the Board**

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

Details of the work of the board and its board committees are set out in "ORDINARY OPERATIONS OF THE BOARD" on page 47.

## **(4) Qualifications and Independence of Independent Directors**

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

Independence of the independent non-executive directors complies with the guidelines on independence as set out in Rule 3.13 of the Listing Rules.

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

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

## **(6) Relationship between the Members of the Board**

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

## **4. CHAIRMAN AND GENERAL MANAGER**

The roles of chairman and general manager shall be taken by different persons with clearly segregated duties. The chairman is responsible for the management of the affairs of the Board such as inspecting the implementation progress of the issues approved by the Board. The general manager is responsible for management of operations of the Company and implementation of strategies formulated by the Board. The duties and responsibilities of the general manager are clearly defined and set out in the Articles of Association of the Company.

# CORPORATE GOVERNANCE REPORT

5. **TERM OF NON-EXECUTIVE DIRECTORS: According to the Articles of Association, Rules of Procedure for the General Meetings of the Shareholders, and Rules of Procedure for the Meetings of the Board of Directors, the term of the non-executive directors under the 7th session of the Board will expire on 31st October 2014.**
6. **STRATEGIC COMMITTEE, AUDIT COMMITTEE, NOMINATION COMMITTEE AND REMUNERATION AND ASSESSMENT COMMITTEE ARE UNDER THE BOARD OF DIRECTORS. DETAILS ARE AS FOLLOWS:**

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

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

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

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

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

*In addition:* According to the resolutions passed at the 13th meeting of the 7th session of the Board held on 27th March 2013, Mr. Yang Xiongsheng, an independent director, was appointed to replace Mr. Liu Minghui as the chairman of Audit Committee and Nomination Committee under the Board with his term of office the same as the term of the current Board.

# CORPORATE GOVERNANCE REPORT

## 7. DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

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

## 8. DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

In 2012, none of the Directors or Supervisors had a material interest in the contracts entered into by the Company, its controlling company or subsidiaries of its controlling company.

## 9. AUDITOR'S FEE

The auditor's fee for 2012

Name of the accounting firm: KPMG Huazhen (Special General Partnership) Amount: RMB2,660,000

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

- (1) General remuneration offered for auditing service;
- (2) General work load on audit work for the previous accounting period;
- (3) General work load on audit work for the previous engagement.

## 10. RIGHTS OF SHAREHOLDERS

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

## 11. RESPONSIBILITY FOR FINANCIAL STATEMENTS

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

The duties of the external auditor of the Company, KPMG Huazhen (Special General Partnership), are set out in the annual report.

# AUDITORS' REPORT

## Auditors' Report

畢馬威華振審字第1300442號

### All Shareholders of Shenji Group Kunming Machine Tool Company Limited

We have audited the accompanying financial statements of Shenji Group Kunming Machine Tool Company Limited ("the Company"), which comprise the consolidated balance sheet and balance sheet as at 31st December 2012, the consolidated income statement and income statement, the consolidated cash flow statement and cash flow statement, the consolidated statement of changes in shareholders' equity and statement of changes in shareholders' equity for the year then ended, and notes to the financial statements.

## 1. MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Company's management is responsible for the preparation and fair presentation of these financial statements. This responsibility includes: (1) preparing these financial statements in accordance with Accounting Standards for Business Enterprises issued by the Ministry of Finance of the People's Republic of China, and fairly presenting them; (2) designing, implementing and maintaining internal control which is necessary to enable that the financial statements are free from material misstatement, whether due to fraud or error.

## 2. AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with China Standards on Auditing for Certified Public Accountants. Those standards require that we comply with China Code of Ethics for 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 procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## 3. OPINION

In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position and financial position of the Company as at 31st December 2012, and the consolidated financial performance and financial performance and the consolidated cash flows and cash flows of the Company for the year then ended in accordance with the requirements of Accounting Standards for Business Enterprises issued by the Ministry of Finance of the People's Republic of China.

**KPMG Huazhen**  
**(Special General Partnership)**

Beijing, China

*Certified Public Accountants*  
*Registered in the People's Republic of China*  
Peng Jing  
Zhong Dan  
27th March 2013

# CONSOLIDATED BALANCE SHEET

As at 31st December 2012

Unit: RMB

Item	Note	2012	2011
<b>CURRENT ASSETS:</b>			
Cash at bank and on hand	V. 1	98,887,040.73	192,200,330.65
Bills receivable	V. 2	74,194,825.88	104,034,946.22
Accounts receivable	V. 3	296,885,249.95	284,945,522.91
Prepayments	V. 5	38,170,658.92	79,699,344.86
Other receivables	V. 4	13,678,852.21	14,229,856.33
Inventories	V. 6	1,011,927,770.40	983,679,390.52
Other current assets	V. 7	1,495,385.23	–
<b>TOTAL CURRENT ASSETS</b>		<b>1,535,239,783.32</b>	<b>1,658,789,391.49</b>
<b>NON-CURRENT ASSETS:</b>			
Long-term equity investments	V. 8	59,124,901.68	61,924,580.95
Fixed assets	V. 9	539,598,993.33	548,781,349.24
Construction in progress	V. 10	182,359,702.75	119,146,793.10
Intangible assets	V. 11	69,000,264.01	35,378,639.17
Goodwill	V. 12	7,296,277.00	7,296,277.00
Long-term deferred expenses	V. 13	1,926,385.55	1,365,116.55
Deferred tax assets	V. 14	62,869,275.31	46,245,088.62
Other non-current assets	V. 15	91,336,642.15	79,737,125.00
<b>TOTAL NON-CURRENT ASSETS</b>		<b>1,013,512,441.78</b>	<b>899,874,969.63</b>
<b>TOTAL ASSETS</b>		<b>2,548,752,225.10</b>	<b>2,558,664,361.12</b>
<b>CURRENT LIABILITIES:</b>			
Short-term loans	V. 18	105,000,000.00	100,000,000.00
Bills payable	V. 19	28,693,005.00	46,596,910.09
Accounts payable	V. 20	506,762,578.19	363,932,002.93
Advances from customers	V. 21	339,341,062.27	433,353,771.35
Employee benefits payable	V. 22	25,500,401.68	33,498,389.64
Taxes payable	V. 23	12,322,840.16	7,310,302.86
Dividends payable	V. 24	135,898.49	135,898.49
Other payables	V. 25	73,419,209.14	40,665,636.99
Non-current liabilities due within one year	V. 27	418,509.00	418,509.00
<b>TOTAL CURRENT LIABILITIES</b>		<b>1,091,593,503.93</b>	<b>1,025,911,421.35</b>
<b>NON-CURRENT LIABILITIES:</b>			
Long-term payables	V. 28	1,705,672.90	1,918,881.90
Special payables	V. 29	15,167,565.87	15,267,565.87
Provisions	V. 26	9,921,145.94	17,390,990.97
Other non-current liabilities	V. 30	66,773,920.91	41,490,702.91
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>93,568,305.62</b>	<b>76,068,141.65</b>
<b>TOTAL LIABILITIES</b>		<b>1,185,161,809.55</b>	<b>1,101,979,563.00</b>

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# CONSOLIDATED BALANCE SHEET

As at 31st December 2012

Unit: RMB  
2011

Item	Note	2012	2011
<b>Shareholders' equity:</b>			
Share capital	V. 31	531,081,103.00	531,081,103.00
Capital reserve	V. 32	27,303,321.72	27,303,321.72
Surplus reserve	V. 33	116,508,002.60	116,508,002.60
Retained earnings	V. 34	643,404,128.51	727,245,922.10
Total equity attributable to shareholders of the Company		1,318,296,555.83	1,402,138,349.42
Minority interests		<u>45,293,859.72</u>	<u>54,546,448.70</u>
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b><u>1,363,590,415.55</u></b>	<b><u>1,456,684,798.12</u></b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b><u>2,548,752,225.10</u></b>	<b><u>2,558,664,361.12</u></b>

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

# BALANCE SHEET

As at 31st December 2012

Unit: RMB

Item	Note	2012	2011
<b>CURRENT ASSETS:</b>			
Cash at bank and on hand		71,927,250.50	147,087,572.52
Bills receivable		51,132,033.52	87,154,946.22
Accounts receivable	XI. 1	212,997,106.53	197,668,708.57
Prepayments		11,023,576.86	45,024,333.22
Dividends receivable		11,000,000.00	40,130,802.55
Other receivables	XI. 2	18,962,601.80	19,977,210.82
Inventories		843,844,975.13	830,051,956.13
Other current assets		1,495,385.23	–
<b>TOTAL CURRENT ASSETS</b>		<b>1,222,382,929.57</b>	<b>1,367,095,530.03</b>
<b>NON-CURRENT ASSETS:</b>			
Long-term equity investments	XI. 3	82,673,167.53	87,617,846.80
Fixed assets		496,634,816.84	498,566,837.42
Construction in progress		182,094,281.75	119,146,793.10
Intangible assets		57,147,408.97	23,215,536.70
Long-term deferred expenses		1,727,777.55	1,058,172.55
Deferred tax assets		53,272,355.95	38,085,867.83
Other non-current assets		91,336,642.15	79,737,125.00
<b>TOTAL NON-CURRENT ASSETS</b>		<b>964,886,450.74</b>	<b>847,428,179.40</b>
<b>TOTAL ASSETS</b>		<b>2,187,269,380.31</b>	<b>2,214,523,709.43</b>
<b>CURRENT LIABILITIES:</b>			
Short-term loans		90,000,000.00	80,000,000.00
Bills payable		–	20,000,000.00
Accounts payable		394,827,490.92	298,667,958.42
Advances from customers		205,275,982.82	281,112,591.02
Employee benefits payable		23,937,684.85	32,029,264.98
Taxes payable		11,755,291.00	5,888,997.79
Other payables		71,088,145.09	50,833,320.18
Non-current liabilities due within one year		418,509.00	418,509.00
<b>TOTAL CURRENT LIABILITIES</b>		<b>797,303,103.68</b>	<b>768,950,641.39</b>
<b>NON-CURRENT LIABILITIES:</b>			
Long-term payables		1,705,672.90	1,918,881.90
Special payables		15,167,565.87	15,167,565.87
Provisions		9,921,145.94	17,390,990.97
Other non-current liabilities		66,773,920.91	41,490,702.91
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>93,568,305.62</b>	<b>75,968,141.65</b>
<b>TOTAL LIABILITIES</b>		<b>890,871,409.30</b>	<b>844,918,783.04</b>

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# BALANCE SHEET

As at 31st December 2012

Unit: RMB  
2011

Item	Note	2012	2011
<b>Shareholders' equity:</b>			
Share capital		531,081,103.00	531,081,103.00
Capital reserve		27,303,321.72	27,303,321.72
Surplus reserve		116,508,002.60	116,508,002.60
Retained earnings		<u>621,505,543.69</u>	<u>694,712,499.07</u>
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b><u>1,296,397,971.01</u></b>	<b><u>1,369,604,926.39</u></b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b><u>2,187,269,380.31</u></b>	<b><u>2,214,523,709.43</u></b>

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.



# CONSOLIDATED INCOME STATEMENT

For the year 2012

Unit: RMB

Item	Note	2012	2011
<b>1. Operating income</b>	V. 35	<b>1,086,311,095.78</b>	<b>1,804,857,564.29</b>
<b>2. Less: Operating costs</b>	V. 35	<b>880,453,359.74</b>	<b>1,368,376,106.28</b>
Business taxes and surcharges	V. 36	7,155,195.74	8,024,321.64
Selling and distribution expenses	V. 37	96,628,154.07	134,188,688.09
General and administrative expenses	V. 38	160,374,456.94	169,652,944.38
Financial expenses	V. 39	1,797,725.19	3,409,201.42
Impairment losses	V. 41	52,262,313.67	62,921,703.56
Add: Investment income ("()"for loss) Including: Income from investments in associates and jointly controlled enterprises	V. 40	2,996,374.90	7,334,821.80
		1,055,320.73	7,334,821.80
<b>3. Operating profit ("()"for losses)</b>		<b>(109,363,734.67)</b>	<b>65,619,420.72</b>
Add: Non-operating income	V. 42	15,558,232.30	5,090,585.51
Less: Non-operating expenses Including: losses from disposal of non-current assets	V. 43	1,434,771.49	1,925,909.70
		516,205.94	499,354.16
<b>4. Profit before income tax ("()" for total losses)</b>		<b>(95,240,273.86)</b>	<b>68,784,096.53</b>
Less: Income tax expenses ("()"for income tax benefit)	V. 44	(12,944,178.86)	16,568,488.10
<b>5. Net profit for the year ("()"for net losses)</b>		<b>(82,296,095.00)</b>	<b>52,215,608.43</b>
Net profit attributable to shareholders of the Company ("()"for net losses)		(73,220,171.53)	54,567,125.16
Minority interests		(9,075,923.47)	(2,351,516.73)
<b>6. Earnings per share ("()"for losses per share):</b>			
(1) Basic earnings per share ("()"for losses per share)	V. 45	(0.14)	0.10
(2) Diluted earnings per share ("()"for losses per share)	V. 45	(0.14)	0.10
<b>7. Other comprehensive income</b>		<b>-</b>	<b>-</b>
<b>8. Total comprehensive income ("()"for total comprehensive losses)</b>		<b>(82,296,095.00)</b>	<b>52,215,608.43</b>
Total comprehensive income attributable to shareholders of the Company ("()"for total comprehensive losses)		(73,220,171.53)	54,567,125.16
Total comprehensive income attributable to minority interests ("()"for total comprehensive losses)		(9,075,923.47)	(2,351,516.73)

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# INCOME STATEMENT

For the year 2012

Unit: RMB

Item	Note	2012	2011
<b>1. Operating income</b>	<i>XI. 4</i>	<b>898,323,213.33</b>	<b>1,543,019,054.78</b>
Less: Operating costs	<i>XI. 4</i>	723,846,145.54	1,142,044,017.59
Business taxes and surcharges		6,468,638.15	6,935,948.23
Selling and distribution expenses		89,872,785.78	124,945,870.63
General and administrative expenses		139,499,723.68	150,841,028.04
Financial expenses		338,189.60	1,899,375.54
Impairment losses		31,778,078.70	61,489,436.88
Add: Investment income ("()" for losses)	<i>XI. 5</i>	1,055,320.73	37,115,911.24
Including: Income from investments in associates and jointly controlled enterprises		<u>1,055,320.73</u>	<u>7,334,821.80</u>
<b>2. Operating profit ("()" for losses)</b>		<b>(92,425,027.39)</b>	<b>91,979,289.11</b>
Add: Non-operating income		14,822,194.63	5,090,528.20
Less: Non-operating expenses		1,064,896.64	1,528,527.77
Including: losses from disposal of non-current assets		<u>516,205.94</u>	<u>449,985.37</u>
<b>3. Profit before income tax ("()" for total losses)</b>		<b>(78,667,729.40)</b>	<b>95,541,289.54</b>
Less: Income tax expenses ("()" for income tax benefit)		<u>(16,082,396.08)</u>	<u>20,709,499.78</u>
<b>4. Net profit for the year ("()" for net losses)</b>		<b>(62,585,333.32)</b>	<b>74,831,789.76</b>
<b>5. Other comprehensive income</b>		<u>—</u>	<u>—</u>
<b>6. Total comprehensive income     ("()" for total comprehensive losses)</b>		<b><u>(62,585,333.32)</u></b>	<b><u>74,831,789.76</u></b>

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# CONSOLIDATED CASH FLOW STATEMENT

For the year 2012

Unit: RMB  
2011

Item	Note	2012	2011
<b>1. Cash flows from operating activities:</b>			
Cash received from sale of goods and rendering of services		1,052,291,530.94	1,964,949,740.05
Refund of taxes		–	66,264.68
Cash received relating to other operating activities	V. 47(1)	29,708,660.83	10,226,078.00
Sub-total of cash inflows from operating activities		1,082,000,191.77	1,975,242,082.73
Cash paid for goods and services		682,112,596.52	1,498,622,290.51
Cash paid to and for employees		300,519,348.00	302,276,499.68
Cash paid for all types of taxes		64,606,683.76	112,120,349.48
Cash paid relating to other operating activities	V. 47(2)	27,190,552.19	61,568,186.36
Sub-total of cash outflows from operating activities		1,074,429,180.47	1,974,587,326.03
Net cash flows from operating activities	V. 48(1)	7,571,011.30	654,756.70
<b>2. Cash flows from investing activities:</b>			
Cash received from return on investments		5,000,000.00	6,000,000.00
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		222,615.77	1,102,590.00
Net cash received from disposal of a subsidiary	V. 48(2)	943,758.31	–
Cash received from security deposits		46,013,203.52	–
Cash received relating to other investing activities	V. 47(3)	14,000,000.00	–
Sub-total of cash inflows from investing activities		66,179,577.60	7,102,590.00
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		102,067,300.63	165,856,206.78
Decrease in cash from loss of control of a subsidiary	V. 48(2)	5,970,608.35	–
Cash paid for security deposits		38,830,140.39	5,980,175.84
Sub-total of cash outflows from investing activities		146,868,049.37	171,836,382.62
Net cash flows from investing activities		(80,688,471.77)	(164,733,792.62)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# CONSOLIDATED CASH FLOW STATEMENT

For the year 2012

Unit: RMB  
2011

Item	Note	2012	2011
<b>3. Cash flows from financing activities:</b>			
Cash received from borrowings		120,000,000.00	100,000,000.00
Cash received relating to other financing activities		—	31,167,565.87
Sub-total of cash inflows from financing activities		<u>120,000,000.00</u>	<u>131,167,565.87</u>
Cash repayments of borrowings		115,000,000.00	46,000,000.00
Cash paid for distribution of dividends, profit or repayment of interest		<u>17,822,306.62</u>	<u>29,972,771.22</u>
Sub-total of cash outflows from financing activities		<u>132,822,306.62</u>	<u>75,972,771.22</u>
Net cash flows from financing activities		<u>(12,822,306.62)</u>	<u>55,194,794.65</u>
<b>4. Effect of foreign exchange rate changes on cash and cash equivalents</b>		<b><u>(190,459.70)</u></b>	<b><u>(1,190,013.48)</u></b>
<b>5. Net increase in cash and cash equivalents</b>			
("()" for net decrease)	V. 48(1)	(86,130,226.79)	(110,074,254.75)
Add: Cash and cash equivalents at the beginning of the year		<u>175,808,019.62</u>	<u>285,882,274.37</u>
<b>6. Cash and cash equivalents at the end of the year</b>	V. 48(3)	<b><u>89,677,792.83</u></b>	<b><u>175,808,019.62</u></b>

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# CASH FLOW STATEMENT

For the year 2012

Item	Note	2012	Unit: RMB 2011
<b>1. Cash flows from operating activities:</b>			
Cash received from sale of goods and rendering of services		889,096,198.05	1,718,455,799.13
Cash received relating to other operating activities		28,769,904.32	9,251,024.91
Sub-total of cash inflows from operating activities		<u>917,866,102.37</u>	<u>1,727,706,824.04</u>
Cash paid for goods and services		561,563,371.85	1,314,457,567.69
Cash paid to and for employees		273,375,993.49	272,568,425.03
Cash paid for all types of taxes		51,460,490.21	97,443,678.81
Cash paid relating to other operating activities		21,056,501.75	49,594,617.93
Sub-total of cash outflows from operating activities		<u>907,456,357.30</u>	<u>1,734,064,289.46</u>
Net cash flows from operating activities	XI. 6 (1)	<u>10,409,745.07</u>	<u>(6,357,465.42)</u>
<b>2. Cash flows from investing activities:</b>			
Net cash received from disposal of subsidiaries		1,000,000.00	1,150,286.89
Cash received from return on investments		6,989,605.81	6,000,000.00
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		182,685.00	1,101,220.00
Cash received from security deposits		4,000,000.00	-
Cash received relating to other investing activities		14,000,000.00	-
Sub-total of cash inflows from investing activities		<u>26,172,290.81</u>	<u>8,251,506.89</u>
Cash paid for security deposits		-	4,000,000.00
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		100,968,224.86	164,525,214.61
Sub-total of cash outflows from investing activities		<u>100,968,224.86</u>	<u>168,525,214.61</u>
Net cash flows from investing activities		<u>(74,795,934.05)</u>	<u>(160,273,707.72)</u>
<b>3. Cash flows from financing activities:</b>			
Cash received from borrowings		90,000,000.00	80,000,000.00
Cash received relating to other financing activities		-	31,167,565.87
Sub-total of cash inflows from financing activities		<u>90,000,000.00</u>	<u>111,167,565.87</u>
Cash repayments of borrowings		80,000,000.00	21,000,000.00
Cash paid for distribution of dividends, profit or repayment of interest		16,583,673.34	27,563,772.78
Sub-total of cash outflows from financing activities		<u>96,583,673.34</u>	<u>48,563,772.78</u>
Net cash flows from financing activities		<u>(6,583,673.34)</u>	<u>62,603,793.09</u>
<b>4. Effect of foreign exchange rate changes on cash and cash equivalents</b>		<u>(190,459.70)</u>	<u>(1,190,013.48)</u>
<b>5. Net increase in cash and cash equivalents</b>			
("(" for net decrease)	XI. 6 (1)	(71,160,322.02)	(105,217,393.53)
Add: Cash and cash equivalents at the beginning of the year		143,087,572.52	248,304,966.05
<b>6. Cash and cash equivalents at the end of the year</b>	XI. 6 (2)	<u><b>71,927,250.50</b></u>	<u><b>143,087,572.52</b></u>

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Unit: RMB

Item	Note	2012						2011					
		Attributable to shareholders of the Company					Total	Attributable to shareholders of the Company					Total
		Share capital	Capital reserve	Surplus reserve	Retained earnings	Minority interests		Share capital	Capital reserve	Surplus reserve	Retained earnings	Minority interests	
1. Balance at the beginning of the year		531,081,103.00	27,303,321.72	116,508,002.60	727,245,922.10	54,546,448.70	1,456,684,798.12	531,081,103.00	27,303,321.72	109,024,823.62	706,716,031.08	56,897,965.43	1,431,023,244.85
2. Changes in equity for the year ("0" for decrease)													
(1) Net profit for the year		-	-	-	(73,220,171.53)	(9,075,923.47)	(82,296,095.00)	-	-	-	54,567,125.16	(2,351,516.73)	52,215,608.43
(2) Other comprehensive income		-	-	-	-	-	-	-	-	-	-	-	-
Sub-total of (1) and (2)		-	-	-	(73,220,171.53)	(9,075,923.47)	(82,296,095.00)	-	-	-	54,567,125.16	(2,351,516.73)	52,215,608.43
(3) Appropriation of profits	V. 34												
1. Appropriation of surplus reserve		-	-	-	-	-	-	-	-	7,483,178.98	(7,483,178.98)	-	-
2. Distribution to shareholders		-	-	-	(10,621,622.06)	-	(10,621,622.06)	-	-	-	(26,554,055.16)	-	(26,554,055.16)
(4) Others													
1. Changes in minority interests from disposal of a subsidiary and loss of control of a subsidiary		-	-	-	-	(176,665.51)	(176,665.51)	-	-	-	-	-	-
3. Balance at the end of the year		531,081,103.00	27,303,321.72	116,508,002.60	643,404,128.51	45,293,859.72	1,363,590,415.55	531,081,103.00	27,303,321.72	116,508,002.60	727,245,922.10	54,546,448.70	1,456,684,798.12

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
Wang Xing

The person in charge of accounting affairs:  
Li Shunzhen

The head of the accounting department:  
Li Hongning

(Seal of the Company)

Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Unit: RMB

Item	Note	2012					2011				
		Share capital	Capital reserve	Surplus reserve	Retained earnings	Total	Share capital	Capital reserve	Surplus reserve	Retained earnings	Total
1. Balance at the beginning of the year		531,081,103.00	27,303,321.72	116,508,002.60	694,712,499.07	1,369,604,926.39	531,081,103.00	27,303,321.72	109,024,823.62	653,917,943.45	1,321,327,191.79
2. Changes in equity for the year ("0" for decrease)											
(1) Net profit for the year		-	-	-	(62,585,333.32)	(62,585,333.32)	-	-	-	74,831,789.76	74,831,789.76
(2) Other comprehensive income		-	-	-	-	-	-	-	-	-	-
Sub-total of (1) and (2)		-	-	-	(62,585,333.32)	(62,585,333.32)	-	-	-	74,831,789.76	74,831,789.76
(3) Appropriation of profits											
1. Appropriation of surplus reserve		-	-	-	-	-	-	-	7,483,178.98	(7,483,178.98)	-
2. Distribution to shareholders		-	-	-	(10,621,622.06)	(10,621,622.06)	-	-	-	(26,554,055.16)	(26,554,055.16)
3. Balance at the end of the year		531,081,103.00	27,303,321.72	116,508,002.60	621,505,543.69	1,296,397,971.01	531,081,103.00	27,303,321.72	116,508,002.60	694,712,499.07	1,369,604,926.39

The financial statements were approved by the Board of Directors of the Company on 27th March 2013.

Legal representative of the Company:  
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Notes to the financial statements set out on pages 63 to 153 form part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (I). CORPORATE INFORMATION

Shenji Group Kunming Machine Tool Company Limited (the “Company”) was established in the People’s Republic of China (“the PRC”) with limited liability on 19th October 1993. The place of registration of the Company is 23 Ciba Road, Kunming City, Yunnan Province, the PRC.

The Company is a stock company limited by restructuring from Kunming Machine Tool Plant approved by [1993] no. 173 Ti Gai Sheng issued by the State Economic Reform Commission. The name at establishment was Kunming Machine Tool Company Limited (“Kunji”). Kunming Machine Tool Plant used its assets and liabilities at 30th June 1993 to invest in the Company. The above assets and liabilities were assessed by Shanghai Accounting Firm. The assessed net assets were RMB179,258,700. The assessment was approved by [1993] no. 420 Guo Zi Ping issued by the National State-owned assets Administration Commission. According to [1993] no. 114 Guo Zi Qi Han Fa issued by the National State-owned assets Administration Commission, the assessed state-owned land use rights included in the above net assets should be reduced by RMB34,217,100, meanwhile, 82.74% of the adjusted net assets (assessment value was RMB145,041,600) was discounted to 120,007,400 shares with par value RMB1.00 per share. The original investors of Kunming Machine Tool Plant, Yunnan Provincial People’s Government and Kunming Jinghua Company Ltd., held 102,397,700 and 17,609,700 shares respectively.

Approved by [1993] no. 50 Zheng Wei Fa issued by the Security Commission of the State Council, Kunji issued and listed 65,000,000 H shares with par value RMB1.00 per share in the Stock Exchange of Hong Kong Limited in December 1993. Then, it issued and listed 60,000,000 A shares with par value RMB1.00 per share in Shanghai Stock Exchange in January 1994.

On 25th December 2000, Xi’an Jiaotong University Industrial (Group) Incorporation (“Jiaotong Group”) entered into Shares Transfer Agreement of Jiaoda Kunji High-Tech Company Limited with the People’s Government of Yunnan Province (“Yunnan Government”) whereby Yunnan Government would transfer 71,052,146 state-owned shares of the Company to Jiaotong Group. The transaction was approved by [2001] no. 283 Cai Qi – the Approval of State-owned Shares Transfer of Jiaoda Kunji High-tech Company Limited issued by the Ministry of Finance of the PRC. Upon completion of share transfer procedure on 5th June 2001, Jiaotong Group became the largest shareholder of the Company.

With effective from 29th March 2002, the Company used the name “Jiaoda Kunji High Tech Company Limited” (“Jiaoda Kunji”) jointly approved by the State Administration for Industry and Commerce of the PRC and the Ministry of Foreign Trade and Economic Cooperation of the PRC after completing the business registration for change of company name in Yunnan Commercial and Industrial Administration Bureau.

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



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (I). CORPORATE INFORMATION *(Continued)*

On 4th April 2006, pursuant to the "Written Reply of the People's Government of Yunnan Province Regarding the Transfer of Title of Jiaoda Kunji High-Tech Co., Ltd." issued by the People's Government of Yunnan Province and the "Written Reply of Yunnan State-owned Assets Supervision and Administration Committee regarding the Grant of Authorization to Yunnan State-owned Assets Operation Co., Ltd. to Exercise the Shareholders' Right of Jiaoda Kunji High-tech Co., Ltd." issued by Yunnan State-owned Assets Supervision and Administration Committee, 31,345,554 state-owned shares held by the People's Government of Yunnan were transferred to Yunnan State-owned Assets Operation Co., Ltd. ("Yunnan State-owned Assets Operation Co., Ltd.") at nil consideration on 31st December 2005. The share transfer was approved by the State-owned Assets Supervision and Administration Committee of the State Council pursuant to the "Written Reply regarding the Transfer of Part of the State-owned Shares of Jiaoda Kunji High-Tech Co., Ltd." (Guo Zi Chan Quan [2006] No. 1412). The transfer was completed on 19th January 2007.

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

On 23rd March 2007, approved by the shareholders' meeting of Jiaoda Kunji, Jiaoda Kunji High-Tech Company changed its name to Shenji Group Kunming Machine Tool Company Limited.

Approved by the annual general meeting of the Company held on 29th June 2007, based on total share capital of 283,243,255 shares of the Company, increased shares on the basis of 5 shares for every 10 shares held to all the shareholders by capitalization of capital reserve, totally increased 141,621,628 shares. After share increase, total issued shares of the Company was 424,864,883 shares, and total registered capital of the Company was RMB424,864,883. The resolution was approved by the "Written Reply Regarding the Change of Name and Increase in Share Capital of Jiaoda Kunji High-Tech Co., Ltd." (Shang Zi Pi [2007] No. 1390) issued by the Ministry of Commerce of the PRC.

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

Approved by the shareholders' meetings held on 23rd June 2010, based on total share capital of 424,864,883 shares of the Company, increased shares on the basis of 2.5 shares for every 10 shares held to all the shareholders by capitalization of capital reserve, totally increased 106,216,220 shares. After share increase, total issued shares of the Company would be 531,081,103 shares, and total registered capital of the Company would be RMB531,081,103. The resolution was approved by the "Written Reply from the Department of Commerce of Yunnan Province Concerning its Consent to the Increase in Share Capital by Capitalization of the Capital Reserve by Shenji Group Kunming Machine Tool Company Limited" (Yun Shang Zi [2010] No. 130).

The Company and its subsidiaries (collectively the "Group") mainly engage in development, design, production and sales of machine tool series products and accessories, sensor and turbo tables and turbo machine and sintering fans series products and accessories.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES

### 1. Basis of preparation of financial statements

The financial statements of the Company have been prepared on a going concern basis.

### 2. Statement of compliance with the corporate accounting standards

The financial statements have been prepared in accordance with the requirements of "Accounting Standards for Business Enterprises – Basic Standard" and 38 Specific Standards issued by the Ministry of Finance on 15th February 2006, and application guidelines, explanations to corporate accounting standards and other relevant regulations issued subsequently (collectively referred to as "corporate accounting standards"). These financial statements provide a true and complete presentation of the consolidated financial position and financial position as at 31st December 2012, the consolidated results of operations and results of operations and the consolidated cash flows and cash flows of the Company for the year 2012.

These financial statements also comply with the disclosure requirements of "Regulation on the Preparation of Information Disclosures of Companies Issuing Public Shares, No. 15: General Requirements for Financial Reports" as revised by the CSRC in 2010 in relation to the disclosure requirements of the financial statements and their accompanying notes.

### 3. Accounting period

The accounting period commences on 1st January and ends on 31st December each year.

### 4. Functional currency

The functional currency of the Company is Renminbi ("RMB"). The Company presents the financial statements in RMB. The functional currency is determined by the Company and its subsidiaries on the basis of the currency in which major income and costs are denominated and settled.

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

#### (1) *Business combination under common control*

A business combination 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 combination, and that control is not transitory. Assets and liabilities that are obtained by the acquirer in a business combination shall be measured at their carrying amounts at the combination date as recorded by the party being acquired. The difference between the carrying amount of the net assets obtained and the carrying amount of the consideration paid for the combination (or the aggregate face value of shares issued as consideration) shall be adjusted to share premium under capital reserve (or capital premium). If the share premium under capital reserve (or capital premium) is not sufficient to absorb the difference, any excess shall be adjusted against retained earnings. Expenses that are directly attributable to business combination are expense in the profit and loss at the period incurred. The combination date is the date on which the acquiring party effectively obtains control of the party being acquired.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

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

#### (2) *Business combinations not under common control*

A business combination not 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 combination. The sum of the assets paid (including the equity interest of acquiree held before the date of acquisition) and liabilities incurred or committed and the equity securities issued by the Group who as an acquirer for obtaining the controlling interests of the acquiree measured at fair value on the date of acquisition minus the fair value of the acquiree's identifiable net assets in the combination, if the difference is positive, it should be recognized as goodwill (please refer to note II. 17), or if the difference is negative, it shall be included in the profit or loss for the period. The transaction expenses of issuing equity securities or liability securities as consideration for combination are included as the initial measurement amount of equity securities or liability securities. The direct expenses incurred in business combination shall be included in the profit or loss for the period. The difference between the fair value of assets paid and its book value should be included in the profit or loss for the period. The Group shall recognize acquiree's identifiable assets, liabilities and contingent liabilities acquired in the business combination at their fair values on the acquisition date that meet the criteria for recognition. Acquisition date is the date on which the acquirer effectively obtains control of the acquiree.

### 6. Preparation of consolidated financial statements

The consolidated financial statements are based on control for the scope of consolidation, and comprise the Company and its subsidiaries. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its operating activities. The financial position, financial performance and cash flow of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Where a subsidiary was acquired during the reporting period, through a business combination involving entities under common control, the financial statements of the subsidiary are included in the consolidated financial statements as if the combination had occurred at the date that common control was established. Therefore, the opening balances and the comparative figures of the consolidated financial statements are restated. In the preparation of the consolidated financial statements, the subsidiary's assets, liabilities and results of operations are included in the consolidated balance sheet and the consolidated income statement, respectively, based on their carrying amounts, from the date that common control was established.

Where a subsidiary was acquired during the reporting period, through a business combination involving entities not under common control, the acquired subsidiaries are included in the consolidated financial statements from the acquisition date, and based on the fair value of those identifiable assets and liabilities at the acquisition date.

For a business combination not involving enterprises under common control and achieved in stages, the Group remeasured its previously-held equity interest in the acquiree to its fair value at the acquisition date. The difference between the fair value and the carrying amount is recognized as investment income for the current period; the amount recognized in other comprehensive income relating to the previously-held equity interest in the acquiree is reclassified as investment income for the current period.

Where the Company acquires a minority interest from a subsidiary's minority shareholders or disposes of a portion of an interest in a subsidiary without a change in control, the difference between the investment cost of newly acquired long-term equity investment and the Company's share of its subsidiary's identifiable net assets and the difference between the consideration received for disposal of long-term equity investment and the Company's share of subsidiary's identifiable net assets are adjusted to the capital reserve (share premium) in the consolidated balance sheet. If the credit balance of capital reserve (share premium) is insufficient, any excess is adjusted to retained earnings.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

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

When the Group loses control of a subsidiary due to the disposal of a portion of an equity investment, the Group ceases to recognize the assets, liabilities, minority interests and other related items of the interests related to the subsidiary. The remaining equity investment is remeasured at its fair value at the date when control is lost. Any profit or loss incurred is recognized as investment income for the current period when control is lost.

Minority interest is presented separately in the consolidated balance sheet within shareholders' equity. Net profit or loss and comprehensive income attributable to minority shareholders are presented separately in the consolidated income statement below the net profit and total comprehensive income line items.

When the amount of loss for the current period attributable to the minority shareholders of a subsidiary exceeds the minority shareholders' portion of the opening balance of shareholders' equity of the subsidiary, the excess is allocated against the minority interests.

When the accounting period or accounting policies of a subsidiary are different from those of the Company, the Company makes necessary adjustments to the financial statements of the subsidiary based on the Company's own accounting period or accounting policies. Intra-group balances and transactions, and any unrealized profit or loss arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealized losses resulting from intra-group transactions are eliminated in the same way as unrealized gains but only to the extent that there is evidence of impairment.

### 7. Determination of cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, and short-term, highly liquid investments, which are readily convertible into known amounts of cash and are subject to an insignificant risk of change in value.

### 8. Foreign currency transactions

When the Group receives capital in foreign currencies from investors, the capital is translated to Renminbi at the spot exchange rate at the date of the receipt. Other foreign currency transactions are, on initial recognition, translated to Renminbi at the spot exchange rates on the dates of the transactions.

A spot exchange rate is an exchange rate quoted by the People's Bank of China or a cross rate determined based on quoted exchange rates.

Monetary items denominated in foreign currencies are translated to Renminbi at the spot exchange rate at the balance sheet date. The resulting exchange differences are recognized in profit or loss, except those arising from the principals and interests on foreign currency borrowings specifically for the purpose of acquisition, construction of qualifying assets for capitalization (see Note II. 15). Non-monetary items denominated in foreign currencies that are measured at historical cost are translated using the foreign exchange rate resulting from transactions. Non-monetary items denominated in foreign currencies that are measured at fair value are translated using the foreign exchange rate at the date the fair value is determined; the resulting exchange differences are recognized in profit or loss.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 9. Financial instruments

Financial instruments of the Group comprise cash at bank and on hand, receivables, payables, loans, and share capital, etc.

#### (1) *Recognition and measurement of financial assets and financial liabilities*

A financial asset or financial liability is recognized in the balance sheet when the Group becomes a party to the contractual provisions of a financial instrument.

The Group classifies financial assets and liabilities into different categories at initial recognition, based on the purpose of acquiring assets or assuming liabilities: loans and receivables and other financial liabilities.

Financial assets and financial liabilities are measured initially at fair value and any attributable transaction costs are included in their initial costs. Subsequent to initial recognition financial assets and liabilities are measured as follows:

– Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Subsequent to initial recognition, receivables are stated at amortized cost using the effective interest method.

– Other financial liabilities

Financial liabilities other than the financial liabilities at fair value through profit or loss are classified as other financial liabilities.

Subsequent to initial recognition, other financial liabilities are stated at amortized cost using the effective interest method.

#### (2) *Presentation of financial assets and financial liabilities*

Financial assets and financial liabilities are presented separately in the balance sheet and shall not be offset. However, a financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when both of the following conditions are satisfied:

– the Group has a legal right to offset the recognized amounts and the legal right is currently enforceable;

– the Group intends either to settle on a net basis, or to realize the financial asset and settle the financial liability simultaneously.

#### (3) *Determination of fair values*

If there is an active market for a financial asset or financial liability, the quoted price in the active market is used to establish the fair value.

If no active market exists for a financial instrument, a valuation technique is used to establish the fair value. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties; reference to the current fair value of another instrument that is substantially the same and discounted cash flow analysis. The Group calibrates the valuation technique and tests it for validity periodically.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 9. Financial instruments *(Continued)*

#### (4) *Derecognition of financial assets and financial liabilities*

A financial asset is derecognized if the Group's contractual rights to the cash flows from the financial asset expire or if the Group transfers substantially all the risks and rewards of ownership of the financial asset to another party.

Where a transfer of a financial asset in its entirety meets the criteria of the derecognition, the difference between the two amounts below is recognized in profit or loss:

- carrying amount of the financial asset transferred;
- the sum of the consideration received from the transfer and any cumulative gains or loss that has been recognized directly in equity.

The Group derecognizes a financial liability (or part of it) only when the underlying present obligation (or part of it) is discharged.

#### (5) *Impairment of financial assets*

The carrying amounts of financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, impairment loss is provided.

Objective evidence that a financial asset is impaired includes, but is not limited to the following:

- (a) significant financial difficulty of the issuer or borrower;
- (b) a breach of contract by the borrower, such as a default or delinquency in interest or principal payments;
- (c) strong probability that the borrower will enter bankruptcy or go through another type of financial reorganisation;
- (d) the disappearance of an active market for the financial asset due to serious financial difficulties on the part of the issuer;
- (e) significant adverse changes in the technological, market, economic or legal environment in which the issuer operates, indicating that the cost of the investment in the equity instrument may not be recovered by the investor;
- (f) a significant or prolonged decline in the fair value of an equity instrument investment to below cost.

For the measurement of impairment of receivables, refer to Note II. 10.

#### (6) *Equity instruments*

An equity instrument is a contract that proves the residual interest of the assets after deducting all liabilities in the Company.

The consideration received from the issuance of equity instruments net of transaction costs is recognized in shareholders' equity.

Consideration and transaction costs paid by the Company for repurchasing self-issued equity instruments are deducted from Shareholders' equity.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 10. Impairment of receivables

Receivables are assessed for impairment both on an individual basis and on a collective group basis.

Where impairment is assessed on an individual basis, an impairment loss in respect of a receivable is calculated as the excess of its carrying amount over the present value of the estimated future cash flows (exclusive of future credit losses that have not been incurred) discounted at the original effective interest rate. The Group discounts the carrying amount of the receivables to its present value and the discounted amount is recognized as impairment loss of asset, all impairment losses are recognized in profit or loss.

The assessment is made collectively where receivables share similar credit risk characteristics (including those having not been individually assessed as impaired), based on their historical loss experiences, and adjusted by the observable figures reflecting present economic conditions.

If, after an impairment loss has been recognized on receivables, there is objective evidence of a recovery in value of the financial asset which can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss. A reversal of an impairment loss will not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognized in prior years.

#### (a) *Significant single accounts receivable which being made single bad debt provision:*

Judgment basis or criteria for receivables that are individually significant	1 type of trade receivable (trade receivables): criteria: RMB7,000,000 for single accounts receivable;
	2 type of other receivable (other receivables): criteria: RMB3,500,000 for single accounts receivable;
	3 type of personal accounts receivable (other receivables): criteria: RMB100,000 for single accounts receivable.

Method of provision for bad and doubtful debts for receivables that are individually significant and assessed individually	The bad debt provision made for individually significant accounts receivable adopted both on individual basis and on collective combination basis. First by individual impairment test, if the present value of estimated future cash flows (exclusive of future credit losses that have not been incurred) discounted at the original effective interest rate is less than its carrying value, the difference should be recognized as impairment loss and should make provision. If the impairment not being incurred after the individual test, the accounts receivable should combine with other receivables to provide bad debt provision by credit risk characteristic combination (see (b) below).
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# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 10. Impairment of receivables *(Continued)*

(b) *Bad debt provision for accounts receivable by combination:*

For accounts receivable not impaired after individual test which stated in (a) above, the Group will include it in the accounts receivable combination with credit risk characters to do the test again.

Basis for determining groups	Divide the accounts receivable into two groups based on companies' nature
Group 1	Receivables from third parties
Group 2	Receivables from related parties
Methods for providing bad debt provision by different groups	
Group 1	Ageing analysis
Group 2	Individual assessment

In group 1, provision for bad debts made by ageing analysis:

	Percentage of provision for trade receivable (%)	Percentage of provision for other receivables (%)
Ageing		
Within 1 year (including 1 year)	5%	5%
1-2 years (including 2 years)	30%	50%
2-3 years (including 3 years)	60%	100%
Over 3 years	95%	100%

In group 2, individual impairment test will be conducted to accounts receivable of related parties at the end of the year. Should objective evidence shows that it incurred impairment, according to the difference between the present value of future estimated cash flow and the book value, assets impairment should be recognized. Should no objective evidence show that it has impairment, no bad debt provision should be made.

### 11. Inventories

(1) *Classification*

Inventories include raw material, work in process, semi-finished goods, finished goods and reusable materials. Reusable materials include low-value consumables, packaging materials and other materials, which can be used repeatedly but do not meet the definition of fixed assets.

(2) *Determination of cost of inventories*

The actual cost of inventories is calculated using the weighted average method.

(3) *The underlying factors in the determination of net realizable value of inventories and the basis of provision for diminution in value of inventories*

Inventories are initially measured at cost. Cost of inventories comprises all costs of purchase, costs of conversion and other expenses that to help deliver the inventories to the current location and situation. In addition to the purchasing cost of raw materials, work in progress and finished goods include direct labour costs and an appropriate allocation of production overheads.

Inventories are measured at the lower of cost and net realizable value at the balance sheet date.



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 11. Inventories *(Continued)*

- (3) *The underlying factors in the determination of net realizable value of inventories and the basis of provision for diminution in value of inventories (Continued)*

Net realizable value is the estimated selling price in the normal course of business less the estimated costs to completion and the estimated expenses and the related taxes necessary to make the sale. The net realizable value of materials held for use in the production of inventories is measured based on the net realizable value of the finished goods in which they will be incorporated. The net realizable value of the quantity of inventory held to satisfy sales or service contracts is based on the contract price. If the quantities of inventories specified in sales contracts are less than the quantities held by the Group, the net realizable value of the excess portion of inventories shall be based on general selling prices.

Any excess of the cost over the net realizable value of each item of inventories is recognized as a provision for diminution in the value of inventories and charged to profit or loss.

- (4) *Inventory system*

The Group maintains a perpetual inventory system for raw material and finished goods and a periodic inventory system for semi-finished goods.

- (5) *Amortization of consumables including low-value consumables and packaging material*

Consumables including low-value consumables and packaging materials are amortized in full when received for use. The amounts of the amortization are included in the cost of the related assets or profit or loss.

### 12. Long-term equity investments

- (1) *Initial investment cost*

- (a) Long-term equity investments acquired through a business combination

- The initial investment cost of a long-term equity investment obtained through a business combination involving entities under common control is the Company's share of the subsidiary's equity at the combination date. The difference between the initial investment cost and the carrying amounts of the consideration given is adjusted to share premium in capital reserve. If the balance of the share premium is insufficient, any excess is adjusted to retained earnings.
- For long-term equity investments obtained through business combinations involving enterprises not under common control, the initial investment cost represents the aggregate of the fair values of assets transferred, liabilities assumed, and equity securities issued by the Company, in exchange for control of the acquiree. For a long-term equity investment obtained through a business combination not involving enterprises under common control and achieved in stages, the initial cost comprises the carrying value of previously-held equity investment in the acquiree immediately before the acquisition date, and the additional investment cost at the acquisition date.

- (b) Long-term equity investments acquired other than through a business combination

- An investment in a subsidiary acquired other than through a business combination is initially recognized at actual payment cost if the Group acquires the investment by cash, or at the value stipulated in the investment contract or agreement if an investment is contributed by shareholders.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

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

#### (2) *Subsequent measurement and recognition of profit and loss*

##### (a) Investments in subsidiaries

In the Company's financial statements, long-term equity investments in subsidiaries are measured subsequently by using the cost method. Cash dividends or profit distributions declared by subsidiaries and attributed to the Company shall be recognized as investment income (not identifying whether it is the net profit realized by investee before or after investment), except those that have been declared but unpaid at the time of acquisition and therefore included in the price paid or consideration.

Investments in subsidiaries are stated at cost less provision for impairment in the balance sheet.

In the Group's consolidated financial statements, long-term equity investments in subsidiaries are accounted for in accordance with the principles described in Note II. 6.

##### (b) Investment in jointly controlled enterprises and associates

A jointly controlled enterprise is an enterprise which operates under joint control (see Note II. 12(3)) in accordance with a contractual agreement between the Group and other parties.

An associate is an enterprise over which the Group has significant influence (see Note II. 12(3)).

An investment in a jointly controlled enterprise or an associate is accounted for using the equity method when subsequent measurement is made, unless the investment meets the requirements as held-for-sale (see Note II. 26).

The Group makes the following accounting treatments when using the equity method:

- Where the initial investment cost of a long-term equity investment exceeds the Group's interest in the fair value of the investee's identifiable net assets at the date of acquisition, the investment is initially recognized at the initial investment cost. Where the initial investment cost is less than the Group's interest in the fair value of the investee's identifiable net assets, the investment is initially recognized at the investor's share of the fair value of the investee's identifiable net assets, and the difference is charged to profit or loss.
- After the acquisition of the investment, the Group recognizes its share of the investee's net profit or loss, and the difference is charged to profit or loss are not quoted in an active market recognized by the Group before the first-time adoption of CAS, as investment income or losses, and adjusts the carrying amount of investment accordingly. The debit balance of the equity investment difference is amortized using the straight-line method over the period which is determined in accordance with previous accounting standards. Once the investee declares any cash dividends or profits distributions, the carrying amount of the investment is reduced by that attributable to the Group.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

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

#### (2) *Subsequent measurement and recognition of profit and loss (Continued)*

##### (b) Investment in jointly controlled enterprises and associates *(Continued)*

The Group recognizes its share of the investee's net profits or losses after making appropriate adjustments to align the accounting policies or accounting periods with those of the Group based on the fair values of the investee's identifiable net assets at the date of acquisition. Unrealized profits and losses resulting from transactions between the Group and its associates or jointly controlled enterprises are eliminated to the extent of the Group's interest in the associates or jointly controlled enterprises. Unrealized losses resulting from transactions between the Group and its associates or jointly controlled enterprises are eliminated in the same way as unrealized gains but only to the extent that there is no evidence of impairment.

- The Group discontinues recognizing its share of net losses of the investee after the carrying amount of the long-term equity investment and any long-term interest that in substance forms part of the Group's net investment in the associate or the jointly controlled enterprises is reduced to zero, except to the extent that the Group has an obligation to assume additional losses. Where net profits are subsequently made by the associate or jointly controlled enterprises, the Group resumes recognizing its share of those profits only after its share of the profits equals the share of losses not recognized.
- For other changes of shareholders' equity other than net profits or losses of jointly controlled enterprises or associates, the Group adjusts the carrying amount of the long-term equity investment and recognizes it in shareholder's equity.

##### (c) Other long-term equity investments

Other long-term equity investments refer to investments where the Group does not have control, joint control or significant influence over the investees, and the investments are not quoted in an active market and their fair value cannot be reliably measured.

Other long-term equity investments are accounted for subsequently using the cost method. Cash dividends or profit distributions declared by subsidiaries and attributed to the Group shall be recognized as investment income (regardless of whether it is the net profit realized by investee before or after investment), except those that have been declared but unpaid at the time of acquisition and therefore included in the price paid or consideration.

#### (3) *Basis for determining the existence of joint control or significant influence over an investee*

Joint control is the contractual agreed sharing of control over an investee's economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing the control. The following evidences shall be considered when determining whether the Group can exercise joint control over an investee:

- no single investor is in a position to control the operating activities unilaterally;
- operating decisions relating to the investee's economic activity require the unanimous consent of the parties sharing the control;
- if the parties sharing the control appoint one investor as the operator or manager of the jointly controlled enterprises through the contractual arrangement, the operator must act within the financial and operating policies that have been agreed by the investors in accordance with the contractual arrangement.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

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

#### (3) *Basis for determining the existence of joint control or significant influence over an investee (Continued)*

Significant influence is the power to participate in the financial and operating policy decisions of an investee but is not control or joint control over those policies. The following one or more evidences shall be considered when determining whether the Group can exercise significant influence over an investee:

- representation on the board of directors or equivalent governing body of the investee;
- participation in policy-making processes;
- material transactions between the investor and the investee;
- interchange of managerial personnel;
- provision of essential technical information.

#### (4) *Method of impairment testing and provision for impairment*

For the method of impairment testing and provision for impairment for subsidiaries, jointly controlled enterprises and associates, refer to Note II. 19.

For other long-term equity investments, the carrying amount is required to be tested for Impairment at the balance sheet date. If there is objective evidence that the investments may be impaired, the impairment shall be assessed on an individual basis. The impairment loss is measured as the amount by which the carrying amount of the investment exceeds the present value of estimated future cash flows discounted at the current market rate on return for a similar financial asset. Such impairment loss is not reversed.

Other long-term equity investments are stated at cost less impairment losses in the balance sheet.

### 13. Fixed assets

#### (1) *Recognition criteria for fixed assets*

Fixed assets represent the tangible assets held by the Group for use in the production of goods, rendering of services or for operation and administrative purposes with useful lives over one accounting year.

The initial cost of a purchased fixed asset comprises the purchase price, related taxes, and any directly attributable expenditure for bringing the asset to working condition for its intended use. The initial cost of self-constructed assets is measured in accordance with the policy set out in Note II. 14.

Where parts of an item of fixed asset have different useful lives or provide benefits to the Group in different patterns thus necessitating use of different depreciation rates or methods, each part is recognized as a separate fixed asset.

The subsequent costs including the cost of replacing part of an item of fixed assets are recognized in the carrying amount of the item if the recognition criteria are satisfied, and the carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of fixed assets are recognized in profit or loss as incurred.

Fixed assets are stated in the balance sheet at cost less accumulated depreciation and impairment losses.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 13. Fixed assets *(Continued)*

#### (2) Depreciation method for fixed assets

Fixed assets are depreciated using the straight-line method over their estimated useful lives on the basis of cost less estimated net residual value and accumulated impairment loss, except for those which meet the requirement as held-for-sale (refer to Note II. 26).

The depreciation period, residual value rate and annual depreciation rate of each type of fixed assets are as follows:

Type	Useful life (year)	Residual value rate (%)	Annual depreciation rate (%)
Buildings and structures	40 years	5%	2.38%
Machinery equipment	5 – 20 years	5%	4.75% – 19%
Transportation equipment	5 – 14 years	5%	6.78% – 19%
Electronic equipment	5 – 14 years	5%	6.78% – 19%

Useful lives, estimated residual values and depreciation methods are reviewed at least each year-end.

#### (3) For the method of impairment testing and provision for impairment, refer to Note II.19.

#### (4) Recognition and measurement of fixed assets acquired under finance leases.

For the recognition and measurement of fixed assets acquired under finance leases, refer to the accounting policy set out in Note II. 25 (2).

#### (5) Disposal of fixed assets

The carrying amount of a fixed asset shall be derecognized:

- on disposal; or
- when no future economic benefits are expected to be generated from its use or disposal.

Gains or losses arising from the retirement or disposal of an item of fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the item, and are recognized in profit or loss on the date of retirement or disposal.

### 14. Construction in progress

The cost of self-constructed fixed assets includes the cost of materials, direct labour, borrowing costs that meet the criteria for capitalization (see Note II.15), and any other costs directly attributable to bringing the asset to working condition for its intended use.

A self-constructed fixed asset is included in construction in progress before it is transferred to fixed assets when it is ready for its intended use. No depreciation is provided against construction in progress.

Construction in progress is stated in the balance sheet at cost less provision for impairment (see Note II.19).

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 15. Borrowing costs

Borrowing costs incurred directly attributable to the acquisition, construction of a qualifying asset are capitalized as part of the cost of the asset.

Except for the above, other borrowing costs are recognized as financial expenses in the income statement when incurred.

During the capitalization period, the amount of interest (including amortization of any discount or premium on borrowing) to be capitalized in each accounting period is determined as follows:

- Where funds are borrowed specifically for the acquisition, construction of a qualifying asset, the amount of interest to be capitalized is the interest expense calculated using effective interest rates during the period less any interest income earned from depositing the borrowed funds or any investment income on the temporary investment of those funds before being used on the asset.
- Where funds are borrowed generally and used for the acquisition, construction of a qualifying asset, the amount of interest to be capitalized on such borrowings is determined by applying a capitalization rate to the weighted average of the excess amounts of cumulative expenditures on the asset over the above amounts of specific borrowings. The capitalization rate is the weighted average of the interest rates applicable to the general-purpose borrowings.

The effective interest rate is determined as the rate that exactly discounts estimated future cash flow through the expected life of the borrowing or, when appropriate, a shorter period to the initially recognized amount of the borrowings.

During the capitalization period, exchange differences related to the principal and interest on a specific-purpose borrowing denominated in foreign currency are capitalized as part of the cost of the qualifying asset. The exchange differences related to the principal and interest on foreign currency borrowings other than a specific-purpose borrowing are recognized as a financial expense in profit and loss in the period they are incurred.

The capitalization period is the period from the date of commencement of capitalization of borrowing costs to the date of cessation of capitalization, excluding any period over which capitalization is suspended. Capitalization of borrowing costs commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities of acquisition that are necessary to prepare the asset for its intended use are in progress, and ceases when the assets become ready for their intended use. Capitalization of borrowing costs is suspended when the acquisition, construction activities are interrupted abnormally and the interruption lasts for over three months.

### 16. Intangible assets

Intangible assets are stated in the balance sheet at cost less accumulated amortization and impairment losses (see Note II.19). Intangible asset's cost less estimated net residual value and accumulated impairment losses is amortized on the straight-line method over its estimated useful life, except that the intangible asset match the conditions of held for sale (refer to Note II.26).

The respective amortization periods for such intangible assets are as follows:

Items	Amortization period
Land use rights	50 years
Various software	3 – 10 years
Others	5 – 10 years

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 16. Intangible assets *(Continued)*

Expenditures on an internal research and development project are classified into expenditures on the research phase and expenditures on the development phase. Expenditures on research phase are recognized in profit or loss when incurred. Expenditures on development phase are capitalized if development costs can be measured reliably, the product or process is technically and commercially feasible, and the Group intends to and has sufficient resources to complete development. Capitalized development costs are stated at cost less impairment losses in the balance sheet (see Note II.19). Other development expenditures are recognized as expenses in the period in which they are incurred.

### 17. Goodwill

The initial cost of Goodwill caused by business combination not under common control is the excess of combination cost and the fair value of obtained identifiable net assets obtained from the acquiree.

Goodwill is not amortized. Goodwill is stated at cost less accumulated impairment losses in the balance sheet (see Note II.19). Goodwill is transferred when its related assets or assets group is disposed, and recognized in profit or loss for the period.

### 18. Long-term deferred expenses

Long-term deferred expenses are amortized in equal installments over the period that it enjoys benefits. Amortization periods for expenditures are:

Item	Amortization period
Decoration	5 years

### 19. Impairment of assets other than inventories, financial assets and other long-term equity investments

The carrying amounts of the following assets are reviewed at each balance sheet date based on the internal and external sources of information to determine whether there is any indication of impairment:

- Fixed assets
- Construction in progress
- Assets acquired under finance lease
- Intangible assets
- Long-term equity investments in subsidiaries, jointly controlled enterprises and associates
- Goodwill
- Long-term deferred expenses
- Other non-current assets etc.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 19. Impairment of assets other than inventories, financial assets and other long-term equity investments *(Continued)*

If any indication exists that an asset may be impaired, the recoverable amount of the asset is estimated. In addition, whether impairment evidence exists, the Group assesses the recoverable amount of goodwill at the end of each year. The Group amortizes the book value of goodwill based on benefit from the synergies of the business combination on its related asset or combination of assets, and on this basis conducts impairment test for goodwill annually.

The recoverable amount of an asset, asset group or set of asset groups is the higher of its fair value less costs to sell and its present value of expected future cash flows.

An asset group is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or asset groups. An asset group is composed of assets directly relating to cash-generation. Identification of an asset group is based on whether major cash inflows generated by the asset group are largely independent of the cash inflows from other assets or asset groups. In identifying an asset group, the Group also considers how management monitors the Group's operations and how management makes decisions about using or disposing of the Group's assets.

An asset's fair value less costs to sell is the amount determined by the price of a sale agreement in an arm's length transaction, less the costs that are directly attributable to the disposal of the asset. The present value of expected future cash flows of an asset is determined by discounting the future cash flows, estimated to be derived from continuing use of the asset and from its ultimate disposal, to their present value using a pre-tax discount rate.

If the result of the recoverable amount estimation indicates the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That 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. For impairment losses related to an asset group or a set of asset groups, first reduce the carrying amount of any goodwill allocated to the asset group or set of asset groups, and then reduce the carrying amount of the other assets in the asset group or set of asset groups on a pro rata basis. However, the carrying amount of an impaired asset will not be reduced below the highest of its individual fair value less costs to sell (if determinable), the present value of expected future cash flows (if determinable) and zero.

Once an impairment loss is recognized, it is not reversed in a subsequent period.

### 20. Provisions

A provision is recognized for an obligation related to a contingency if the Group has a present obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the effect of time value of money is material, provisions are determined by discounting the expected future cash flows.



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 21. Revenue

Revenue is the gross inflow of economic benefit arising in the course of the Group's ordinary activities when the inflows result in increase in shareholder's equity, other than increase relating to contributions from shareholders. Revenue is recognized in profit or loss when it is probable that the economic benefits will flow to the Group, the revenue and costs can be measured reliably and the following respective conditions are met.

#### (1) *Sale of goods*

Revenue from sale of goods is recognized when all of the general conditions stated above and the following conditions are satisfied:

- The significant risks and rewards of ownership of goods have been transferred to the buyers;
- The Group retains neither continuing managerial involvements to the degree usually associated with ownership nor effective control over the goods sold.

Revenue from the sale of goods is measured at the fair value of the considerations received or receivable under the sales contract or agreement.

#### (2) *Rendering of services*

Revenue from rendering of services is measured at the fair value of the considerations received or receivable under the contract or agreement.

At the balance sheet date, where the outcome of a transaction involving the rendering of services can be estimated reliably, revenue from the rendering of services is recognized in the income statement by reference to the stage of completion of the transaction based on the progress of work performed or the ratio of cost happened to the proportion of total estimated cost.

Where the outcome of rendering of services cannot be estimated reliably, if the costs incurred are expected to be recoverable, revenues are recognized to the extent that the costs incurred that are expected to be recoverable, and an equivalent amount is charged to profit or loss as service cost; if the costs incurred are not expected to be recoverable, the costs incurred are recognized in profit or loss and no service revenue is recognized.

#### (3) *Interest income*

Interest income is recognized on a time proportion basis with reference to the principle and the applicable effective interest rate.

#### (4) *Royalty income of intangible assets*

Royalty income of intangible assets is calculated based on the agreed charging time and method in the relevant contract or agreement.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 22. Employee benefits

Employee benefits are all forms of considerations given and other relevant expenditures incurred in exchange for services rendered by employees. Except for termination benefits, employee benefits are recognized as a liability in the period in which the associated services are rendered by employees, with a corresponding increase in cost of relevant assets or expenses in the current period.

#### (a) *Social insurance benefit and housing fund*

Pursuant to relevant regulations of PRC, the Group has joined a social insurance system established and managed by the government organization. At the applicable rates based on the amounts stipulated by national government, the Group has joined housing fund and made contributions to the basic pension insurance, basic medical insurance, unemployment insurance, injury insurance and maternity insurance. The contributions to social insurance and housing fund mentioned above are recognized as cost of assets or charged to profit or loss on an accrual basis. The Group will have no further payment obligations after periodic contributions mentioned above pursuant to national regulations.

#### (b) *Termination benefits*

When the Group terminates the employment relationship with employees before the employment contracts have expired, or provides compensation as an offer to encourage employees to accept voluntary redundancy, a provision for the termination benefits provided, is recognized in profit or loss when both of the following conditions have been satisfied:

- The Group has a formal plan for the termination of employment or has made an offer to employees for voluntary redundancy, which will be implemented shortly.
- The Group is not allowed to withdraw from termination plan or redundancy offer unilaterally.

#### (c) *Early retirement benefits*

The early retirement is recognized only when the Group has clear commitment to provide benefits to the staff who initially retire early and the commitment cannot be withdrawn unilaterally. If the related payment is over one year and the amount is significant, the amounts should be measured at discounted value.

### 23. Government grants

Government grants are transfers of monetary assets or non-monetary assets from the government to the Group at no consideration except for the capital contribution from the government as an investor in the Group. Special funds such as investment grants allocated by the government, if clearly defined in official documents as part of “capital reserve” are dealt with as capital contributions, and not regarded as government grants.

A government grant is recognized when there is reasonable assurance that the grant will be received and that the Group will comply with the conditions attaching to the grant.

If a government grant is in the form of a transfer of a monetary asset, it is measured at the amount that is received or receivable. If a government grant is in the form of a transfer of a non-monetary asset, it is measured at its fair value.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 23. Government grants *(Continued)*

A government grant related to an asset is recognized initially as deferred income and amortized to profit or loss on a straight-line basis over the useful life of the asset. A grant that compensates the Group for expenses or losses to be incurred in the subsequent periods is recognized initially as deferred income and recognized in profit or loss in the same periods in which the expenses are recognized. A grant that compensates the Group for expenses or losses incurred is recognized in profit or loss immediately.

### 24. Income tax

Current and deferred tax is recognised in profit or loss except to the extent that they relate to business combinations or items recognised directly in equity (including other comprehensive income).

Current tax is the expected income tax payable calculated at the applicable tax rate on taxable income for the year, plus any adjustment to income tax payable in respect of previous years.

At the balance sheet date, current tax assets and liabilities are offset if the Group has a legally enforceable right to set them off and also intends either to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities and their tax bases, which include the deductible losses and tax credits carried forward to subsequent years. Deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilized.

Deferred tax is not recognized for the temporary differences arising from the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting profit nor taxable profit (or deductible loss). Deferred tax is not recognised for taxable temporary differences arising from the initial recognition of goodwill.

At the balance sheet date, the carrying amount of deferred tax assets and liabilities are measured based on the expected manner of recovery or settlement of the carrying amount of the assets and liabilities, using tax rates that are expected to be applied in the period when the asset is recovered or the liability is settled in accordance with tax laws.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date. The carrying amount of a deferred tax asset is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the benefit of the deferred tax asset to be utilized. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

At the balance sheet date, deferred tax assets and liabilities are offset if all the following conditions are met:

- the taxable entity has the legal rights to settle the income tax assets and income tax liabilities for the current period by net amount;
- they relate to income taxes levied by the same tax authority on either the taxable entity has a legally enforceable right or set off current income tax assets against current income tax liabilities, and different taxable entities which either intend to settle the current income tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 25. Operating and finance leases

A lease is classified as either a finance lease or an operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of a leased asset to the lessee, irrespective of whether the legal title to the asset is eventually transferred or not. An operating lease is a lease other than a finance lease.

#### (1) *Operating lease charges*

Rental payments under operating leases are recognized as costs or expenses on a straight-line basis over the lease term.

#### (2) *Assets acquired under finance leases*

When the Group acquires an asset under a finance lease, the asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments, each determined at the inception of the lease. The minimum lease payments are recorded as long-term payables. The difference between the value of the leased assets and the minimum lease payments is recognized as unrecognized finance charges. Initial direct costs that are attributable to a finance lease incurred by the Group are added to the amounts recognized for the leased asset. Depreciation and impairment losses are accounted for in accordance with the accounting policies described in Notes II.13 (2) and II.19, respectively.

If there is a reasonable certainty that the Group will obtain ownership of a leased asset at the end of the lease term, the leased asset is depreciated over its estimated useful life. Otherwise, the leased asset is depreciated over the shorter of the lease term and its estimated useful life.

Unrecognized finance charge under finance lease is amortized using an effective interest method over the lease term. The amortization is accounted for in accordance with policies of borrowing costs (see Note II.15).

At the balance sheet date, long-term payables arising from finance leases, net of the unrecognized finance charges, are presented into long-term liabilities and long-term liabilities due within one year.

### 26. Assets held for sale

The Group has resolved and signed a non-cancellable agreement on the transfer of the assets classified as held for sale with the transferee, and the transfer is expected to be completed within one year. Such non-current assets included fixed assets, intangible assets, investment property subsequently measured using the cost model, long-term equity investment (excluding financial assets and deferred tax assets). Non-current assets held for sale are stated at the lower of carrying amount and net realisable value. Any excess of the carrying amount over the net realisable value is recognised as impairment loss. At the balance sheet date, non-current assets held for sale are presented into each asset item by category.

### 27. Profit distributions to shareholders

Dividends or distributions of profits proposed in the profit appropriation plan which will be considered and approved after the balance sheet date, are not recognized as a liability at the balance sheet date but disclosed in the notes separately.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 28. Related parties

If a party has the power to control, jointly control or exercise significant influence over another party, or where two or more parties are subject to common control, joint control or significant influence from another party, they are considered to be related parties. Related parties may be individuals or enterprises. Enterprises which is under common control only from the State and that have no other related party relationships are not regarded as related parties of the Group. Related parties of the Group and Company include, but are not limited to:

- (a) the Company's parent;
- (b) the Company's subsidiaries;
- (c) enterprises that are controlled by the Company's parent;
- (d) investors that have joint control or exercise significant influence over the Group;
- (e) enterprises or individuals under control or joint control with the Group;
- (f) jointly controlled enterprises of the Group, including subsidiaries of jointly controlled enterprises;
- (g) associates of the Group, including subsidiaries of associates;
- (h) principal individual investors and close family members of the Group;
- (i) key management personnel of the Group and close family members of such individuals;
- (j) key management personnel of the Company's parent;
- (k) close family members of key management personnel of the Company's parent; and
- (l) other enterprises that are controlled or jointly controlled by principal individual investors, key management personnel of the Group, and close family members of such individuals.

Besides the related parties stated above, determined in accordance with the requirements of CAS, the following enterprises and individuals are considered as (but not restricted to) relate parties of the Group or Company based on the requirements of Administrative Procedures on the Information Disclosures of Listed Companies issued by the CSRC:

- (m) enterprises or persons that act in concert that hold 5% or more of the Company's shares;
- (n) individuals and close family members of such individuals who directly or indirectly hold 5% or more of the Company's shares, supervisors for listed companies and their close family members;
- (o) enterprises that satisfy any of the aforesaid conditions in (a), (c) and (m) during the past 12 months or will satisfy them within the next 12 months pursuant to a relevant agreement;
- (p) individuals who satisfy any of the aforesaid conditions in (i), (j) and (n) during the past 12 months or will satisfy them within the next 12 months pursuant to a relevant agreement; and
- (q) enterprises, other than the Company and subsidiaries controlled by the Company, which are controlled directly or indirectly by an individual defined in (i), (j), (n) or (p), or in which such an individual assumes the position of a director or senior executive.

### 29. Segment reporting

The Group determines the operating segments on the basis of internal structure, management requirements and internal reporting system, and determines reporting segments based on the operating segments. An operating segment is a component of the Group that meets the following criteria:

- that may earn revenue and incur expenses in daily business activities;
- whose operating results are regularly reviewed by the Group's management to allocate its resources and assess its performance;
- for which discrete financial information on financial positions, financial performance and cash flow is available to the Group.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 29. Segment reporting *(Continued)*

Two or more operating segments can be aggregated into one operating segment if the segments have similar economic characteristics and the segments are similar in each of the following respects:

- the nature of each product and service;
- the nature of production process;
- the type or class of customers for their products and services;
- the methods used to distribute their products or provide their services;
- the influence brought by law, administrative regulations on production of products and provision of services.

Inter-segment revenues are measured on the basis of actual transaction price for such transactions for segment reporting, and segment accounting policies are consistent with those used for the preparation of financial statements of the Group.

### 30. Significant accounting estimates and judgments

The preparation of financial statements requires management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Key assumptions and judgments on uncertainties related to estimates are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Aparting from the information of risk factors and fair value assumption of the impairment of goodwill, termination benefits and financial instruments contained in Notes V. 12, 22 and Note X. 3, other key sources of estimation uncertainty are as follows:

#### (a) *Impairment of receivables*

As described in Note II.10, receivables that are measured at amortization cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, impairment loss is provided. Objective evidence of impairment includes observable data that comes to the attention of the Group about loss events such as a significant decline in the estimated future cash flow of an individual debtor or the portfolio of debtors, and significant changes in the financial condition that have an adverse effect on the debtor. If there is an indication that the receivables has recovered to its value and is related to the events occurred after the recognition of the loss, the impairment loss recognized in prior years is reversed.

#### (b) *Provision for diminution of inventory cost*

As stated in Note II. 11, the Group estimates the net realisable value of inventories periodically and recognize the excess of inventory cost over its net realizable value as diminution of inventory cost. When making estimation of the realizable value of inventories, the Group considers the purpose of holding the inventory based on available information including its market price and previous operation costs of the Group. The actual selling price, production costs and sales expenses and taxes may vary with sales status, production technologies or the actual usage of the inventories and the provision for diminution of inventory cost may change accordingly. The adjustments to the provision for diminution of inventory cost will have effects upon the profit and loss for the period of change in estimation.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (II). SIGNIFICANT ACCOUNTING POLICIES OF THE COMPANY AND ACCOUNTING ESTIMATES *(Continued)*

### 30. Significant accounting estimates and judgments *(Continued)*

(c) *Impairment of other assets excluding inventories, financial assets and other long-term equity investments*

As described in Note II.19, other assets excluding inventories, financial assets and other long-term equity investments are reviewed at each balance sheet date to determine whether the carrying amount exceeds the recoverable amount of the assets. If there are indications that the carrying amount of the long-term asset cannot be recovered, the asset is impaired and impairment loss is provided.

The recoverable amount of an asset (asset group) is the greater of its fair value net of selling price and its present value of expected future cash flows. Since the market price of the asset (the asset group) cannot be obtained reliably, the fair value of the asset cannot be estimated reliably. In assessing the present value of expected future cash flows, significant judgments are exercised over the asset's production volume, selling price, related operating expenses and discounting rate to calculate the present value. All relevant materials which can be obtained are used for estimation of the recoverable amount, including the estimation of the production volume, selling price and related operating expenses based on reasonable and supportable assumption.

(d) *Depreciation and amortization of fixed assets and intangible assets*

As described in Notes II.13 and 16, fixed assets and intangible assets are depreciated and amortized using the straight-line method over their useful lives after taking into account residual value. The estimated useful lives are regularly reviewed to determine the depreciation and amortization costs charged in each reporting period. The useful lives are determined based on historical experience of similar assets and estimated technical changes. If there is an indication that there has been a change in the factors used to determine the depreciation or amortization, the amount of depreciation or amortization is revised.

(e) *Product quality warranty*

As described in Note V. 26, according to recent maintenance experience, the Group has made provisions for providing after-sales quality maintenance to its customers on the sales of machine tool products. Since the recent maintenance experience might not reflect the maintenance information for sold products in the future, the management needs to apply more judgments to estimate the provisions. The increase or decrease of the provisions will affect the profit or loss in the future year.

## (III). TAXATION

### 1. Major types of tax and tax rates

Types	Tax basis	Tax rate
Value added tax	In accordance with Tax Law, tax on sales of goods or taxable service income for the period after deducting the current allowed deduction of tax, the balance should be the taxable VAT in accordance with the policies	17%
Business tax	In accordance with taxable operating income	3%-5%
City construction tax	In accordance with actual business tax paid and VAT payable	1%-7%
Education fee surcharges	In accordance with actual business tax paid and VAT payable	3%
Local education surcharges	In accordance with actual business tax paid and VAT payable	2%
Enterprise income tax	In accordance with income tax payable	Note

Note: The applicable rate of income tax for 2012 of the Company and the Company's subsidiaries Xi'an Ser Turbo Machinery Manufacturing Co., Ltd (Xi'an Ser) and Changsha Ser Turbine Machinery Co., Ltd. (formerly known as "Changsha Ser Turbo Equipment Co., Ltd.") (Changsha Ser) is 15% (2011: 15%) and the applicable rate of income tax of other subsidiaries for 2012 is 25% (2011: 25%).

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## 2. Preferential tax policies and approvals

As at 27th July 2011, Ministry of Finance, China Custom and State Administration of Taxation jointly issued the Notice Issues on Tax Policies for the Implementation of the Strategy Further Exploration and Development of the Western Region (Cai Shui [2011] No. 58), according to which, from 1st January 2011 to 31st December 2020, the enterprises of encouraged industries established in the western regions are subject to an income tax rate of 15%. In accordance with the Announcement No.12 of 2012 issued by the State Administration of Taxation on 6th April 2012, namely the Announcement Regarding the Implementation of Corporate Income Tax Policies for the Development of the Western China, and the Letter of Confirmation Recognising the Relevant Businesses of Shenji Group Kunming Machine Tool Company Limited as State Encouraged Industry (Yun Fagaiban Xibu [2012] No.312) issued by Development and Reform Commission of Yunnan Province on 21st May 2012, as our research and development, production and sales of digital machine tool and high-performance components meet the relevant criteria as stipulated in Order No.9 of NDRC (namely Guiding Catalogue for Industrial Structure Adjustments (Version 2011)) and the requirements regarding the encouraged industries as set out in Cai Shui [2011] No.58 Notice, the Company is entitled to a preferential income tax rate.

The Company fulfilled the above requirements in 2012 and thus enjoyed a preferential corporate income tax rate of 15%. The applicable corporate income tax rate of the Company for 2012 was 15% (2011: 15%).

The subsidiaries that are entitled to preferential tax treatments are as follows:

Name of enterprises	Preferential tax rate	Reason
Xi'an Ser	15%	Hi-tech enterprise
Changsha Ser	15%	Hi-tech enterprise

There is no change in the applicable tax rates and preferential tax treatments for the Company's subsidiaries in current year as compared with previous year.

## (IV). BUSINESS COMBINATION AND CONSOLIDATED FINANCIAL STATEMENTS

### 1. Background of major subsidiaries

#### (1) Subsidiaries acquired through establishment or investment

Full name	Type of subsidiaries	Place of registration	Business nature and scope of business	Organization code	Registered capital	Actual capital contribution at the end of the year	Proportion of shareholding (%)	Proportion of voting rights (%)	Consolidated statements	Minority interests at the end of the year (RMB)	Reversal of
											minority loss interest from minority interest (RMB)
Kunming Kunji General Machine Co., Ltd. ("General Machine") (note 1)	Company with limited liabilities	China	Development, design, production and sales of machine tool series products and accessories	665546112	RMB3,000,000	RMB3,000,000	100%	100%	Yes	-	-
Changsha Ser (note 2)	Company with limited liabilities	China	Development, design, production and sales of compressor series products and accessories	75801180-3	RMB10,000,000	RMB10,000,000	100%	100%	Yes	-	-



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (IV). BUSINESS COMBINATION AND CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

### 1. Background of major subsidiaries (Continued)

#### (1) Subsidiaries acquired through establishment or investment (Continued)

Note 1: On 19th October 2010, the Company resolved to dissolve General Machine. Subsequently, the Company carried out liquidation in accordance with the requirements under relevant laws and regulations which was substantially completed by now. However, now that the Company wished to continue its business expansion via that company, the cancellation of the company was suspended.

Note 2: With approval from the Administration for Industry and Commerce of Changsha City, Hunan Province, Changsha Ser was renamed as Changsha Ser Turbine Machinery Co., Ltd. and obtained the renewed enterprise legal person business license (No. 430194000001977) on 16th May 2012.

#### (2) Subsidiaries acquired from business combination not under common control

Full name	Type of subsidiaries	Type of enterprise	Place of registration	Business nature and scope of business	Organization code	Registered capital	Actual capital contribution at the end of the year	Proportion of shareholding (%)	Proportion of voting rights (%)	Consolidated statements	Reversal of minority interests	
											Minority interests at the end of the year (RMB)	loss interest from minority interest (RMB)
Xi'an Ser (note)	Non-controlling subsidiaries	Company with limited liabilities	China	Development, design, production and sales of compressor series products and accessories	22063182-4	RMB 50,000,000	RMB 50,000,000	45%	60%	Yes	45,293,859.72	432,659.88

Note: The percentage of voting rights of the Group in Xi'an Ser is determined by the percentage of voting rights of the Group in the board of directors of Xi'an Ser. Xi'an Ser was consolidated due to the fact that the Group has gained control over its financial and operational decision making.

### 2. Explanation to the change of scope of consolidation of the Company

Fujian Kunji Conventional Machine Tool Co., Ltd. ("Fujian Kunji") was originally a subsidiary of the Company and 50% of its shares were held by the Company. On 21st March 2012, the Company reached an agreement with Fujian Chenggong Machine Tool Co., Ltd. ("Chenggong Machine Tool"), another shareholder of Fujian Kunji, to transfer 50% of Fujian Kunji's shares held by the Company to Chenggong Machine Tool. The financial performance of Fujian Kunji from 1st January 2012 to the date of the Group's losing control has been consolidated into the Group's consolidated income statement for the current year.

Xi'an Ser, a subsidiary of the Company, originally held 51% equity interest in Hangzhou Ser Gas Engineering Co., Ltd (Hangzhou Ser). The original registered capital of Hangzhou Ser was RMB1,200,000. In May 2012, the Group decided not to participate in the proposal on increase capital investment by other shareholders of Hangzhou Ser. According to a resolution passed by the shareholders at the general meeting and the amended articles of association of Hangzhou Ser, its two shareholders who are natural persons made additional contribution to the company in an aggregate amount of RMB8,800,000, increasing their respective shareholding in Hangzhou Ser to 46.55% and 42% upon such additional contribution. The original capital investment of RMB612,000 by Xi'an Ser which accounted for 51% of the share capital would represent 11.45% of the shareholding in Hangzhou Ser after the increase capital investment. After the completion of the increase capital investment, both Xi'an Ser and the Group lost their control of Hangzhou Ser. As such, Hangzhou Ser ceased to be a subsidiary of the Group. The financial performance of Hangzhou Ser from 1st January 2012 to the date of the Group's losing control has been consolidated into the Group's consolidated income statement for the current year.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (IV). BUSINESS COMBINATION AND CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

### 3. Entities no longer consolidated in the Company during the reporting period

(1) Subsidiaries no longer consolidated in the Company during the year

Unit: RMB

Name	Note	Carrying amounts at the date of losing control			At 31st December 2011			From 1st January 2012 to the date of losing control		
		Total assets	Total liabilities	Total shareholders' equity	Total assets	Total liabilities	Total shareholders' equity	Operating income	Operating cost and expenses	Net loss
Fujian Kunji	(IV).2	8,245,504.66	9,228,909.67	(983,405.01)	8,307,992.56	9,105,332.98	(797,340.42)	1,021,311.96	1,207,376.55	(186,064.59)
Hangzhou Ser	(IV).2	<u>16,045,914.63</u>	<u>14,681,898.29</u>	<u>1,364,016.34</u>	<u>11,175,812.13</u>	<u>8,928,816.45</u>	<u>2,246,995.68</u>	<u>800,952.28</u>	<u>1,683,931.62</u>	<u>(882,979.34)</u>

## (V). NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. Cash at bank and on hand

Unit: RMB

Item	Original currency	2012		RMB/RMB equivalents	Original currency	2011		RMB/RMB equivalents
		Exchange rate				Exchange rate		
Cash on hand:	-	-		314,067.72	-	-		503,574.06
RMB	-	-		284,355.04	-	-		461,601.60
HKD	5,132.76	0.8108		4,161.80	5,137.07	0.8107		4,161.03
USD	2,186.15	6.2855		13,741.05	2,866.46	6.3009		18,059.32
EUR	1,419.86	8.3176		11,809.83	2,420.30	8.1625		19,752.11
Cash at bank:	-	-		89,363,725.11	-	-		175,304,445.56
RMB	-	-		74,477,458.47	-	-		159,138,846.02
HKD	8,908,052.06	0.8108		7,222,810.21	8,916,284.47	0.8107		7,228,431.82
USD	1,208,691.32	6.2855		7,597,229.29	1,405,490.18	6.3009		8,855,851.43
EUR	7,962.29	8.3176		66,227.14	9,962.71	8.1625		81,316.29
Security deposits	-	-		9,209,247.90	-	-		16,392,311.03
RMB	-	-		9,209,247.90	-	-		16,392,311.03
<b>Total</b>	-	-		<b>98,887,040.73</b>	-	-		<b>192,200,330.65</b>

As at 31st December 2012, security deposits of RMB9,209,247.90 (at 31st December 2011: RMB16,392,311.03) were pledged for the Group's bank guarantees and bank acceptance notes.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 2. Bills receivable

#### (1) Classification of bills receivable

Type	Unit: RMB	
	2012	2011
Bank acceptance notes	<u>74,194,825.88</u>	<u>104,034,946.22</u>

The above bills receivable are due within one year.

None of the above bills receivable was due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

(2) At as the end of the year, no bills receivable was pledged.

(3) At as the end of the year, no bills receivable was transferred to accounts receivable due to non-performance of the issuers.

### 3. Accounts receivable

#### (1) Analysis of accounts receivable by the type of customers:

Type of customers	Unit: RMB	
	2012	2011
Third party	524,468,635.11	461,679,432.22
Related party	4,181,928.75	6,094,433.84
Subtotal	528,650,563.86	467,773,866.06
Less: provision for bad and doubtful debts	<u>231,765,313.91</u>	<u>182,828,343.15</u>
Total	<u>296,885,249.95</u>	<u>284,945,522.91</u>

#### (2) Ageing analysis of accounts receivable:

Ageing	Unit: RMB	
	2012	2011
Within one year (including one year)	174,337,635.14	160,235,520.22
1-2 years (including two years)	115,276,294.74	131,994,960.49
2-3 years (including three years)	95,221,246.10	73,342,118.82
Over three years	143,815,387.88	102,201,266.53
Subtotal	528,650,563.86	467,773,866.06
Less: provision for bad and doubtful debts	<u>231,765,313.91</u>	<u>182,828,343.15</u>
Total	<u>296,885,249.95</u>	<u>284,945,522.91</u>

The ageing of accounts receivable is calculated starting from the date of recognition.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 3. Accounts receivable (Continued)

#### (3) Analysis of accounts receivable by category

Unit: RMB

Type	Note	2012		2011		2012		2011	
		Carrying amount	Provision for bad	Carrying amount	Provision for bad	Carrying amount	Provision for bad	Carrying amount	Provision for bad
		Amount	and doubtful debts	Amount	and doubtful debts	Amount	and doubtful debts	Amount	and doubtful debts
		Proportion	Amount	Proportion	Amount	Proportion	Amount	Proportion	Amount
		(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Individually significant and assessed individually for impairment	(4)	41,753,757.01	7.90	12,425,627.10	29.76	89,372,562.83	19.11	12,612,691.31	14.11
Collectively assessed for impairment*									
Group 1	(5)	482,714,878.10	91.31	219,339,686.81	45.44	372,306,869.39	79.59	170,215,651.84	45.72
Group 2	(10)	4,181,928.75	0.79	-	-	6,094,433.84	1.30	-	-
Sub-total		<u>486,896,806.85</u>	<u>92.10</u>	<u>219,339,686.81</u>	<u>45.05</u>	<u>378,401,303.23</u>	<u>80.89</u>	<u>170,215,651.84</u>	<u>44.98</u>
Total		<u>528,650,563.86</u>	<u>100.00</u>	<u>231,765,313.91</u>	<u>-</u>	<u>467,773,866.06</u>	<u>100.00</u>	<u>182,828,343.15</u>	<u>-</u>

Note\*: This category included accounts receivable having been individually assessed but not impaired

The Group did not receive any collateral for the above accounts receivable with provision for bad and doubtful debts.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 3. Accounts receivable (Continued)

- (4) Individually significant accounts receivable with individual bad debt provision as at the end of the year:

Unit: RMB

Type	Carrying amount	Provision for bad and doubtful debts	Proportion	Reasons for making provision
Accounts receivable	41,753,757.01	12,425,627.10	29.76	Impairment occurred under individual assessment method

- (5) Provisions for accounts receivable in groups using ageing analysis method:

Unit: RMB

Ageing	2012		Provision for bad and doubtful debts	2011		Provision for bad and doubtful debts
	Carrying amount	Proportion (%)		Carrying amount	Proportion (%)	
Within one year	170,155,706.39	35.25	8,422,640.03	108,521,429.37	29.15	5,624,619.36
1-2 years	92,048,537.73	19.07	27,475,061.33	97,708,010.38	26.24	29,312,403.11
2-3 years	76,695,246.10	15.89	47,425,147.66	63,876,163.11	17.16	38,282,426.17
Over 3 years	143,815,387.88	29.79	136,016,837.79	102,201,266.53	27.45	96,996,203.20
Total	<u>482,714,878.10</u>	<u>100.00</u>	<u>219,339,686.81</u>	<u>372,306,869.39</u>	<u>100.00</u>	<u>170,215,651.84</u>

- (6) During the year, no significant bad debt provision for the accounts receivable was reversed or collected.
- (7) During the year, there was no significant writing-off for the accounts receivable.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 3. Accounts receivable (Continued)

#### (8) Amounts of top five accounts receivable

Debtor	Relationship with the Company	Amount	Ageing	Unit: RMB
				Percentage of total accounts receivable (%)
1st	Third party	23,227,757.01	Over one year	4.39
2nd	Third party	21,623,532.70	Within one year	4.09
3rd	Third party	18,526,000.00	Over one year	3.50
4th	Third party	16,380,000.00	Within one year	3.10
5th	Third party	13,054,000.00	Over one year	2.47
Total		<u>92,811,289.71</u>		<u>17.55</u>

As names of the third party customers are confidential commercial information of the Group, we did not disclose specific names of such customers.

(9) None of the above accounts receivables was due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

#### (10) Accounts receivables due from related parties

Debtor	Note	Relationship with the Company	Amount	Unit: RMB
				Percentage of total accounts receivable (%)
Kunming TOS Machine Tool Manufacturing Co., Ltd. ("Kunming TOS")	VI. 6	Jointly controlled enterprise	4,181,928.75	0.79

As at 31st December 2012, the Group conducted individual assessment on accounts receivables due from related parties and considered that there was no need to make provisions for bad and doubtful debts.

#### (11) Credit policy

The account receivables of the Group were mainly in the form of deposit for warranty, which generally would due after one year of installation of the products according to the sales contracts entered into with customers. Except for deposit for warranty, all payments are payable by the end of the negotiated credit term. The Group would grant credit term of one to three months in general to customers according to their payment records and transaction performance.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 4. Other receivables

(1) Analysis of other receivables by the type of customers:

Type of customers	2012	Unit: RMB	
		2012	2011
Third party	18,107,078.55	17,520,895.29	
Related party	370,448.02	930,594.93	
Sub-total	18,477,526.57	18,451,490.22	
Less: provision for bad and doubtful debts	4,798,674.36	4,221,633.89	
Total	<u>13,678,852.21</u>	<u>14,229,856.33</u>	

(2) Ageing analysis of other receivables:

Ageing	2012	Unit: RMB	
		2012	2011
Within one year (including one year)	13,367,793.27	13,181,557.63	
1-2 years (including two years)	2,107,195.48	2,870,339.98	
2-3 years (including three years)	1,160,952.70	765,174.94	
Over three years	1,841,585.12	1,634,417.67	
Sub-total	18,477,526.57	18,451,490.22	
Less: provision for bad and doubtful debts	4,798,674.36	4,221,633.89	
Total	<u>13,678,852.21</u>	<u>14,229,856.33</u>	

The ageing of other receivables is calculated starting from the date of recognition.

(3) Analysis of other receivables by category:

Type	Note	2012				2011			
		Carrying amount		Provision for bad and doubtful debts		Carrying amount		Provision for bad and doubtful debts	
		Amount	Proportion (%)	Amount	Proportion (%)	Amount	Proportion (%)	Amount	Proportion (%)
Individually significant and assessed individually for impairment	(4)	-	-	-	-	1,014,793.03	5.50	664,785.54	65.51
Collectively assessed for impairment*									
Group 1	(5)	18,107,078.55	98.00	4,798,674.36	26.50	16,506,102.26	89.46	3,556,848.35	21.55
Group 2	(10)	370,448.02	2.00	-	-	930,594.93	5.04	-	-
Sub-total		<u>18,477,526.57</u>	<u>100.00</u>	<u>4,798,674.36</u>	<u>25.97</u>	<u>17,436,697.19</u>	<u>94.50</u>	<u>3,556,848.35</u>	<u>20.40</u>
Total		<u>18,477,526.57</u>	<u>100.00</u>	<u>4,798,674.36</u>	<u>-</u>	<u>18,451,490.22</u>	<u>100.00</u>	<u>4,221,633.89</u>	<u>-</u>

Note\*: This category included other receivables having been individually assessed but not impaired

The Group did not received any collateral for the above other receivables with provision for bad and doubtful debts.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 4. Other receivables (Continued)

(4) No other receivables was individually significant and assessed individually for bad and doubtful debts at the year end.

(5) Other receivables in groups with provision for bad and doubtful debts using ageing analysis method:

Unit: RMB

Ageing	2012		Provision for bad and doubtful debts	2011		Provision for bad and doubtful debts
	Carrying amount Amount	Proportion (%)		Carrying amount Amount	Proportion (%)	
Within one year	12,997,345.25	71.78	687,852.53	11,935,165.34	72.31	591,571.89
1-2 years	2,107,195.48	11.64	1,132,434.01	2,770,339.98	16.78	1,164,679.52
2-3 years	1,160,952.70	6.41	1,136,802.70	765,174.94	4.64	765,174.94
Over 3 years	1,841,585.12	10.17	1,841,585.12	1,035,422.00	6.27	1,035,422.00
Total	18,107,078.55	100.00	4,798,674.36	16,506,102.26	100.00	3,556,848.35

(6) During the year, no significant bad debt provision for other receivables was reversed or collected.

(7) During the year, there was no significant writing-off for other receivables.

(8) Amounts of top five other receivables

Unit: RMB

Debtor	Relationship with the Company	Amount	Ageing	Percentage of total other receivables (%)
Jiangsu Complete Equipment Co., Ltd.	Third party	1,308,400.00	Within one year	7.08
Fujian Kunji	Third party	710,723.72	Over one year	3.85
Henan Runlong Commercial Trading Co., Ltd.	Third party	580,000.00	Over one year	3.14
Shaanxi Qinyuan Tendering Co., Ltd.	Third party	510,000.00	Over one year	2.76
Beijing Asia International Exhibition Co., Ltd. (北京亞細亞國際展覽公司)	Third party	485,253.00	Within one year	2.63
Total	-	3,594,376.72	-	19.46

(9) None of the above other receivables was due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 4. Other receivables (Continued)

#### (10) Other receivables due from related parties

Debtor	Note	Relationship with the Company	Amount	Unit: RMB
				Percentage of total other receivables (%)
Kunming TOS	VI. 6	Jointly controlled enterprise	370,448.02	2.00

As at 31st December 2012, the Group conducted individual assessment on other receivables due from related parties and considered that there was no need to make provisions for bad and doubtful debts.

### 5. Prepayments

#### (1) Prepayments by category

Item	Unit: RMB	
	2012	2011
Prepayment for materials	33,630,628.97	79,699,344.86
Others	4,540,029.95	–
Total	38,170,658.92	79,699,344.86

#### (2) Ageing analysis of prepayments

Ageing	Unit: RMB			
	2012	2011	2012	2011
	Amount	Proportion (%)	Amount	Proportion (%)
Within one year (including one year)	35,678,651.27	93.47	74,758,304.84	93.80
1-2 years (including 2 years)	328,263.90	0.86	1,188,237.42	1.49
2-3 years (including 3 years)	937,417.42	2.46	639,125.00	0.80
Over 3 years	1,226,326.33	3.21	3,113,677.60	3.91
Total	38,170,658.92	100.00	79,699,344.86	100.00

The ageing of prepayments is calculated starting from the date of recognition.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 5. Prepayments (Continued)

#### (3) Amounts of top five prepayments

Unit: RMB

Name	Relationship with the Company	Amount	Percentage of total prepayments (%)	Prepayment time	Reasons for non-settlement
Hangzhou Chinen Steam Turbine Power Co., Ltd	Third party	14,228,193.50	37.28	Within one year	Prepayment for materials undue
Hangzhou Ser	Third party	2,620,480.00	6.87	Within one year	Prepayment for materials undue
Siemens International Trading (Shanghai) Co. Ltd.	Third party	2,164,439.75	5.67	Within one year	Prepayment for materials undue
Beijing Big Power Industrial Control Co., Ltd (北京大力浩然工業控制有限公司)	Third party	1,202,390.00	3.15	Over one year	Prepayment for materials undue
Yi Xin International Limited (怡新國際有限公司)	Third party	1,023,596.62	2.68	Within one year	Prepayment for materials undue
Total		21,239,099.87	55.65		

(4) None of the above prepayments was made to shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

### 6. Inventories

#### (1) Inventories by category

Unit: RMB

Inventories by category	Book value	2012 Provision for diminution in value of inventories	Carrying amount	Book Value	2011 Provision for diminution in value of inventories	Carrying amount
Raw materials	98,920,608.00	3,065,619.64	95,854,988.36	136,500,099.11	3,065,619.64	133,434,479.47
Consumables	4,481,378.28	82,781.00	4,398,597.28	6,096,567.83	82,781.00	6,013,786.83
Work in progress	543,240,944.02	13,237,418.87	530,003,525.15	506,056,400.92	10,435,282.97	495,621,117.95
Finished goods	377,437,360.82	7,287,560.78	370,149,800.04	334,943,612.36	2,684,150.37	332,259,461.99
Commissioned processing materials	11,520,859.57	-	11,520,859.57	16,350,544.28	-	16,350,544.28
Total	1,035,601,150.69	23,673,380.29	1,011,927,770.40	999,947,224.50	16,267,833.98	983,679,390.52

As at 31st December 2012, no inventory was pledged (2011: nil) by the Group.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 6. Inventories (Continued)

#### (2) Analysis of the movements of inventories for the year

Unit: RMB

Inventories by category	Opening balance	Increase during the year	Decrease during the year	Closing balance
Raw materials	136,500,099.11	654,127,340.37	691,706,831.48	98,920,608.00
Consumables	6,096,567.83	9,955,525.54	11,570,715.09	4,481,378.28
Work in progress	506,056,400.92	916,891,243.45	879,706,700.35	543,240,944.02
Finished goods	334,943,612.36	878,534,425.98	836,040,677.52	377,437,360.82
Commissioned processing of materials	16,350,544.28	31,942,815.80	36,772,500.51	11,520,859.57
Sub-total	999,947,224.50	2,491,451,351.14	2,455,797,424.95	1,035,601,150.69
Less: Provision for diminution in value of inventories	16,267,833.98	7,405,546.31	-	23,673,380.29
Total	983,679,390.52	2,484,045,804.83	2,455,797,424.95	1,011,927,770.40

#### (3) Provision for diminution in value of inventories

Unit: RMB

Inventories by category	Opening balance	Provision made for the year	Decrease during the year	Closing balance
Raw materials	3,065,619.64	-	-	3,065,619.64
Consumables	82,781.00	-	-	82,781.00
Work in progress	10,435,282.97	2,802,135.90	-	13,237,418.87
Finished goods	2,684,150.37	4,603,410.41	-	7,287,560.78
Total	16,267,833.98	7,405,546.31	-	23,673,380.29

### 7. Other Current assets

Unit: RMB

Item	2012	2011
Prepaid income taxes	1,495,385.23	-

### 8. Long-term equity investments

#### (1) Long-term equity investments by category:

Unit: RMB

Item	2012	2011
Investments in jointly controlled enterprises	43,631,371.02	47,500,223.66
Investments in associates	14,348,530.66	14,424,357.29
Other long-term equity investments	3,145,000.00	2,000,000.00
Sub-total	61,124,901.68	63,924,580.95
Less: provision for impairment	2,000,000.00	2,000,000.00
Total	59,124,901.68	61,924,580.95

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 8. Long-term equity investments (Continued)

(2) Movements of long-term equity investments during the year:

Unit: RMB

Invested company	Investment cost	Opening balance	Increase/decrease	Closing balance	Shareholding in	Percentage	Explanation	Impairment provision	Impairment provision made during the year	Cash dividend for the year
					the invested company (%) (A)	of voting rights in the invested company (%) (B)	for discrepancy between (A) and (B)			
Under equity method:										
jointly controlled enterprise										
Kunming TOS	24,739,533.99	47,500,223.66	(3,868,852.64)	43,631,371.02	50.00	50.00	-	-	-	5,000,000.00
Under equity method:										
associate										
Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite")										
	14,000,000.00	14,424,357.29	(75,826.63)	14,348,530.66	23.34	23.34	-	-	-	-
Under cost method:										
other long-term equity investments										
Yunnan Cheng Jiang Copper Products Plant (note)										
	2,000,000.00	2,000,000.00	-	2,000,000.00	40.00	40.00	-	2,000,000.00	-	-
Hangzhou Ser	1,145,000.00	-	1,145,000.00	1,145,000.00	11.45	11.45	-	-	-	-
Sub-total	3,145,000.00	2,000,000.00	1,145,000.00	3,145,000.00	-	-	-	2,000,000.00	-	-
Total	41,884,533.99	63,924,580.95	(2,799,679.27)	61,124,901.68	-	-	-	2,000,000.00	-	5,000,000.00

Note: Full provision for impairment loss on long-term investment of Yunnan Cheng Jiang Copper Products Plant was made in 1999 because the plant has lost the ability of sustainable operation. In 2009, as approved at the 7th meeting of the six session of the Board of the Company, the Company began to dispose of such investment. As at the date of the financial statement, the process of disposal is still in progress.

(3) Information of major jointly controlled enterprises and associates:

Unit: RMB

Invested company	Total assets at the end of the year	Total liabilities at the end of the year	Total net assets at the end of the year	Total operating income for the year	Net profit/(loss) for the year
1. Jointly controlled enterprise Kunming TOS	171,785,797.33	84,523,055.29	87,262,742.04	87,651,903.42	2,262,294.72
2. Associate Xi'an Ruite	132,391,726.86	70,915,588.64	61,476,138.22	38,209,763.90	(324,878.45)

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 9. Fixed assets

#### (1) Details of fixed assets

Item	Unit: RMB				
	Building and structures	Machinery and equipment	Transportation equipment	Electronic equipment	Total
Cost					
Opening balance	331,923,773.17	510,166,514.61	32,560,070.76	14,924,651.01	889,575,009.55
Addition during the year	1,404,365.67	7,688,228.16	945,830.65	737,045.91	10,775,470.39
Transfer from construction in progress	6,797,179.86	19,404,018.57	583,760.68	-	26,784,959.11
Disposal during the year	(185,612.50)	(3,887,517.43)	(589,517.00)	(978,263.72)	(5,640,910.65)
Decrease due to the change in the scope of consolidation	-	(1,335,984.16)	(1,506,177.00)	(438,483.46)	(3,280,644.62)
Closing balance	339,939,706.20	532,035,259.75	31,993,968.09	14,244,949.74	918,213,883.78
Accumulated depreciation					
Opening balance	79,098,901.62	232,397,742.87	15,834,765.99	9,753,870.07	337,085,280.55
Charge for the year	9,837,260.65	30,634,352.58	2,975,304.96	1,500,679.86	44,947,598.05
Written off during the year	(178,188.00)	(2,620,467.34)	(548,591.49)	(867,644.64)	(4,214,891.47)
Decrease due to the change in the scope of consolidation	-	(844,524.96)	(884,721.27)	(376,624.49)	(2,105,870.72)
Closing balance	88,757,974.27	259,567,103.15	17,376,758.19	10,010,280.80	375,712,116.41
Impairment provision					
Opening balance	-	3,606,029.68	-	102,350.08	3,708,379.76
Written off on disposal	-	(744,621.57)	-	(60,984.15)	(805,605.72)
Closing balance	-	2,861,408.11	-	41,365.93	2,902,774.04
Carrying amounts					
At the end of the year	<u>251,181,731.93</u>	<u>269,606,748.49</u>	<u>14,617,209.90</u>	<u>4,193,303.01</u>	<u>539,598,993.33</u>
At the beginning of the year	<u>252,824,871.55</u>	<u>274,162,742.06</u>	<u>16,725,304.77</u>	<u>5,068,430.86</u>	<u>548,781,349.24</u>

During the year, the depreciation of the Group's fixed assets amounted to RMB44,947,598.05.

The Group transferred construction-in-progress to fixed assets at cost during the year amounting to RMB26,784,959.11.

As at 31st December 2012, fixed assets (buildings and structures) of the Group with net book value of RMB12,310,969.12 were pledged to banks for short-term loans (2011: RMB10,458,326.16).

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 9. Fixed assets (Continued)

#### (2) Temporarily idle fixed assets

Item	Cost	Accumulated depreciation	Impairment provision	Carrying amount	Unit: RMB
					Remark
Machinery and equipment	2,581,951.07	2,161,072.55	-	420,878.52	Temporarily sealed and stored

#### (3) Fixed assets acquired under finance leases

Items	Cost	Accumulated depreciation	Unit: RMB
			Carrying Amount
As at 31st December 2012			
Buildings and structures	2,592,597.82	2,488,893.91	103,703.91
As at 31st December 2011			
Buildings and structures	2,592,597.82	2,488,893.91	103,703.91

In 2012 and 2011, fixed assets acquired under finance leases were fully depreciated.

#### (4) Fixed assets with pending certificates of ownership

As at 31st December 2012 and at the date of approval of this statement, the Group is applying for property certificates for some buildings and structures. The time of obtaining property certificates is depending upon the consideration and approval procedures of the relevant government authorities. The carrying amount of the above mentioned fixed assets was RMB48,683,361.32 (2011: RMB42,506,860.24).

Directors of the Company are of the opinion that pending the grant of property certificates will not affect the usage and operation of the buildings and structures.

### 10. Construction in progress

#### (1) Information of construction in progress

Project	Book value	2012		Book value	2011	
		Impairment provision	Carrying amount		Impairment provision	Carrying amount
Heavy casting base	173,621,841.69	-	173,621,841.69	90,650,165.27	-	90,650,165.27
CNC cylindrical grinder and grinder imported from Switzerland for small parts workshop	-	-	-	10,247,728.44	-	10,247,728.44
Other items	10,794,792.43	2,056,931.37	8,737,861.06	20,305,830.76	2,056,931.37	18,248,899.39
Total	184,416,634.12	2,056,931.37	182,359,702.75	121,203,724.47	2,056,931.37	119,146,793.10

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 10. Construction in progress (Continued)

#### (2) Movements of major construction projects in progress during the year

Unit: RMB

Project	Budget	Opening balance	Additions during the year	Transfer to fixed assets during the year	Other decreases	Closing balance	Investment percentage to total budget (%)	Project progress	Accumulated amount of interest capitalized	Of which,	Interest rate of capitalization	Source of the fund
										interest capitalized during the year		
Heavy casting base	729,560,000.00	90,650,165.27	87,627,383.46	-	4,655,707.04	173,621,841.69	23.80	36%	6,615,355.31	6,615,355.31	6.86%	Self-financing and budgetary investment of central government
CNC cylindrical grinder and grinder imported from Switzerland for small parts workshop	12,000,000.00	10,247,728.44	610,000.00	10,857,728.44	-	-	90.48	100%	-	-	-	Self-financing
Other items	-	18,248,899.39	6,416,192.34	15,927,230.67	-	8,737,861.06	-	-	-	-	-	-
<b>Total</b>	<b>-</b>	<b>119,146,793.10</b>	<b>94,653,575.80</b>	<b>26,784,959.11</b>	<b>4,655,707.04</b>	<b>182,359,702.75</b>	<b>-</b>	<b>-</b>	<b>6,615,355.31</b>	<b>6,615,355.31</b>	<b>6.86%</b>	<b>-</b>

#### (3) Progress of major construction project during the year

Project	Work progress	Remark
Heavy casting base	36%	Major structure for the base under construction

### 11. Intangible assets

Unit: RMB

Item	Land use rights	Various software	Others	Total
Cost				
Opening balance	25,925,562.02	19,661,919.41	3,736,089.93	49,323,571.36
Addition during the year	35,964,921.44	19,808.01	10,191.99	35,994,921.44
Disposal during the year	-	(27,400.00)	-	(27,400.00)
Closing balance	61,890,483.46	19,654,327.42	3,746,281.92	85,291,092.80
Accumulated amortization				
Opening balance	3,651,809.29	9,740,611.03	552,511.87	13,944,932.19
Charge for the year	905,193.20	1,339,286.73	119,226.80	2,363,706.73
Written off during the year	-	(17,810.13)	-	(17,810.13)
Closing balance	4,557,002.49	11,062,087.63	671,738.67	16,290,828.79
Carrying amounts				
At the end of the year	57,333,480.97	8,592,239.79	3,074,543.25	69,000,264.01
At the beginning of the year	22,273,752.73	9,921,308.38	3,183,578.06	35,378,639.17

Amortization for intangible assets of the Group for the year was RMB2,363,706.73.

As at 31st December 2012, land use rights with the carrying amounts of RMB6,635,282.83 was pledged to banks for short-term loans (2011: RMB12,100,712.60).

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 12. Goodwill

Invested company	Opening balance	Increase during the year	Decrease during the year	Closing balance	Unit: RMB
					Impairment provision at the end of the year
Xi'an Ser	7,296,277.00	–	–	7,296,277.00	–

When the Group acquired Xi'an Ser in 2001, the cost of merger was higher than the fair value of the identifiable assets and liabilities of Xi'an Ser corresponding to the interests acquired, and the difference was recognized as goodwill related to Xi'an Ser.

The recoverable amount of Xi'an Ser is determined based on the present value of the estimated future cash flows. The Group prepared cash flow forecasts for this asset based on the recent 5 years financial budgets approved by the management and a 10% discount rate before tax. The cash flows after the 5 years forecast would remain stable. The forecast result imposed no impairment loss to the recoverable amounts. However, the key assumptions on which the discount estimated cash flows were based may vary. The management considered that if negative change occurred to the key assumptions, the book value of the Company may exceed its recoverable amount.

The key assumptions for the calculation of the present value of estimated future cash flows for Xi'an Ser were the gross profit margin and the growth rate of operating income of the turbo machine segment. The management determined these key assumptions based on the historical information prior to the estimated period.

### 13. Long-term deferred expenses

Item	Opening balance	Increase during the year	Amortization during the year	Unit: RMB	
				Closing balance	
Decoration	1,365,116.55	1,095,703.88	534,434.88	1,926,385.55	



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 14. Deferred tax assets

(1) Reconciliation of composition of deferred tax assets and liabilities

Unit: RMB

Item	2012		2011	
	Deductible temporary difference	Deferred tax assets	Deductible temporary difference	Deferred tax assets
<b>Deferred tax assets:</b>				
Provision for bad and doubtful debts	236,563,988.27	35,484,598.24	187,049,977.04	28,226,996.55
Provision for diminution in value of inventories	23,673,380.29	3,551,007.05	16,267,833.98	2,440,175.10
Provision for impairment of fixed assets	2,902,774.04	435,416.10	3,708,379.76	556,256.96
Provision for impairment of construction in progress	2,056,931.37	308,539.71	2,056,931.37	308,539.71
Provision for impairment of long-term equity investments	2,000,000.00	300,000.00	3,500,000.00	525,000.00
Provisions	9,921,145.94	1,488,171.89	17,390,990.97	2,608,648.64
Depreciation of fixed assets	5,365,577.75	804,836.66	5,432,865.15	814,929.77
Accrued expenses	15,653,693.25	2,348,053.99	4,140,100.00	621,015.00
Unrealized internal profits	5,402,946.04	810,441.91	6,527,481.51	979,122.23
Discounted value of retirement benefits for internal staff under early retirement	9,148,819.78	1,372,322.97	11,325,508.61	1,698,826.30
Government grants	65,131,518.00	9,769,727.70	39,643,000.00	5,946,450.00
Payables overdue for two years	1,276,914.33	191,537.15	1,276,914.33	191,537.15
Deductible tax losses	40,030,812.98	6,004,621.94	9,980,608.03	1,327,591.21
Total	419,128,502.04	62,869,275.31	308,300,590.75	46,245,088.62

(2) Breakdown of unrecognized deferred tax assets

Unit: RMB

Item	2012	2011
Deductible tax losses of subsidiaries	9,918,640.83	4,733,074.58

(3) Expiration of deductible tax losses for unrecognized deferred tax assets

Unit: RMB

Year	2012	2011
2013	–	201,495.36
2014	–	730,877.95
2015	8,013,861.90	2,448,294.03
2016	836,746.12	1,352,407.24
2017	1,068,032.81	–
Total	<u>9,918,640.83</u>	<u>4,733,074.58</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 15. Other non-current assets

Item	Unit: RMB	
	2012	2011
Project prepayments	6,359,675.00	10,770,514.20
Prepayments for land use rights (Note)	33,410,785.60	50,720,000.00
Prepayments for contracted technology licensing fee and purchase of relevant equipment (Note (VI). 5(1) note 3)	47,666,181.55	18,246,610.80
Others	3,900,000.00	–
<b>Total</b>	<b>91,336,642.15</b>	<b>79,737,125.00</b>

Note: As at 31st December 2012 and 31st December 2011, the prepayments for land use right was paid to the People's Government of Songming City of Yunnan Province for a piece of land in Yanglin Industrial Development Zone. In 2012, the Company obtained portion of the land use rights, for which the price was transferred to intangible assets, while the land use right certificate for the remaining part is still being applied.

### 16. Breakdown of provision for impairment of assets

Item	Note	Unit: RMB			Increase during the year		Decrease during the year		Closing balance
		Opening balance	Charge for the year	Other	Reversal	Write-off			
Accounts receivable	(V)3	182,828,343.15	44,203,336.28	5,035,778.21	–	302,143.73	231,765,313.91		
Other receivables	(V)4	4,221,633.89	710,723.72	–	57,292.64	76,390.61	4,798,674.36		
Inventories	(V)6	16,267,833.98	7,405,546.31	–	–	–	23,673,380.29		
Long-term equity investments	(V)8	2,000,000.00	–	–	–	–	2,000,000.00		
Fixed assets	(V)9	3,708,379.76	–	–	–	805,605.72	2,902,774.04		
Construction in progress	(V)10	2,056,931.37	–	–	–	–	2,056,931.37		
<b>Total</b>		<b>211,083,122.15</b>	<b>52,319,606.31</b>	<b>5,035,778.21</b>	<b>57,292.64</b>	<b>1,184,140.06</b>	<b>267,197,073.97</b>		

Please refer to notes to the relevant assets for reasons of impairment loss recognized for different assets during the year.

### 17. Restricted assets

As at 31st December 2012, the assets with restrictions placed on their ownership as follows:

Item	Note	Unit: RMB			Closing balance
		Opening balance	Increase during the year	Decrease during the year	
Assets pledged as collateral					
– Cash at bank and on hand	(V)1	16,392,311.03	38,830,140.39	46,013,203.52	9,209,247.90
– Fixed assets	(V)9	10,458,326.16	2,793,608.80	940,965.84	12,310,969.12
– Intangible assets	(V)11	12,100,712.60	–	5,465,429.77	6,635,282.83
<b>Total</b>		<b>38,951,349.79</b>	<b>41,623,749.19</b>	<b>52,419,599.13</b>	<b>28,155,499.85</b>

During the financial reporting period, restricted ownership security deposits are deposited with the bank as security for the letters of guarantee and bank acceptance notes issued by the bank for the Group.

Restricted ownership fixed assets and intangible assets were pledged for short-term loans. After repayment of the short-term loans, the term of restriction will be released.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 18. Short-term loans

(1) Types of short-term loans:

Item	2012	Unit: RMB
		2011
Secured loans	15,000,000.00	20,000,000.00
Guarantee loans	<u>90,000,000.00</u>	<u>80,000,000.00</u>
Total	<u>105,000,000.00</u>	<u>100,000,000.00</u>

(2) As at 31st December 2012, the Group had no short-term loans due but outstanding.

### 19. Bills payable

Item	2012	Unit: RMB
		2011
Bank acceptance bills	<u>28,693,005.00</u>	<u>46,596,910.09</u>

The above amount of bills payable will be due within one year.

### 20. Accounts payable

(1) Types of accounts payable are as follows:

Item	2012	Unit: RMB
		2011
Accounts payable to related company	34,449,887.87	45,553,713.06
Accounts payable to suppliers	<u>472,312,690.32</u>	<u>318,378,289.87</u>
Total	<u>506,762,578.19</u>	<u>363,932,002.93</u>

(2) There were no accounts payable to shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 20. Accounts payable (Continued)

(3) Ageing analysis of accounts payable:

Ageing	2012		2011	
	Book value Amount	Proportion (%)	Book value Amount	Proportion (%)
Within one year (including one year)	452,775,354.00	89.35	345,694,705.24	94.99
1-2 years (including 2 years)	38,002,306.15	7.50	13,028,799.15	3.58
2-3 years (including 3 years)	12,272,909.56	2.42	2,547,823.45	0.70
Over 3 years	3,712,008.48	0.73	2,660,675.09	0.73
Total	<u>506,762,578.19</u>	<u>100.00</u>	<u>363,932,002.93</u>	<u>100.00</u>

Unit: RMB

The ageing of accounts payable is calculated starting from the date of recognition.

The significant accounts payable aged over one year of the Group mainly represented the outstanding purchase amounts of ancillary equipments and raw materials.

### 21. Advances from customers

All advances from customers are payment for goods received in advance from the customers of the Company.

(1) Advances from customers by ageing of accounts are as follows:

Ageing	2012		2011	
	Book value Amount	Proportion (%)	Book value Amount	Proportion (%)
Within one year (including one year)	199,856,646.59	58.90	356,431,749.52	82.25
1-2 years (including 2 years)	111,355,965.17	32.82	49,972,174.63	11.53
2-3 years (including 3 years)	16,609,370.58	4.89	19,731,124.00	4.55
Over 3 years	11,519,079.93	3.39	7,218,723.20	1.67
Total	<u>339,341,062.27</u>	<u>100.00</u>	<u>433,353,771.35</u>	<u>100.00</u>

Unit: RMB

The significant advances from customers aged over one year of the Group mainly represented the receipt in advance that are not yet settled.

(2) There were no advances from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 22. Employee benefits payable

Item	<i>Unit: RMB</i>			
	Opening balance	Accrued during the year	Paid during the year	Closing balance
1. Salary, bonus, subsidy and grants (note 1)	13,082,236.69	218,949,608.71	223,827,735.29	8,204,110.11
2. Staff welfare	36,665.44	4,537,670.88	4,574,336.32	–
3. Social insurance	2,367,737.95	45,458,852.35	47,826,590.30	–
Including: (i) Medical insurance	1,580,270.88	12,741,585.68	14,321,856.56	–
(ii) Basic retirement insurance	1,058,657.09	27,827,968.87	28,886,625.96	–
(iii) Unemployment insurance	(406,477.56)	2,844,787.22	2,438,309.66	–
(iv) Work injury insurance	131,612.90	810,862.95	942,475.85	–
(v) Maternity insurance	3,674.64	1,233,647.63	1,237,322.27	–
4. Housing fund	1,835,953.72	15,812,946.31	15,802,243.31	1,846,656.72
5. Termination benefits (including early retirement fee) (note 2)	11,325,508.61	2,487,821.63	4,664,510.46	9,148,819.78
6. Union expenses and employees education expenses	4,850,287.23	5,274,460.16	3,823,932.32	6,300,815.07
Total	<u>33,498,389.64</u>	<u>292,521,360.04</u>	<u>300,519,348.00</u>	<u>25,500,401.68</u>

Note 1: Except for accrued year-end bonuses, the Group paid the accrued salary, bonus, subsidy and grants in January 2013. As at 31st December 2012, the Group did not have any accrued salary in arrears.

Note 2: As at 31st December 2012, the above termination benefits did not include the compensation for termination of labour service contract.

Some employees of the Group retired from employment prior to their statutory retirement age. According to the requirements of the early retirement plan of the Group, from the date of ceasing service provision up to their respective statutory retirement dates, such employee salary as proposed salary and social insurance for early retirement employees were recognised at their discounted present value as provisions and were included in current administrative expenses (“early retirement expenses”). The discount rate selected by the Group represented the interest rate of national bonds having the same credit term with early retirement plan of the Group.

### 23. Taxes payable

Item	<i>Unit: RMB</i>	
	2012	2011
Value added tax	8,657,696.02	3,199,549.74
Business tax	29,904.30	120,830.69
Corporate income tax	337,754.29	267,149.52
Others	<u>3,297,485.55</u>	<u>3,722,772.91</u>
Total	<u>12,322,840.16</u>	<u>7,310,302.86</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 24. Dividends payable

Item	2012	Unit: RMB
		2011
Cash dividends declared but outstanding	135,898.49	135,898.49

### 25. Other payables

(1) Other payables are as follows:

Item	2012	Unit: RMB
		2011
Payable for projects	37,848,515.07	–
Secured deposits for projects	3,020,058.50	4,607,662.25
Leasing expenses	5,563,318.96	2,254,373.81
Auditor's fee	2,160,000.00	2,150,000.00
Commissions and business promotion fees	8,863,815.00	20,414,223.33
Others	15,963,501.61	11,239,377.60
Total	<u>73,419,209.14</u>	<u>40,665,636.99</u>

There were no other payables due to shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

(2) Other payables by ageing of accounts are as follows:

Ageing	2012		2011		Unit: RMB
	Book value	Proportion (%)	Book value	Proportion (%)	
	balance amount		balance amount		
Within one year					
(including one year)	53,811,347.81	73.29	35,435,519.62	87.14	
1-2 years (including 2 years)	14,958,695.50	20.37	1,293,896.67	3.18	
2-3 years (including 3 years)	1,163,850.00	1.59	2,263,850.30	5.57	
Over 3 years	3,485,315.83	4.75	1,672,370.40	4.11	
Total	<u>73,419,209.14</u>	<u>100.00</u>	<u>40,665,636.99</u>	<u>100.00</u>	

As at 31st December 2012, the significant other payables aged over one year of the Group mainly represented secured deposits for projects and outstanding sales commissions.

(3) As at 31st December 2012, the significant other payables of the Group mainly represented construction projects payment to the contractors.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 26. Provisions

Item	Unit: RMB	
	2012	2011
Product quality warranty	<u>9,921,145.94</u>	<u>17,390,990.97</u>

Generally, the Group provides after-sale quality service guarantee to its customers who buy machine tool products from the Group. If the products have malfunction caused by non-accident or quality problems within one year after sale, the Group will provide free maintenance. The above product quality warranty was made based on the Group's forecasted product quality warranty expenditures needed to be undertaken for products sold during the year and prior years.

### 27. Non-current liabilities due within one year

Information of non-current liabilities due within one year is as follows:

Item	Note	Unit: RMB	
		2012	2011
Obligation under finance lease	V.28	213,209.00	213,209.00
Sales and lease back	V.30	<u>205,300.00</u>	<u>205,300.00</u>
Total		<u>418,509.00</u>	<u>418,509.00</u>

### 28. Long-term payables

Item	Unit: RMB	
	2012	2011
Obligation under finance lease	1,918,881.90	2,132,090.90
Less: obligation under finance lease due within one year	<u>213,209.00</u>	<u>213,209.00</u>
Total	<u>1,705,672.90</u>	<u>1,918,881.90</u>

Obligation under finance lease reflected the present value of minimum lease payments caused by the Group's lease of some workshops and factory buildings after sale in 2001. The lease constituted finance lease and the term of lease was 20 years.

As at 31st December 2012, the balance of unrecognised finance expenses of the Group was RMB1,160,639.12 (2011: RMB1,289,599.00).

There were no long-term payables due to shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 28. Long-term payables (Continued)

The minimum finance lease payment of the Group payable after 31st December 2012 is as follows:

Minimum lease payments	2012	2011
Within one year (including one year)	342,168.88	342,168.88
1-2 years (including 2 years)	342,168.88	342,168.88
2-3 years (including 3 years)	342,168.88	342,168.88
Over 3 years	2,053,014.38	2,395,183.26
Sub-total	3,079,521.02	3,421,689.90
Less: unrecognised finance charges	<u>1,160,639.12</u>	<u>1,289,599.00</u>
Total	<u>1,918,881.90</u>	<u>2,132,090.90</u>

The above amount of finance lease payment due within one year after deducting unrecognised finance charges was disclosed in note V. 27.

### 29. Special payables

Item	Opening balance	Increase during the year	Decrease during the year	Unit: RMB Closing balance
Specific appropriation from Shanxi Intellectual Property Office	100,000.00	-	100,000.00	-
Tax refund for import tariff and import VAT for key parts of machine tools (note)	<u>15,167,565.87</u>	<u>-</u>	<u>-</u>	<u>15,167,565.87</u>
Total	<u>15,267,565.87</u>	<u>-</u>	<u>100,000.00</u>	<u>15,167,565.87</u>

Note: Pursuant to the stipulations of the "Notice from the Ministry of Finance, National Development Reform Commission, China Customs, State Administration of Taxation on Import Duties Policy Related to Several Opinions on the Acceleration of Revitalising the Equipment Manufacturing Industry" (Cai Guan Shui [2007] No. 11), the tax refund will be treated as state investment, and should convert into state capital within the specified time. If an enterprise cannot convert the tax refund into state capital within the specified time, it should return the refund to state treasury on time. According to the resolution passed at the 19th meeting of the sixth session of the Board of the Company held on 16th August 2010, the Company would directly issue shares to its state-owned substantial shareholders Shenji Group and Yunnan Industrial Investment within two years after receiving the tax refund and complete the procedure of converting tax refund into state capital. Before that time, the Company will treat it as special payables according to accounting standards.



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 30. Other non-current liabilities

Item	2012	Unit: RMB 2011
Deferred income		
– sales and lease back (note 1)	1,642,402.91	1,847,702.91
– government grants (note 2)	<u>65,131,518.00</u>	<u>39,643,000.00</u>
Total	<u>66,773,920.91</u>	<u>41,490,702.91</u>

Note 1: Deferred income-sales and lease back were caused by the Group's lease of some buildings and structures and land use rights after sale in 2001 and the lease constituted operating lease. Therefore, the difference between the income of selling premises and land use rights and the original book value formed deferred income and would be amortised by straight-line method within 20 years of leasing period. In 2012, the Group treated the deferred income which was forecasted to be transferred to income statement within one year as non-current liabilities due within one year (see Note V. 27).

Note 2: As at 31st December 2012, the government grants mainly included:

- specific state grants of RMB8,035,000.00 and RMB10,924,000.00 for developing technology innovation platform for precision horizontal and vertical products machining center and TGK46100 series hightech boring and milling machine tools respectively;
- government grants of RMB29,884,000.00 for land formation, civil construction and equipment purchasing and installation for the heavy casting base (see Note V. 10).

### 31. Share capital

Item	Unit: RMB Opening and closing balance
Ordinary domestic A Shares	390,186,228.20
Overseas foreign H Shares listed in Hong Kong	<u>140,894,874.80</u>
Total	<u>531,081,103.00</u>

### 32. Capital reserve

Item	Unit: RMB Opening and closing balance
Share premium	19,206,777.12
Other capital reserves – others	<u>8,096,544.60</u>
Total	<u>27,303,321.72</u>

### 33. Surplus reserve

Item	Opening balance	Increase during the year	Decrease during the year	Unit: RMB Closing balance
Statutory surplus reserve	<u>116,508,002.60</u>	<u>–</u>	<u>–</u>	<u>116,508,002.60</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 34. Retained earnings

Item	Note	Unit: RMB Amount
Retained earnings at the beginning of the year		727,245,922.10
Add: net losses attributable to shareholders of the Company for the year		(73,220,171.53)
Less: Appropriation for statutory surplus reserve		-
Dividends payable on ordinary shares	(1)	<u>10,621,622.06</u>
Retained earnings at the end of the year	(2)	<u>643,404,128.51</u>

(1) *Distribution of dividends on ordinary shares*

At the general meeting held on 15th May 2012, the payment of a dividend of RMB0.02 per share (2011: RMB0.05 per share) or RMB10,621,622.06 in respect of the year 2011 was approved (2011: RMB26,554,055.15).

(2) *Retained earnings at the end of the year*

RMB157,620.39 of surplus reserve attributed to the Company was made by subsidiaries during the year (2011: RMB228,079.02).

As at 31st December 2012, the Group's retained earnings attributed to the Company included RMB6,907,902.55 of surplus reserve drawn by subsidiaries of the Company (2011: RMB6,750,282.16).

### 35. Operating income and operating costs

(1) *Operating income and operating costs*

Item	2012	2011
Operating income from principal activities	1,082,295,370.62	1,798,749,531.20
Including: income from sales of goods	1,066,989,921.61	1,778,371,514.54
income from services	15,305,449.01	20,378,016.66
Other operating income	<u>4,015,725.16</u>	<u>6,108,033.09</u>
Total of operating income	<u>1,086,311,095.78</u>	<u>1,804,857,564.29</u>
Operating costs	<u>880,453,359.74</u>	<u>1,368,376,106.28</u>

(2) *Principal activities (by industry)*

Industry	2012		2011	
	Operating income	Operating costs	Operating income	Operating costs
Machine tools	898,760,425.29	724,801,016.49	1,548,123,743.44	1,149,136,018.72
Turbo machines	<u>187,550,670.49</u>	<u>155,652,343.25</u>	<u>256,733,820.85</u>	<u>219,240,087.56</u>
Total	<u>1,086,311,095.78</u>	<u>880,453,359.74</u>	<u>1,804,857,564.29</u>	<u>1,368,376,106.28</u>

(3) *Please refer to note X. 2 (2) for information regarding income from external customers as set out by different areas by the Group.*

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 35. Operating income and operating costs (Continued)

(4) Operating income from top five customers in 2012

Name of customers	Operating income	Unit: RMB
		Proportion to total operating income (%)
1st	69,999,999.90	6.44
2nd	64,034,188.02	5.89
3rd	42,952,219.67	3.95
4th	22,794,871.79	2.10
5th	22,462,051.28	2.07
Total	<u>222,243,330.66</u>	<u>20.45</u>

As names of customers involve the commercial confidential information of the Group, we did not disclose the specific names of the top five customers in 2012.

### 36. Business taxes and surcharges

Item	2012	2011	Unit: RMB
			Taxation basis and rates
Business tax	11,048.24	22,931.25	3% – 5% of operating income
Urban maintenance and construction tax	4,155,659.37	4,727,000.36	1% – 7% of paid VAT and business tax
Education surcharges	1,910,381.75	2,132,201.57	3% of paid VAT and business tax
Local education surcharges	1,078,106.38	1,142,188.46	2% of paid VAT and business tax
Total	7,155,195.74	8,024,321.64	

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 37. Selling and distribution expenses

Item	Unit: RMB	
	2012	2011
Staff cost	34,676,230.13	28,567,237.60
Sales commission and business promotion expenses	4,765,756.67	32,743,045.33
Depreciation expenses	938,404.43	1,077,046.01
Others	56,247,762.84	71,801,359.15
Total	<u>96,628,154.07</u>	<u>134,188,688.09</u>

### 38. General and administrative expenses

Item	Unit: RMB	
	2012	2011
Staff cost	63,435,571.38	67,292,056.59
Depreciation expenses	9,139,581.69	8,713,597.84
Others	87,799,303.87	93,647,289.95
Total	<u>160,374,456.94</u>	<u>169,652,944.38</u>

### 39. Finance expenses

Item	Unit: RMB	
	2012	2011
Interest expenses on loans	8,507,777.84	3,712,939.82
Less: interest expenses capitalized	6,615,355.31	–
Interest income	(655,934.64)	(1,459,190.35)
Net exchange gain	(500,885.54)	(76,054.68)
Other financial expenses	1,062,122.84	1,231,506.63
Total	<u>1,797,725.19</u>	<u>3,409,201.42</u>

The interest rate per annum, at which the borrowing cost were capitalized for the current year by the Group was 6.86% (2011: Nil).

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 40. Investment income

Item	Note	2012	Unit: RMB 2011
Income from long-term equity investments accounted for using the equity method	V.8	1,055,320.73	7,334,821.80
Income from disposal of long-term equity investments		1,408,054.17	-
Others		533,000.00	-
Total		<u>2,996,374.90</u>	<u>7,334,821.80</u>

(1) Information on income from long-term equity investments accounted for using the equity method is as follows:

Invested companies	2012	Unit: RMB 2011
Kunming TOS	1,131,147.36	7,534,798.57
Xi'an Ruite	(75,826.63)	(199,976.77)
Total	<u>1,055,320.73</u>	<u>7,334,821.80</u>

### 41. Asset impairment losses

Item	2012	Unit: RMB 2011
Accounts receivable	44,203,336.28	56,493,076.37
Other receivables	653,431.08	1,891,628.04
Inventories	7,405,546.31	4,536,999.15
Total	<u>52,262,313.67</u>	<u>62,921,703.56</u>

### 42. Non-operating income

(1) Non-operating income by item is as follows:

Item	Note	2012	2011	Unit: RMB Amount included in extraordinary gains or losses for the year 2012
Gain on disposal of non-current assets		51,454.39	1,892,985.09	51,454.39
Government grants	(2)	15,369,410.00	2,552,408.50	15,369,410.00
Others		137,367.91	645,191.92	137,367.91
Total		<u>15,558,232.30</u>	<u>5,090,585.51</u>	<u>15,558,232.30</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 42. Non-operating income (Continued)

(2) Breakdown of government grants:

Item	2012	2011	Explanation
THM series precision horizontal products machining center	8,142,000.00	–	Note
Large Precision CNC boring and milling machines (TKS6916)	2,600,000.00	–	–
Others	4,627,410.00	2,552,408.50	–
Total	<u>15,369,410.00</u>	<u>2,552,408.50</u>	–

Note: Pursuant to the Written Reply Regarding Research Subjects for 2009 (Gongxinbu Zhuang Han (2009) No.619) and the agreements entered into by the Company and other cooperation units, the research project (THM series precision horizontal products machining center) jointly submitted by the Company (as the subject responsible unit) and other cooperation units is expected to receive government grants in an amount of RMB8.14 million. The Company received the government grants in December 2010 and July 2011, which were recognized as deferred gain. In 2012, the research project has received the approval from the relevant government authorities. Therefore, the grants received were transferred from deferred gain to non-operating income by the Company in the same year.

### 43. Non-operating expenses

Item	2012	2011	Unit: RMB Amount included in extraordinary gains or losses for the year 2012
Losses on disposal of fixed assets	516,205.94	499,354.16	516,205.94
Donations provided	–	8,000.00	–
Others	918,565.55	1,418,555.54	918,565.55
Total	<u>1,434,771.49</u>	<u>1,925,909.70</u>	<u>1,434,771.49</u>

### 44. Income tax expenses

Item	Note	2012	Unit: RMB 2011
Current tax expenses for the year based on tax law and related regulations		892,777.43	12,758,248.81
Under provision for income tax in respect of preceding years		2,853,031.09	–
Changes in deferred tax assets	(1)	<u>(16,689,987.38)</u>	<u>3,810,239.29</u>
Total		<u>(12,944,178.86)</u>	<u>16,568,488.10</u>

During the 12 months ended 31st December 2012 and 31st December 2011, the Group did not have assessable profits subject to Hong Kong Profits Tax. Therefore, no provision has been made for Hong Kong Profits Tax.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 44. Income tax expenses (Continued)

(1) The analysis of changes in deferred tax is set out below:

Item	2012	Unit: RMB
		2011
Origination and reversal of the temporary differences	(17,052,661.67)	(8,832,491.81)
Effects of tax rate changes on deferred tax	-	17,957,297.13
Unrecognised deductible losses	531,923.19	338,101.81
Reversal of deferred tax assets recognised in prior years	1,327,591.20	750,000.00
Using deductible losses unrecognised in prior years	(1,496,840.10)	(6,402,667.84)
Total	<u>(16,689,987.38)</u>	<u>3,810,239.29</u>

(2) The relationship between income tax expenses and accounting profit:

Item	2012	Unit: RMB
		2011
Profit before tax ("()" for loss)	(95,240,273.86)	68,784,096.53
Expected income tax under tax rate applicable to relevant region	(23,810,068.47)	17,196,024.13
Add: Non-deductible expenses non-taxable income	261,223.30 (263,830.18)	1,503,757.07 (1,833,705.45)
Unrecognised deductible losses	531,923.19	338,101.81
Reversal of deferred tax assets recognised in prior years	1,327,591.20	750,000.00
Using deductible losses unrecognised in prior years	(1,496,840.10)	(6,402,667.84)
Effects of different tax rates	12,005,705.39	-
Effects of tax rate changes on deferred tax	-	17,957,297.13
Effects of items eligible for additional deduction	(3,757,729.32)	(4,604,571.13)
Effects on preferential income tax	(595,184.96)	(8,335,747.62)
Income tax underpaid in respect of preceding years	<u>2,853,031.09</u>	<u>-</u>
Income tax expenses for the year ("()" for income tax income)	<u>(12,944,178.86)</u>	<u>16,568,488.10</u>

### 45. Calculation of basic earnings per share and diluted earnings per share

(1) Basic earnings per share

The basic earnings per share was calculated by dividing the consolidated net profit attributable to ordinary shareholders of the Company by the weighted average number of the outstanding ordinary shares of the Company:

	2012	2011
Consolidated net profit attributable to ordinary shareholders of the Company ("()" for loss) (RMB)	(73,220,171.53)	54,567,125.16
Weighted average number of the outstanding ordinary shares of the Company (share)	531,081,103.00	531,081,103.00
Basic earnings per share ("()" for loss) (RMB/share)	(0.14)	0.10

In 2012 and 2011, there were no changes in the number of outstanding ordinary shares of the Company. The weighted average number of ordinary shares outstanding for such years was the same as the number of ordinary shares as at 1st January 2012.

(2) Diluted earnings per share

The diluted earnings per share was the same as the basic earnings per share, because the Company did not have any potentially dilutive ordinary shares during the year.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 46. Income statement supplementary information

Item	2012	Unit: RMB
		2011
Staff cost incurred	292,521,360.04	301,118,479.53
Depreciation expenses	44,947,598.05	39,557,808.83
Amortization of intangible assets	2,363,706.73	3,047,547.88
Auditor's fee	<u>2,660,000.00</u>	<u>2,700,000.00</u>

### 47. Notes to cash flow statement

(1) Cash received relating to other operating activities during the year

Item	Unit: RMB
	Amount
Government grants for R&D of products	26,757,928.00
Others	<u>2,950,732.83</u>
Total	<u>29,708,660.83</u>

(2) Cash paid relating to other operating activities during the year

Item	Unit: RMB
	Amount
Product quality warranty expenses	17,077,956.49
Others	<u>10,112,595.70</u>
Total	<u>27,190,552.19</u>

(3) Cash received relating to other investing activities during the year

Item	Unit: RMB
	Amount
Government grants for heavy base	<u>14,000,000.00</u>



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 48. Related information of cash flow statement

(1) Supplementary information on cash flow statement

Supplementary information	Unit: RMB	
	2012	2011
<b>1. Reconciliation of net profit (“()” for net loss) to cash flows from operating activities:</b>		
Net profit (“()” for net loss)	(82,296,095.00)	52,215,608.43
Add: Provision for impairment of assets	52,262,313.67	62,921,703.56
Depreciation of fixed assets	44,947,598.05	39,557,808.83
Amortization of intangible assets	2,363,706.73	3,047,547.88
Amortization of long-term deferred expenses	534,434.88	178,093.26
Amortization of deferred gain	(205,300.00)	(205,300.20)
Loss on disposal of fixed assets (“()” for profit)	464,751.55	(1,393,630.93)
Finance expense	1,391,536.99	4,116,520.60
Investment income	(2,996,374.90)	(7,334,821.80)
Decrease in deferred tax assets (“()” for increase)	(16,624,186.69)	3,810,239.29
Increase in inventories	(35,653,926.19)	(235,440,378.85)
Increase in operating receivable	(91,577,090.32)	(190,586,600.85)
Increase in operating payable	134,959,642.53	269,767,967.48
Net cash flows from operating activities	<u>7,571,011.30</u>	<u>654,756.70</u>
<b>2. Net change in cash and cash equivalents:</b>		
Cash balance at the end of the year	89,677,792.83	175,808,019.62
Less: cash balance at the beginning of the year	175,808,019.62	285,882,274.37
Net increase in cash and cash equivalents (“()” for decrease)	(86,130,226.79)	(110,074,254.75)

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 48. Related information of cash flow statement (Continued)

(2) Relevant information on disposal and loss of control of a subsidiary during the year:

Relevant information on disposal of a subsidiary

	2012	2011
Consideration of disposing a subsidiary	1,000,000.00	–
Cash received from disposal of a subsidiary	1,000,000.00	–
Less: cash held by the subsidiary on the date of disposal	56,241.69	–
Net cash received from disposal of a subsidiary	943,758.31	–
Non-cash assets and liabilities, held by the disposed subsidiary on the date of disposal		
– Current assets (other than cash)	7,607,843.68	–
– Non-current assets	581,419.29	–
– Current liabilities	9,228,909.67	–
– Non-current liabilities	–	–

Relevant information on loss of control of a subsidiary

	2012	2011
Cash held by the subsidiary on the date of losing control	5,970,608.35	–
Decrease in net cash resulted from loss of control of a subsidiary	(5,970,608.35)	–
Non-cash assets and liabilities held by the subsidiary on the date of losing control		
– Current assets (other than cash)	9,381,614.22	–
– Non-current assets	693,692.06	–
– Current liabilities	14,681,898.29	–
– Non-current liabilities	–	–

(3) Composition of cash and cash equivalents

Item	2012	2011
Cash		<i>Unit: RMB</i>
Including: cash on hand	314,067.72	503,574.06
Bank deposits available on demand	89,363,725.11	175,304,445.56
Cash balance at the end of the year	<u>89,677,792.83</u>	<u>175,808,019.62</u>

Note: Cash disclosed above does not include the amounts of monetary funds with restricted usage and short-term investments.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 49. Director's remuneration

Details of director's remuneration for the year ended 31st December 2012:

Unit: RMB thousand

	Director's fee	Salaries, allowances and benefits in kind	Retirement scheme contributions	Discretionary bonuses (iii)	Total
Executive directors:					
Wang Xing (Chairman)	100	404	68	161	733
Zhang Xiaoyi	83	402	50	201	736
Ye Nong	64	344	68	251	727
Li Shunzhen	64	346	59	31	500
Pi Jianguo (i)	–	–	–	50	50
Non-executive directors:					
Guan Xin	57	–	–	–	57
Gao Minghui	64	408	–	161	633
Zhang Tao (ii)	–	–	–	–	–
Li Zhenxiong (ii)	–	–	–	–	–
Independent directors:					
Li Dongru	143	–	–	–	143
Chen Fusheng	200	–	–	–	200
Xiao Jianming	143	–	–	–	143
Liu Minghui	143	–	–	–	143
<b>Total</b>	<b>1,061</b>	<b>1,904</b>	<b>245</b>	<b>855</b>	<b>4,065</b>

Note:

- (i) Mr. Pi Jianguo has resigned on 31st October 2011 because of the expiration of term of office.
- (ii) The director had elected to waive any remuneration to him from the Group.
- (iii) Discretionary bonuses represent the bonuses paid in 2012 and related to the performance of 2011.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 49. Director's remuneration *(Continued)*

Details of director's remuneration for the year ended 31st December 2011:

*Unit: RMB thousand*

	Director's fee	Salaries, allowances and benefits in kind	Retirement scheme contributions	Discretionary bonuses	Total
Executive directors:					
Wang Xing ( <i>Chairman</i> ) (i)	65	206	–	–	271
Zhang Xiaoyi	70	429	37	180	716
Ye Nong	51	359	59	180	649
Li Shunzhen (ii)	11	61	9	–	81
Pi Jianguo (iii)	40	346	73	50	509
Non-executive directors:					
Guan Xin	45	–	–	–	45
Gao Minghui (i)/(ii)	71	404	59	100	634
Zhang Tao (vi)	–	–	–	–	–
Li Zhenxiong (vi)	–	–	–	–	–
Independent directors:					
Wayne Yu (iv)	79	–	–	–	79
Chen Ying (iii)	95	–	–	–	95
Li Dongru	119	–	–	–	119
Chen Fusheng (v)	83	–	–	–	83
Xiao Jianming (ii)	24	–	–	–	24
Liu Minghui	119	–	–	–	119
Total	<u>872</u>	<u>1,805</u>	<u>237</u>	<u>510</u>	<u>3,424</u>

*Note:*

- (i) On 27th July 2011, Mr. Gao Minghui resigned the position of chairman and director Mr. Wang Xing was appointed Chairman of the Company.
- (ii) The Company held a general meeting on 31st October 2011 to review and approve Ms. Li Shunzhen as executive director of the Company with effect from 31st October 2011, Mr. Gao Minghui as non-executive director of the Company with effect from 31st October 2011 and Mr. Xiao Jianming as independent non-executive director of the Company with effect from 31st October 2011.
- (iii) Mr. Pi Jianguo and Mr. Chen Ying has resigned on 31st October 2011 because of the expiration of term of office.
- (iv) Mr. Wayne Yu has resigned on 15th June 2011 due to the expiration of term of office.
- (v) The Company held a general meeting on 18th July 2011 to review and approve Mr. Chen Fusheng as independent non-executive director of the Company with effect from 18th July 2011.
- (vi) The director had elected to waive any remuneration to him from the Group.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

### 50. Individuals With Highest Emoluments

Of the five individuals with the highest emoluments, four (2011: four) are directors whose emolument are disclosed in note V. 49. The aggregate of the emoluments in respect of the remaining individuals are as follows:

Item	Unit: RMB thousand	
	2012	2011
Salaries and other emoluments	346	366
Discretionary bonuses	50	180
Retirement scheme contributions	251	37
Total	<u>647</u>	<u>583</u>

The emoluments of the one individual (2011: one) with the highest emoluments are within the following band:

Item	2012	2011
HKD Nil – HKD 1,000,000	1	1

## (VI). RELATED PARTIES AND TRANSACTIONS

### 1. Information on the largest shareholder of the Company

Name of the largest shareholder	Type	Place of registration	Legal representative	Business nature	Registered capital	Percentage of shareholding (%)	Percentage of voting rights (%)	Ultimate controlling shareholder of the Company	Organization code
Shenji Group	Limited liability company	China	Guan Xiyou	Production and sales of machine tools	1,556,480,000	25.09	25.09	Shenyang State-owned Assets Supervision and Administration Commission	243381258

### 2. Subsidiaries of the Company

Please see Note IV for information of subsidiaries of the Company.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS *(Continued)*

### 3. Jointly controlled enterprises and associated companies of the Company

Name of investee	Type	Place of registration	Legal representative	Business nature	Registered capital	Percentage of shareholding (%)	Percentage of voting rights (%)	Organization code
1. Jointly controlled enterprise Kunming TOS	Limited company	China	Ing. JanRYDL	Production and sales of machine tools	EUR5,000,000	50	50	77266099-X
2. Associated company Xi'an Ruite	Limited company	China	Tian Huisheng	Production and sales of laser prototyping machine	RMB60,000,000	23.34	23.34	79166780-4

### 4. Information on other related parties

Name of other related parties	Related relationship	Organization code
Yunnan Yun Ji Group Import and Export Co., Ltd. ("Yun Ji I & E Co.")	Subsidiary of the largest shareholder of the Company	709781545
Yunnan CY Group Co., Ltd.	Subsidiary of the largest shareholder of the Company	919190831
Kunming Kunji Group Co., Ltd. ("Kunji Group Co.")	Subsidiary of the second largest shareholder of the Company	216547232
Yunnan State-owned Assets Property Management Co., Ltd. ("Yunnan State-owned Assets Property")	Subsidiary of the second largest shareholder of the Company	291887852
Yunnan CY (Group) Company Jinhui Spraying Factory ("Jinhui Spraying Factory")	Subsidiary of the largest shareholder of the Company	99211416-5
Yunnan CY Group Co., Ltd., Products Trading Centre ("Trading Centre")	Subsidiary of the largest shareholder of the Company	292147185
Shenyang Machine Tool Company Limited	Subsidiary of the largest shareholder of the Company	24340683-0
Shenyang Machine Tool (Group) Kunming Co., Ltd.	Subsidiary of the largest shareholder of the Company	76705620-2

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS (Continued)

### 5. Related party transactions

#### (1) Summary of related party transactions

The Group

Related party	Nature of connected transactions	Pricing method and decision-making procedures of connected transactions	2012		Unit: RMB 2011	
			Amount	Percentage of the same type of transactions (%)	Amount	Percentage of the same type of transactions (%)
Key management (Note 8)	service Remuneration	Based on relevant terms of agreement	7,292,899.68	2.49	6,517,384.69	2.37
Trading Centre	Sales of goods	Based on relevant terms of agreement	294,871.79	0.03	957,264.96	7.00
Kunming TOS (Note 4)	Sales of goods	Based on normal commercial terms	8,314,124.19	0.78	10,225,251.69	0.66
Yunji I & E Co.	Sales of goods	Based on normal commercial terms	282,615.38	0.03	1,794.87	-
Yunnan CY Group Co., Ltd.	Sales of goods	Based on normal commercial terms	-	-	292,863.25	0.02
Kunming TOS (Note 4)	Purchase of goods	Based on normal commercial terms	74,850,427.35	10.97	105,850,902.77	11.39
Jinhui Spraying Factory (Note 5)	Purchase of goods	Based on normal commercial terms	3,855,789.70	0.57	3,644,430.73	0.39
Shenyang Machine Tool Company Limited	Purchase of goods	Based on normal commercial terms	-	-	405,749.91	0.04
Kunming TOS	Receipt of funds-funding transactions	Based on relevant terms of agreement	30,000,000.00	100.00	-	-
Kunming TOS	Provision of funds-other expenses on behalf of related parties	Based on relevant terms of agreement	4,396,759.90	100.00	-	-
Yunnan CY Group Co., Ltd.	Provision of services	Based on normal commercial terms	63,459.84	0.41	-	-
Shenyang Machine Tool Company Limited (Note 6)	Purchase of equipment	Based on normal commercial terms	-	-	9,475,871.81	5.08
Yunnan CY Group Co., Ltd. (Note 7)	Purchase of equipment	Based on normal commercial terms	-	-	1,640,601.71	0.88
Shenyang Machine Tool (Group) Kunming Co., Ltd.	Purchase of premises	Based on relevant terms of agreement	350,000.00	0.34	-	-
Yunnan CY Group Co., Ltd.	Receipt of service	Based on normal commercial terms	66,500.00	0.01	-	-
Kunji Group Co. (Note 2)	Receipt of service	Based on relevant terms of agreement	130,772.88	0.02	212,125.10	0.09
Yunnan State-owned Assets Property	Receipt of service	Based on relevant terms of agreement	409,082.10	0.06	495,578.82	0.21
Schiess (Note 3)	Receipt of service	Based on relevant terms of agreement	-	-	3,483,152.00	100.00
Kunji Group Co. (VI. 5(2))	leasing	Based on relevant terms of agreement	5,250,000.00	69.36	5,250,000.00	68.07
Yunnan State-owned Assets Property (VI. 5(2))	leasing	Based on relevant terms of agreement	1,306,065.00	17.26	1,198,150.00	15.54
Schiess (Note 3)	Payment of contract technology license fees	Based on relevant terms of agreement	10,575,351.60	100.00	18,246,610.80	100.00
Schiess (Note 3)	Purchase of equipment	Based on relevant terms of agreement	18,844,219.15	18.46	-	-

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS (Continued)

### 5. Related party transactions (Continued)

#### (1) Summary of related party transactions (Continued)

The Company

Related party	Nature of connected transactions	Pricing method and decision-making procedures of connected transactions	2012		Unit: RMB 2011	
			Amount	Percentage of the same type of transactions (%)	Amount	Percentage of the same type of transactions (%)
Key management (Note 8)	Service Remuneration	Based on relevant terms of agreement	7,292,899.68	2.75	6,517,384.69	2.59
Trading Centre	Sales of goods	Based on relevant terms of agreement	294,871.79	0.03	957,264.96	7.00
Fujian Kunji (Note 1)	Sales of goods	Based on relevant terms of agreement	-	-	204,679.50	0.01
Kunming TOS (Note 4)	Sales of goods	Based on normal commercial terms	8,314,124.19	0.95	10,225,251.69	0.66
Yunji I & E Co.	Sales of goods	Based on normal commercial terms	282,615.38	0.03	1,794.87	-
Yunnan CY Group Co., Ltd.	Sales of goods	Based on normal commercial terms	-	-	292,863.25	0.02
Kunming TOS (Note 4)	Purchase of goods	Based on normal commercial terms	74,850,427.35	13.33	105,850,902.77	13.28
Jinhui Spraying Factory (Note 5)	Purchase of goods	Based on normal commercial terms	3,855,789.70	0.69	3,644,430.73	0.46
Shenyang Machine Tool Company Limited	Purchase of goods	Based on normal commercial terms	-	-	405,749.91	0.05
General Machine	Purchase of goods	Based on normal commercial terms	20,000,000.00	3.56	2,604,618.23	0.33
Kunming TOS	Receipt of funds - funding transactions	Based on relevant terms of agreement	30,000,000.00	100.00	-	-
Kunming TOS	Provision of funds - other expenses on behalf of related parties	Based on relevant terms of agreement	4,396,759.90	100.00	-	-
Xi'an Ser	Provision of services	Based on relevant terms of agreement	72,149.57	0.47	2,155,575.62	100.00
Xi'an Ser	Interest income	Based on relevant terms of agreement	584,100.00	100.00	-	-
Shenyang Machine Tool Company Limited (Note 6)	Purchase of equipment	Based on normal commercial terms	-	-	9,475,871.81	5.18
Yunnan CY Group Co., Ltd. (Note 7)	Purchase of equipment	Based on normal commercial terms	-	-	1,640,601.71	0.90
Shenyang Machine Tool (Group) Kunming Co., Ltd.	Purchase of premises	Based on relevant terms of agreement	350,000.00	0.35	-	-
Yunnan CY Group Co., Ltd.	Receipt of service	Based on normal commercial terms	66,500.00	0.01	-	-
Yunnan CY Group Co., Ltd.	Provision of services	Based on normal commercial terms	63,459.84	0.41	-	-
Kunji Group Co. (Note 2)	Receipt of service	Based on relevant terms of agreement	130,772.88	0.02	212,125.10	0.10
Yunnan State-owned Assets Property	Receipt of service	Based on relevant terms of agreement	409,082.10	0.07	495,578.82	0.23
Schiess (Note 3)	Receipt of service	Based on relevant terms of agreement	-	-	3,483,152.00	100.00
Yunnan State-owned Assets Property (VI. 5(2))	leasing	Based on relevant terms of agreement	1,306,065.00	17.90	1,198,150.00	18.62
Kunji Group Co. (VI. 5(2))	leasing	Based on relevant terms of agreement	5,250,000.00	71.97	5,250,000.00	81.60
Schiess (Note 3)	Payment of contract technology license fees	Based on relevant terms of agreement	10,575,351.60	100.00	18,246,610.80	100.00
Schiess (Note 3)	Purchase of equipment	Based on relevant terms of agreement	18,844,219.15	18.66	-	-



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS *(Continued)*

### 5. Related party transactions *(Continued)*

#### (1) Summary of related party transactions *(Continued)*

*Note 1:* On 21st March 2012, the Company disposed of all of its shares in Fujian Kunji. Thereafter, Fujian Kunji ceased to be a related party of the Company.

*Note 2:* According to the services agreement entered into between the Company and Kunji Group Company, the Company agreed to provide certain public utility services such as water and electricity to Kunji Group Company, while Kunji Group Company agreed to provide certain services to the Company including property management, employee's medical services, education and administration of retired staff. Service fee is reviewed by both parties on an annual basis.

*Note 3:* As reviewed and approved by the first extraordinary general meeting of 2011 of the Company held on 18th July 2011, the Company and Schiess entered into the Proprietary Technology and Patent Licensing Contract to introduce the proprietary technology for the design, manufacture and installation of double column 2000mm-crossrail machine ("contract products"), and obtain the exclusive and non-transferable license for the production in PRC and sale in Asia of these contract products.

According to the Proprietary Technology and Patent Licensing Contract, contractual expenses include:

- License Fee in one lump-sum: EUR6,600,000;
- Technical training fees: EUR700,000; and
- Technical service fees for the first two prototype machines of machine models VMG6 and VM8: EUR200,000;

In August 2011, under the terms of the contract, the Company paid 30% of the contract technology license fee to Schiess, which amounted to EUR1,980,000 (equivalent to RMB18,246,610.80), and received part of the technical documents (including design drawing, process and content) of the first prototype machine. As at 31st December 2011, the amount was included in the balance sheet as other non-current assets (refer to note V. 15). The Company paid technical training fees of EUR400,000 (equivalent to RMB3,483,152.00) to Schiess in November 2011.

In November 2012, under the terms of the contract, the Company paid 20% of the contract technology license fee to Schiess, which amounted to EUR1,320,000 (equivalent to RMB10,575,351.60).

In December 2011, the Company and Schiess entered into a contract to purchase assembly components of VMG6 prototype machine from Schiess with an amount of EUR4,481,309.00. In April 2012, under the terms of the contract, the Company prepaid EUR2,261,256.83 (equivalent to RMB18,844,219.15) to Schiess for VMG6 prototype machine. As at 31st December 2012, such amount together with 50% of the accumulated prepaid contract technology license fee was included in the balance sheet as other non-current assets (refer to Note V. 15).

*Note 4:* The ordinary business framework agreement was entered between the Company and Kunming TOS regarding the purchase of goods, receipt of services, sales of goods and provision of services etc. in 2012.

*Note 5:* The framework agreement was entered between the Company and Jinhui Spraying Factory regarding the purchase of machine tool's packing material in 2011 with effective from 21st September 2011 to 31st December 2013.

*Note 6:* The framework agreement was entered between the Company and Shenyang Machine Tool Co., Ltd. regarding the purchase of vertical lathe and radial drill in 2011 with effective from 21st September 2011 to 31st December 2013.

*Note 7:* The framework agreement was entered between the Company and Yunnan CY (Group) Company regarding the purchase of lathe in 2011 with effective from 21st September 2011 to 31st December 2013.

*Note 8:* The amount comprised remunerations paid to directors (see Note V.49) and certain highest paid employees (see Note V.50) of the Company.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS *(Continued)*

### 5. Related party transactions *(Continued)*

(2) Leases:

Leasing information of the Group and the Company

*Unit: RMB*

Name of leaser	Name of leasee	Type of leased assets	Inception date of lease	Maturity date of lease	Basis for determining lease fee	Lease fee recognised in 2012
Yunnan State-owned Assets Property	The Company	Land and premises	1st January 2011	31st December 2013	Based on relevant terms of agreement <i>(Note 1)</i>	1,088,065.00
Kunji Group Co.	The Company	Land and premises	12th November 2001	11th November 2021	Based on relevant terms of agreement <i>(Note 2)</i>	5,250,000.00

*Note 1:* The transactions were about rental fees for land and premises paid to Yunnan State-owned Assets Property.

The rental agreement for land and premises was entered between the Company and Yunnan State-owned Assets Property. on 28th July 2011. The rental for the first, second and third year amounted to RMB989,150, RMB1,088,065 and RMB1,196,871, respectively. The agreement was effective from 1st January 2011 to 31st December 2013.

*Note 2:* The transactions were about rental fees for premises and land use rights paid to Kunji Group Co.. Kunji Group Co. was authorized by the People's Government of Yunnan Province to succeed the rights and obligations of the "The Premise Rental Agreement" and "The Land Use Rights Rental Agreement" signed between the People's Government of Yunnan Province and the Company on 12th November 2001.

On 1st February 2011, the Company entered into an agreement for rental adjustment with Kunji Group Co.. The annual rent of land use rights was adjusted to RMB4,457,340, and the annual rent of premises was adjusted to RMB792,660. The adjusted annual rent was effective from 12th November 2010 to 11th November 2013.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS (Continued)

### 6. Receivables and payables from/to related parties

The Group

Receivables from related parties

*Unit: RMB*

Item	Related parties	2012		2011	
		Carrying amount	Provision for bad and doubtful debt	Carrying amount	Provision for bad and doubtful debt
Bills receivable	Trading Center	160,000.00	-	-	-
Accounts receivable	Kunming TOS	4,181,928.75	-	6,085,433.84	-
Accounts receivable	Trading Center	-	-	9,000.00	-
Other receivables	Kunming TOS	370,448.02	-	930,594.93	-
Prepayments	Yunnan State-owned Assets Property	9,000.00	-	-	-
Other non-current assets	Schiess	47,666,181.55	-	18,246,610.80	-

The Group

Payables to related parties

*Unit: RMB*

Item	Related parties	2012		2011	
Accounts payable	Kunming TOS		33,230,241.15		43,510,497.07
Accounts payable	Jinhui Spraying Factory		1,094,005.69		2,043,215.99
Advances from customers	Trading Center		5,000.00		-
Other payables	Kunji Group Company		5,250,000.00		2,625,000.00
Other payables	Yunnan CY Group Co., Ltd.		-		1,461,801.71
Accounts payable	Shenyang Machine Tool Co., Ltd.		125,641.03		-
Other payables	Shenyang Machine Tool Co., Ltd.		-		1,875,871.81

The Company

Receivables from related parties

*Unit: RMB*

Item	Related parties	2012		2011	
		Carrying amount	Provision for bad and doubtful debt	Carrying amount	Provision for bad and doubtful debt
Bills receivable	Trading Center	160,000.00	-	-	-
Accounts receivables	Kunming TOS	4,181,928.75	-	6,085,433.84	-
Accounts receivables	Changsha Ser	244,000.00	-	244,000.00	-
Accounts receivables	Fujian Kunji (Note VI.5(1) (Note 1))	-	-	4,992,195.83	1,130,000.00
Accounts receivables	Trading Center	-	-	9,000.00	-
Other receivables	Kunming TOS	370,448.02	-	930,594.93	-
Other receivables	Xi'an Ser	7,220,746.31	-	6,564,496.74	-
Other receivables	Fujian Kunji (Note VI.5(1) (Note 1))	-	-	637,604.30	-
Prepayments	Yunnan State-owned Assets Property	9,000.00	-	-	-
Other non-current assets	Schiess	47,666,181.55	-	18,246,610.80	-
Dividends receivables	Xi'an Ser	11,000,000.00	-	11,000,000.00	-
Dividends receivables	General Machine	-	-	29,130,802.55	-

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VI). RELATED PARTIES AND TRANSACTIONS *(Continued)*

### 6. Receivables and payables from/to related parties *(Continued)*

The Company

Payables to related parties

Items	Related parties	2012	Unit: RMB
			2011
Accounts payable	Kunming TOS	33,230,241.15	43,510,497.07
Accounts payable	Jinhui Spraying Factory	1,094,005.69	2,043,215.99
Accounts payable	Fujian Kunji <i>(Note VI.5(1) (Note 1))</i>	–	325,000.00
Advances from customers	Trading Center	5,000.00	–
Advances from customers	Changsha Ser	9,120.67	9,120.67
Accounts payable	Shenyang Machine Tool Co., Ltd.	125,641.03	–
Other payables	Shenyang Machine Tool Co., Ltd.	–	1,875,871.81
Other payables	General Machine	–	12,640,191.46
Other payables	Kunji Group Company	5,250,000.00	2,625,000.00
Other payables	Yunnan CY Group Co., Ltd.	–	1,461,801.71

## (VII). CONTINGENCIES

### Contingent liabilities arising from outstanding litigations and arbitration and related financial effect

- (1) The Company signed a sales contract with Yancheng Xinde Oil Machine Company (“Xinde Machine”) in June 2002 for sales of four machine tools with an aggregate amount of approximately RMB11.9 million. The four related machine tools have been delivered to Xinde Machine before October 2003. In June 2009, Xinde Machine filed a lawsuit against the Company alleging that the goods delivered by the Company were unqualified and sought for return of goods, refund of advances paid of RMB10.7 million and payment of penalty and compensation of RMB0.3 million and RMB3.7 million respectively. The Company has denied the claim and filed a counter claim against Xinde Machine alleging that it was unreasonable for Xinde Machine to claim for return of goods after use of the Company’s products for more than 6 years and requesting Xinde Machine to repay the unpaid amount of RMB1.3 million for the goods.

The Intermediate People’s Court of Yancheng City made a ruling in relation to the aforesaid litigation on 18th May 2012. It was ruled that the Company should refund the advances paid of RMB2,375,000 and bear the costs of the action in the amount of approximately RMB26,000. The Company refused to accept the ruling and appealed to the Higher People’s Court of Jiangsu Province on 20th July 2012. The case has entered the second-instance stage.

Up to the date of the financial statements, the above case is still under the second-instance stage. In consultation with legal counsels, the management considered it may not be quite probable that a significant outflow of economic benefits would arise from the outcome of the above case. Therefore, no provision has been made in respect of the above pending case in the financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (VIII). COMMITMENTS

### 1. Significant commitments

#### (1) Capital commitments

Items	2012	Unit: RMB
		2011
Construction contract signed but not implemented or not fully implemented	167,161,428.53	171,007,819.14
Construction contract authorized but not signed or not implemented or not fully implemented	273,919,396.41	422,571,073.06
Proprietary technology and patent licensing contract signed and implementing or proposed to implement	70,113,578.61	74,405,718.64
Total	<u>511,194,403.55</u>	<u>667,984,610.84</u>

#### (2) Operating Lease commitments

According to the irrevocable lease agreement of premises, the minimum lease payments after the date of 31st December that the Group should pay are as follows:

Items	2012	Unit: RMB
		2011
Within 1 year (including 1 year)	7,878,041.00	7,189,857.00
1-2 years (including 2 years)	5,941,200.00	7,041,550.00
2-3 years (including 3 years)	5,250,000.00	5,691,200.00
Over 3 years	30,625,000.00	35,000,000.00
Total	<u>49,694,241.00</u>	<u>54,922,607.00</u>

## (IX). EVENTS AFTER BALANCE SHEET DATE

### 1. Profit appropriation after the balance sheet date

The Company has incurred a loss in 2012. The Board of directors did not propose to distribute cash dividends on ordinary shares for 2012 in accordance with the Company's dividend policy after the balance sheet date.

### 2. Issue of the medium-term notes

On 28th December 2012, the Company convened the third extraordinary general meeting of 2012 and the resolution regarding the issue of medium-term notes was considered and passed. The Company intended to issue the medium-term notes with an aggregate amount not more than RMB580 million and a term not more than 3 years by two tranches in the National Association of Financial Market Institutional Investors. The proceeds from the issue of the medium-term notes will be mainly used to supplement the Company's working capital, import technology and develop technology.

As of the date of approval of these financial statements, the Board of directors is still in the process of making relevant application for the medium-term notes.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS

### 1. Leases

Please refer to note V.28 for information of amounts payable of the Group in respect of finance lease.

### 2. Segment Reporting

According to the internal organization structure, the requirements of management and internal reporting system, the Group defined its business into two reportable segments – boring machine and turbo machines. Each reportable segment is a separate business unit and provides different goods and services. As each segment needs different technology and marketing strategy, it needs separate management. The management of the Group will review the financial information of different segment regularly for the purpose of resources allocation and assessment of segment performance.

#### (1) Information of gain or loss, assets and liabilities for the reporting segments

In order to assess the performance of each segment and to allocate resources, the management of the Group will review assets, liabilities, income, expenses, and operating results which attribute to each segment. The preparation basis of these information is as follows:

Segment assets include current assets of all tangible assets, intangible assets, accounts receivable, prepayments, and inventories attributable to each segment, but not including deferred tax assets caused by the unrealized gains and losses of the Group's internal transactions, long-term equity investment and other undistributed assets of headquarters. Segment liabilities include accounts payable, advance from customers, bank loans and expected liabilities attributable to each segment.

Segment operating results is about the income generated by each segment (including income from transactions with outside parties and income from transactions between segments), deducting expenses caused by each segment, depreciation, amortization and impairment losses attributable to assets of each segment, and the net interest expense arising from between bank deposit and bank loans attributable to each segment. The pricing of transactions between segments is similar to that of transactions with outside parties. The Group did not allocate investment income and directors' remuneration to each segment.

The information of each reportable segment of the Group disclosed below is the data for the management of the Group to calculate the profit (loss), assets and liabilities of each segment or data not being used but provided to management regularly:

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS (Continued)

### 2. Segment Reporting (Continued)

(1) Information of gain or loss, assets and liabilities for the reporting segments (Continued)

2012

Unit: RMB

Item	Business segment of boring machines	Business segment of turbo machines	Elimination between segments	Undistributed items	Total
Revenue from external customers	898,760,425.29	187,550,670.49	-	-	1,086,311,095.78
Inter-segment revenue	-	-	-	-	-
Investment income from jointly controlled enterprises and associated companies	-	-	-	1,055,320.73	1,055,320.73
Impairment loss of assets for the period	32,908,078.70	19,354,234.97	-	-	52,262,313.67
Depreciation and amortization expenses	40,019,120.88	7,292,183.90	-	-	47,311,304.78
Interest income from bank deposits	500,844.53	155,090.11	-	-	655,934.64
Interest expense	317,008.34	1,575,414.19	-	-	1,892,422.53
Total profit ("0" for total loss)	(79,562,656.82)	(16,747,683.18)	-	1,070,066.14	(95,240,273.86)
Income tax expenses ("0" for income tax income)	(12,343,710.97)	(769,148.21)	-	168,680.32	(12,944,178.86)
Net profits ("0" for net loss)	(67,218,945.85)	(15,978,534.97)	-	901,385.82	(82,296,095.00)
Total assets	2,112,174,009.05	395,116,739.44	(18,473,866.98)	59,935,343.59	2,548,752,225.10
Total liabilities	890,871,409.30	312,764,267.23	(18,473,866.98)	-	1,185,161,809.55
Other significant non-cash items:					
- other non-cash expenses other than depreciation and amortization	61,870,425.13	-	-	-	61,870,425.13
- long-term equity investment	-	-	-	59,124,901.68	59,124,901.68
- other increment of non-current assets other than long-term equity investment	136,106,324.12	661,936.60	-	-	136,768,260.72

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS (Continued)

### 2. Segment Reporting (Continued)

(1) Information of gain or loss, assets and liabilities for the reporting segments (Continued)

2011

Unit: RMB

Item	Business segment of boring machines	Business segment of turbo machines	Elimination between segments	Undistributed items	Total
Revenue from external customers	1,548,123,743.44	256,733,820.85	-	-	1,804,857,564.29
Inter-segment revenue	-	-	-	-	-
Investment income from jointly controlled enterprises and associated companies	-	-	-	7,334,821.80	7,334,821.80
Impairment loss of assets for the period	55,532,688.41	7,389,015.15	-	-	62,921,703.56
Depreciation and amortization expenses	35,409,017.23	7,196,339.48	-	-	42,605,356.71
Interest income from bank deposits	1,083,161.36	376,028.99	-	-	1,459,190.35
Interest expense	1,370,128.27	2,342,811.55	-	-	3,712,939.82
Total profit ("") for total loss	67,294,713.05	(2,422,696.55)	-	3,912,080.03	68,784,096.53
Income tax expenses ("") for income tax income)	15,883,637.86	1,012,100.76	-	(327,250.52)	16,568,488.10
Net profits ("") for net loss)	51,411,075.19	(3,434,797.31)	-	4,239,330.55	52,215,608.43
Total assets	2,177,134,752.09	398,345,322.68	(79,719,416.83)	62,903,703.18	2,558,664,361.12
Total liabilities	882,353,032.33	299,345,947.50	(79,719,416.83)	-	1,101,979,563.00
Other significant non-cash items:					
- other non-cash expenses other than depreciation and amortization	80,931,727.62	-	-	-	80,931,727.62
- long-term equity investment	-	-	-	61,924,580.95	61,924,580.95
- other increment of non-current assets other than long-term equity investment	186,254,866.80	3,674,765.03	-	-	189,929,631.83



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 2. Segment Reporting *(Continued)*

#### (2) Geographic Information

The following table sets out information about the geographical location of the Group's revenue from external customers. The geographical location of customers is based on the location at which the goods delivered or the services were provided.

Items	2012	2011
China	1,066,795,765.11	1,783,015,467.75
International	19,515,330.67	21,842,096.54
Total	<u>1,086,311,095.78</u>	<u>1,804,857,564.29</u>

The non-current assets of the Group are located in the mainland of China.

#### (3) Major Customers

All revenues of the Group from individual customers are lower than 10% of total revenues of the Group for the year 2012 and 2011.

### 3. Risk and sensitivity analysis and fair value of financial instruments

The Group is exposed to the following risks from financial instruments during its ordinary activities:

- Credit risk
- Liquidity risk
- Interest rate risk
- Foreign exchange risk

This note presents information about the Group's exposure to each of the above risks and their sources, the Group's objectives, policies and processes for measuring and managing risks, etc.

The goal of the Group's involvement in risk management is to balance the risk and revenue and minimize the adverse effects on financial results of the Group brought by the financial risks. The Group's risk management policies are established to identify and analyze the risks confronted by the Group, to set appropriate risk limits and control program, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The internal audit department of the Group also examines whether the exercise of internal control system meets the requirements of risk management policies on periodical and random basis.

#### (1) Credit Risk

Credit risk refers to the risk of financial loss incurred to one party of the financial instrument due to the other party's failure of performing its duty. The Group's credit risk is primarily attributable to monetary capital and accounts receivables, etc.. Exposure to these credit risks are monitored by management on an ongoing basis.

As the Group principally puts monetary funds excluding cash to the financial institutions with good credit standing, the management considers that there is no significant credit risk and the Group will not incur loss from the counterparty's default.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (1) Credit Risk *(Continued)*

In respect of receivables, the sales department of the Group has established a credit policy under which individual credit evaluations are performed on all customers to determine the amount and term of credit. Credit grading is depending on the financial condition, external grading and bank credit record (if any). Generally, except for deposit for warranty, all payments have to be paid by the end of the negotiated credit term. The group authorized credit term to customers according to their payment records and transaction performance, generally, the credit term will be one to three months. Normally, the Group does not require collateral from customers.

In monitoring customer credit risk, customers are grouped according to some factors, such as ageing and maturity date.

The accounts receivable of the Group and the Company as at 31st December 2012 and 31st December 2011 that are overdue but not impaired assessed via individual and collective basis are not significant.

The credit risk of the Group is principally impacted by self-characteristics of each customer other than their industries or countries and areas where their businesses operate. Therefore, significant concentration of credit risk is principally attributable to individual customers' significant accounts receivable. 29.73% (2011: 16.86%) of the total accounts receivable and other receivables was due from the Group's top five buyers.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet. The Group does not provide any other guarantees resulted in credit risk exposure.

#### (2) Liquidity risk

Liquidity refers to the risk of short of funds when an enterprise performs its duty related to financial liabilities. The Group and its subsidiaries are responsible for their own cash management, including short-term investment for surplus cash and the raising of loans to satisfy expected cash demands (if the amount of borrowings exceeds the preset limits, the approval from the board of directors is required). The Group's policy is to regularly monitor its short-term and long-term liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash, readily realizable marketable securities and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (2) Liquidity risk *(Continued)*

As at the balance sheet date, the residual contractual term of the financial assets and liabilities of the Group calculated at the undiscounted contractual cash flow (including at contractual interest (in the case of floating rate, at the prevailing interest as at 31st December) and their earliest date required to be repaid are as follows:

*Unit: RMB*

Items	2012 Undiscounted contractual cash flow				Total	Carrying amount at balance sheet
	Within one year or on demand	1-2 years	2-5 years	Over 5 years		
<b>Financial assets</b>						
- Cash at bank and on hand	98,887,040.73	-	-	-	98,887,040.73	98,887,040.73
- Accounts receivable and other receivables	310,564,102.16	-	-	-	310,564,102.16	310,564,102.16
- Bills receivable	74,194,825.88	-	-	-	74,194,825.88	74,194,825.88
Sub-total	<u>483,645,968.77</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>483,645,968.77</u>	<u>483,645,968.77</u>
<b>Financial liabilities</b>						
- Short term loans	(108,583,522.85)	-	-	-	(108,583,522.85)	(105,000,000.00)
- Accounts payable and other payables	(580,181,787.33)	-	-	-	(580,181,787.33)	(580,181,787.33)
- Employee benefits payable	(19,779,809.31)	(2,750,556.88)	(3,246,845.12)	(801,470.20)	(26,578,681.51)	(25,500,401.68)
- Bills payable	(28,693,005.00)	-	-	-	(28,693,005.00)	(28,693,005.00)
- Taxes payable	(12,322,840.16)	-	-	-	(12,322,840.16)	(12,322,840.16)
- Finance lease amount payable	(342,168.88)	(342,168.88)	(1,026,506.64)	(1,368,676.62)	(3,079,521.02)	(1,918,881.90)
Sub-total	<u>(749,903,133.53)</u>	<u>(3,092,725.76)</u>	<u>(4,273,351.76)</u>	<u>(2,170,146.82)</u>	<u>(759,439,357.87)</u>	<u>(753,616,916.07)</u>
Net amount	<u>(266,257,164.76)</u>	<u>(3,092,725.76)</u>	<u>(4,273,351.76)</u>	<u>(2,170,146.82)</u>	<u>(275,793,389.10)</u>	<u>(269,970,947.30)</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (2) Liquidity risk *(Continued)*

Unit: RMB

Items	2011 Undiscounted contractual cash flow				Total	Carrying amount at balance sheet
	Within one year or on demand	1-2 years	2-5 years	Over 5 years		
<b>Financial assets</b>						
- Cash at bank and on hand	192,200,330.65	-	-	-	192,200,330.65	192,200,330.65
- Accounts receivable and other receivables	299,175,379.24	-	-	-	299,175,379.24	299,175,379.24
- Bills receivable	104,034,946.22	-	-	-	104,034,946.22	104,034,946.22
Sub-total	<u>595,410,656.11</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>595,410,656.11</u>	<u>595,410,656.11</u>
<b>Financial liabilities</b>						
- Short term loans	(104,649,545.78)	-	-	-	(104,649,545.78)	(100,000,000.00)
- Accounts payable and other payables	(404,597,639.92)	-	-	-	(404,597,639.92)	(404,597,639.92)
- Employee benefits payable	(26,050,999.69)	(3,124,236.31)	(4,585,874.65)	(1,155,605.19)	(34,916,715.84)	(33,498,389.64)
- Bills payable	(46,596,910.09)	-	-	-	(46,596,910.09)	(46,596,910.09)
- Taxes payable	(7,310,302.86)	-	-	-	(7,310,302.86)	(7,310,302.86)
- Finance lease amount payable	(342,168.88)	(342,168.88)	(1,026,506.64)	(1,710,844.60)	(3,421,689.00)	(2,132,090.90)
Sub-total	<u>(589,547,567.22)</u>	<u>(3,466,405.19)</u>	<u>(5,612,381.29)</u>	<u>(2,866,449.79)</u>	<u>(601,492,803.49)</u>	<u>(594,135,333.41)</u>
Net amount	<u>5,863,088.89</u>	<u>(3,466,405.19)</u>	<u>(5,612,381.29)</u>	<u>(2,866,449.79)</u>	<u>(6,082,147.38)</u>	<u>1,275,322.70</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (3) Interest Rate Risk

The Group's exposure to fair value interest rate risk and cash flow interest rate risk mainly arise from interest-bearing financial instruments with fixed rate and floating rate. The Group determined the proportion of fixed interest rate and floating interest rate risk based on the market conditions and maintained an appropriate mix of fixed interest rate and floating interest rate through regular review and supervision. The Company did not hedge interest rate risk with derivative financial instruments.

- (a) The interest-bearing financial instruments held by the Group as at 31st December are as follows:

Items	Unit: RMB	
	2012 Amount	2011 Amount
Fixed interest rate financial instruments		
Financial assets		
– monetary fund	–	1,500,000.00
Financial liabilities		
– short-term borrowings	(15,000,000.00)	–
Total	<u>(15,000,000.00)</u>	<u>1,500,000.00</u>
Floating interest rate financial instruments		
Financial assets		
– monetary fund	98,887,040.73	190,700,330.65
Financial liabilities		
– short-term borrowings	(90,000,000.00)	(100,000,000.00)
Total	<u>8,887,040.73</u>	<u>90,700,330.65</u>

- (b) Sensitivity Analysis

As at 31st December 2012, if the interest rates had been 1 basis point higher/lower and all other variables held constant, the net profit and shareholder equity of the Group would increase/decrease RMB755.40 (2011: RMB7,709.53).

The sensitivity analysis above indicates the instantaneous change in the net profit and shareholder equity that would arise assuming that the change in interest rates had occurred at the balance sheet date and had been applied to re-measure those financial instruments held by the Group which expose the Group to fair value interest rate risk at the balance sheet date. In respect of the exposure to cash flow interest rate risk arising from floating rate non-derivative instruments held by the Group at the balance sheet date, the impact on the net profit and shareholder equity is estimated as an annualised impact on interest expense or income of such a change in interest rates. The analysis is performed on the same basis for the prior year.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (4) Foreign Exchange Risk

In respect of accounts receivables and payables denominated in foreign currencies other than the functional currency, the Group ensures that its net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates when necessary to address short-term imbalances.

- (a) The Group's exposure as at 31st December to currency risk arising from recognised major assets or liabilities denominated in foreign currencies is as follows. For presentation purposes, the amounts of the exposure are shown in Renminbi, translated using the spot rate at the balance sheet date.

*Unit: RMB*

	2012				2011			
	EUR	USD	Japanese YEN	HKD	EUR	USD	Japanese YEN	HKD
Cash at bank and on hand	78,036.97	7,610,970.34	-	7,226,972.01	101,068.40	8,873,910.75	-	7,232,592.85
Bills receivable	-	-	-	-	-	-	-	-
Accounts receivable	-	1,893,784.06	-	-	-	6,060,997.01	-	-
Other receivables	-	-	-	-	-	-	-	11,994.11
Prepayments	2,571,246.68	1,023,610.07	257,225.32	-	-	-	-	-
Advance from customers	-	(3,714,474.69)	-	-	(14,389.82)	(10,066,056.00)	-	-
Total balance sheet exposure	2,649,283.65	6,813,889.78	257,225.32	7,226,972.01	86,678.58	4,868,851.76	-	7,244,586.96

- (b) The exchange rates of RMB to foreign currency applicable by the Group are as follows:

*Unit: RMB*

Items	Average rate		Reporting date mid-spot rate	
	2012	2011	2012	2011
USD	6.2932	6.4618	6.2855	6.3009
Japanese YEN	0.0771	0.0812	0.0730	0.0811
HKD	0.8108	0.8308	0.8108	0.8107
EUR	8.2401	8.4845	8.3176	8.1625

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (4) Foreign Exchange Risk *(Continued)*

##### (c) Sensitivity analysis

Assuming all other risk variables other than exchange rate remained constant, a 1% appreciation of the RMB against the USD, Japanese yen, Euro and HKD at 31st December would have increased (decreased) shareholder equity and net profit by the amount shown below, whose effect is in RMB and translated using the spot rate at the balance sheet date.

Items	Equity	Unit: RMB Net profit
As at 31st December 2012		
USD	(57,918.06)	(57,918.06)
Japanese YEN	(2,186.42)	(2,186.42)
HKD	(61,429.26)	(61,429.26)
EUR	(22,518.91)	(22,518.91)
Total	<u>(144,052.65)</u>	<u>(144,052.65)</u>
As at 31st December 2011		
USD	(41,385.24)	(41,385.24)
HKD	(61,578.99)	(61,578.99)
EUR	(736.77)	(736.77)
Total	<u>(103,701.00)</u>	<u>(103,701.00)</u>

A 1% depreciation of the RMB against the USD, Japanese yen, Euro and HKD at 31st December would have had the equal but opposite effect on them to the amounts shown above, on the basis that all other variables remain constant.

The above sensitivity analysis has been ascertained assuming that the change in foreign exchange rates had occurred at the balance sheet date and had re-measured the exposure to foreign exchange risk for financial instruments held by the Group at that date. The analysis was performed on the same assumption and method of the previous year.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (X). OTHER SIGNIFICANT EVENTS *(Continued)*

### 3. Risk and sensitivity analysis and fair value of financial instruments *(Continued)*

#### (5) Fair value

The carrying amounts of the Group's financial assets and financial liabilities as reflected in the consolidated statement of financial position approximate their respective fair values at 31st December.

#### (6) Determination of Fair value

The main methods and assumptions applied by the Group to estimate the fair value of financial instruments are as follows.

##### (a) Accounts receivable

The fair value is based on present value of future cash flow forecast, and the discount rate is market rate at balance sheet date.

##### (b) Borrowings and other non-derivative financial liabilities

The fair value of borrowings and other non-derivative financial liabilities is based on present value of future cash flow forecast, and the discount rate is market rate at balance sheet date.

##### (c) Interest rates used for determining fair value

The Group uses the interest rate of RMB loan as of the balance sheet date plus an adequate constant credit spread to discount financial instruments. The interest rates used are as follows:

Item	2012	2011
Accounts receivable	6.00%	6.56%
Borrowings and other non-derivative financial liabilities	6.00%	6.56%

### 1. Accounts receivable

#### (1) Analysis of the accounts receivable in accordance with the type of customers:

Type of customers	Unit: RMB	
	2012	2011
Third parties	394,118,535.57	340,328,421.27
Related parties	4,425,928.75	11,330,629.67
Sub-total	398,544,464.32	351,659,050.94
Less: provision for bad and doubtful debts	185,547,357.79	153,990,342.37
Total	<u>212,997,106.53</u>	<u>197,668,708.57</u>



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 1. Accounts Receivable (Continued)

(2) Ageing analysis of the accounts receivable:

Ageing	Unit: RMB	
	2012	2011
Within one year (including one year)	135,923,002.67	104,681,157.63
1-2 years (including two years)	73,253,832.15	95,827,346.73
2-3 years (including three years)	68,656,121.72	62,773,342.74
Over three years	120,711,507.78	88,377,203.84
Sub-total	398,544,464.32	351,659,050.94
Less: provision for bad and doubtful debts	185,547,357.79	153,990,342.37
Total	<u>212,997,106.53</u>	<u>197,668,708.57</u>

The ageing is calculated from the date accounts receivable is recognized.

(3) Analysis of the accounts receivable by category

Type	Note	2012				2011			
		Book balance		Provision for bad and doubtful debts		Book balance		Provision for bad and doubtful debts	
		Proportion		Proportion		Proportion		Proportion	
		Amount	(%)	Amount	(%)	Amount	(%)	Amount	(%)
Individually significant and assessed individually for impairment	(4)	-	-	-	-	39,628,805.82	11.27	10,125,503.46	25.55
Collectively assessed for impairment*									
Group 1	(5)	394,118,535.57	98.89	185,547,357.79	47.08	300,699,615.45	85.51	142,734,838.91	47.47
Group 2	(10)	4,425,928.75	1.11	-	-	11,330,629.67	3.22	1,130,000.00	9.97
Sub-total of groups		<u>398,544,464.32</u>	<u>100.00</u>	<u>185,547,357.79</u>	<u>46.56</u>	<u>312,030,245.12</u>	<u>88.73</u>	<u>143,864,838.91</u>	<u>46.11</u>
Total		<u>398,544,464.32</u>	<u>100.00</u>	<u>185,547,357.79</u>	<u>-</u>	<u>351,659,050.94</u>	<u>100.00</u>	<u>153,990,342.37</u>	<u>-</u>

Note\*: This category included accounts receivable having been individually assessed but not impaired

The Company did not have any collateral for the above accounts receivable with provision for bad and doubtful debt.

(4) As at the end of the year, there was no individually significant accounts receivable assessed individually for bad and doubtful debts.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 1. Accounts Receivable (Continued)

(5) Accounts receivables provided for bad debt using ageing analysis method:

Unit: RMB

Ageing	2012			2011		
	Book balance Amount	Proportion (%)	Provision for bad and doubtful debts	Book balance Amount	Proportion (%)	Provision for bad and doubtful debts
Within one year	131,741,073.92	33.43	6,501,908.41	80,194,823.79	26.67	4,261,530.10
1-2 years	73,253,832.15	18.59	21,976,149.65	80,536,396.62	26.78	24,160,918.99
2-3 years	68,656,121.72	17.42	42,601,673.03	53,307,387.03	17.73	31,984,432.22
Over 3 years	120,467,507.78	30.56	114,467,626.70	86,661,008.01	28.82	82,327,957.60
Total	<u>394,118,535.57</u>	<u>100.00</u>	<u>185,547,357.79</u>	<u>300,699,615.45</u>	<u>100.00</u>	<u>142,734,838.91</u>

(6) There was no significant provision for bad and doubtful debts reversed or collected for the accounts receivable for the year.

(7) There was no significant writing-off for the accounts receivable for the year.

(8) Amounts of top five accounts receivable

Unit: RMB

Ranking	Relationship with the Company	Amount	Age	Percentage to total accounts receivable (%)
1st	Third party	21,623,532.70	Within one year	5.43
2nd	Third party	13,054,000.00	Over one year	3.28
3rd	Third party	10,668,000.00	Within one year	2.68
4th	Third party	8,177,400.00	Over one year	2.05
5th	Third party	<u>7,256,403.79</u>	Within one year	<u>1.82</u>
Total		<u>60,779,336.49</u>		<u>15.26</u>

As names of third party customers involve the business secret of the Company, we did not disclose the specific names of the customers.

(9) In the above balances, there were no accounts receivable due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 1. Accounts Receivable (Continued)

(10) Accounts receivable from related parties

Name of the related party	Note	Relationship with the Company	Amount	Unit: RMB Percentage to total accounts receivable (%)
Kunming TOS	VI. 6	Jointly controlled enterprise	4,181,928.75	1.05
Changsha Ser	VI. 6	Subsidiary	244,000.00	0.06
Total			<u>4,425,928.75</u>	<u>1.11</u>

### 2. Other Receivables

(1) Analysis of other receivables by the type of customers:

Type	2012	Unit: RMB 2011
Third parties	15,620,182.68	15,439,858.98
Related parties	7,591,194.33	8,132,695.97
Sub-total	23,211,377.01	23,572,554.95
Less: provision for bad and doubtful debts	<u>4,248,775.21</u>	<u>3,595,344.13</u>
Total	<u>18,962,601.80</u>	<u>19,977,210.82</u>

(2) Ageing analysis of other receivables:

Ageing	2012	Unit: RMB 2011
Within one year (including one year)	12,054,246.27	14,508,931.01
1-2 years (including two years)	4,246,989.15	4,598,950.71
2-3 years (including three years)	3,268,260.68	3,015,855.68
Over three years	3,641,880.91	1,448,817.55
Sub-total	23,211,377.01	23,572,554.95
Less: provision for bad and doubtful debts	<u>4,248,775.21</u>	<u>3,595,344.13</u>
Total	<u>18,962,601.80</u>	<u>19,977,210.82</u>

The ageing is calculated from the date other receivables are recognized.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 2. Other receivables (Continued)

(3) Analysis of other receivables by category:

Unit: RMB

Type	Note	2012				2011			
		Carrying amount		Provision for bad and doubtful debts		Carrying amount		Provision for bad and doubtful debts	
		Amount	Proportion (%)	Amount	Proportion (%)	Amount	Proportion (%)	Amount	Proportion (%)
Individually significant and assessed individually for impairment	(4)	-	-	-	-	6,910,074.10	29.31	196,722.87	2.85
Collectively assessed for impairment*									
Group 1	(5)	15,620,182.68	67.30	4,248,775.21	27.20	15,094,281.62	64.03	3,398,621.26	22.52
Group 2	(10)	7,591,194.33	32.70	-	-	1,568,199.23	6.66	-	-
Sub-total of groups		<u>23,211,377.01</u>	<u>100.00</u>	<u>4,248,775.21</u>	<u>18.30</u>	<u>16,662,480.85</u>	<u>70.69</u>	<u>3,398,621.26</u>	<u>20.40</u>
Total		<u>23,211,377.01</u>	<u>100.00</u>	<u>4,248,775.21</u>	<u>-</u>	<u>23,572,554.95</u>	<u>100.00</u>	<u>3,595,344.13</u>	<u>-</u>

Note\*: This category included other receivables having been individually assessed but not impaired.

The Company did not have any collateral for the above other receivables with provision for bad and doubtful debt.

(4) As at the end of the year, there was no individually significant other receivables assessed individually for bad and doubtful debts.

(5) Other receivables provided for bad debt using ageing analysis method:

Unit: RMB

Ageing	2012			2011		
	Carrying amount		Provision for bad and doubtful debts	Carrying amount		Provision for bad and doubtful debts
	Amount	Proportion (%)		Amount	Proportion (%)	
Within one year	11,027,548.68	70.60	620,840.87	11,156,731.22	73.92	554,819.09
1-2 years	2,087,071.85	13.36	1,122,372.19	2,187,496.46	14.49	1,093,748.23
2-3 years	1,121,452.70	7.18	1,121,452.70	744,681.94	4.93	744,681.94
Over 3 years	1,384,109.45	8.86	1,384,109.45	1,005,372.00	6.66	1,005,372.00
Total	<u>15,620,182.68</u>	<u>100.00</u>	<u>4,248,775.21</u>	<u>15,094,281.62</u>	<u>100.00</u>	<u>3,398,621.26</u>

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 2. Other receivables (Continued)

- (6) There was no significant provision for bad and doubtful debt to be reversed or collected for the other receivables for the year.
- (7) There was no write-off for the other receivables for the year.
- (8) Amounts of top five other receivables

Name	Relationship with the Company	Amount	Ageing	Unit: RMB Percentage of total other receivables (%)
Xi'an Ser	Subsidiary	7,220,746.31	Over one year	31.11
Jiangsu Complete Equipment Co., Ltd.	Third party	1,308,400.00	Within one year	5.64
Fujian Kunji	Third party	710,723.72	Over one year	3.06
Henan Runlong Commercial Trading Co., Ltd.	Third party	580,000.00	Over one year	2.50
Shaanxi Qinyuan Tendering Co., Ltd.	Third party	510,000.00	Over one year	2.20
Total		<u>10,329,870.03</u>		<u>44.51</u>

- (9) In the above balances, there were no other receivables due from shareholders holding over 5% (or 5%) shares of the Company entitling voting rights.

- (10) Other receivables from related parties

Name	Note	Relationship with the Company	Amount	Unit: RMB Percentage of total other receivables (%)
Kunming TOS	VI. 6	Jointly controlled enterprise	370,448.02	1.60
Xi'an Ser	VI. 6	Subsidiary	7,220,746.31	31.11
Total			<u>7,591,194.33</u>	<u>32.71</u>

As at 31st December 2012, the Company conducted individual assessment on other receivables due from related parties and considered that there was no need to make provisions for bad and doubtful debts.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 3. Long-term equity investments

(1) Long-term equity investments by type:

Items	Unit: RMB	
	2012	2011
Investment in subsidiaries	24,693,265.85	27,193,265.85
Investment in jointly controlled enterprises	43,631,371.02	47,500,223.66
Investment in associated companies	14,348,530.66	14,424,357.29
Other long-term equity investments	2,000,000.00	2,000,000.00
Sub-total	84,673,167.53	91,117,846.80
Less: impairment provision	2,000,000.00	3,500,000.00
Total	<u>82,673,167.53</u>	<u>87,617,846.80</u>

(2) Analysis of changes of long-term equity investment for the year:

Invested company	Investment cost	Opening balance	Increase/decrease	Closing balance	Percentage of shareholding in the invested company (%)(A)	Percentage of voting rights in the invested company (%)(B)	Explanation for difference between (A) and (B)	Unit: RMB		
								Impairment provision	Impairment provision for the year	Cash dividend for the year
<b>Under equity method:</b>										
<b>jointly controlled enterprises</b>										
Kunming TOS	24,739,533.99	47,500,223.66	(3,868,852.64)	43,631,371.02	50.00	50.00	-	-	-	5,000,000.00
<b>Under equity method:</b>										
<b>associated company</b>										
Xi'an Ruite	14,000,000.00	14,424,357.29	(75,826.63)	14,348,530.66	23.34	23.34	-	-	-	-
<b>Under cost method:</b>										
<b>subsidiary</b>										
Xi'an Ser	21,693,265.85	21,693,265.85	-	21,693,265.85	45.00	60.00	Note	-	-	-
General Machine	3,000,000.00	3,000,000.00	-	3,000,000.00	100.00	100.00	-	-	-	-
Fujian Kunji	2,500,000.00	2,500,000.00	(2,500,000.00)	-	50.00	60.00	Note	-	-	-
Sub-total	27,193,265.85	27,193,265.85	(2,500,000.00)	24,693,265.85	-	-	-	-	-	-
<b>Under cost method:</b>										
<b>other long-term equity investment</b>										
Yunnan Cheng Jiang										
Copper Products Plant	2,000,000.00	2,000,000.00	-	2,000,000.00	40.00	40.00	-	2,000,000.00	-	-
Total	<u>67,932,799.84</u>	<u>91,117,846.80</u>	<u>(6,444,679.27)</u>	<u>84,673,167.53</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,000,000.00</u>	<u>-</u>	<u>5,000,000.00</u>

Note: the percentage of voting rights of Company in the above companies is determined by the percentage to total voting rights in the board of directors of the above companies. The Company can have control to the above companies' finance and operating decisions. Therefore, the Company treated these companies as subsidiaries and adopts cost method for accounting.

(3) Information of major jointly controlled enterprises and associated companies:

Please refer to note V.8(3) for information of major jointly controlled enterprise and associated companies.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 4. Operating income and operating costs

(1) Operating income and operating costs

Items	Unit: RMB	
	2012	2011
Operating income	893,723,388.17	1,534,953,705.20
Including: Income from sales of products	878,417,939.16	1,514,575,688.54
Income from rendering services	15,305,449.01	20,378,016.66
Other operating income	<u>4,599,825.16</u>	<u>8,065,349.58</u>
Total operating income	<u>898,323,213.33</u>	<u>1,543,019,054.78</u>
Operating costs	<u>723,846,145.54</u>	<u>1,142,044,017.59</u>

(2) Operating income (by business line)

Business	2012		2011	
	Operating income	Operating cost	Operating income	Operating cost
Sales and service of boring machines	<u>898,323,213.33</u>	<u>723,846,145.54</u>	<u>1,543,019,054.78</u>	<u>1,142,044,017.59</u>

(3) Operating income from the top five customers in 2012

Ranking	Unit: RMB	
	Operating income	Percentage to total operating income (%)
1st	64,034,188.02	7.13
2nd	42,952,219.67	4.78
3rd	22,794,871.79	2.54
4th	22,462,051.28	2.50
5th	<u>21,282,051.28</u>	<u>2.37</u>
Total	<u>173,525,382.04</u>	<u>19.32</u>

The Company has not disclosed the specific names of the top 5 customers for the year 2012, which involved commercial secret of the Group.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 5. Investment income

Items	Note	2012	Unit: RMB 2011
Income from long-term equity investment under equity method	(2)	1,055,320.73	7,334,821.80
Income from long-term equity investment under cost method	(1)	–	29,130,802.55
Investment income from disposal of subsidiaries		–	650,286.89
Total		<u>1,055,320.73</u>	<u>37,115,911.24</u>

(1) The amount of Long-term equity investment income under cost method:

Invested company	2012	Unit: RMB 2011
General Machine	–	<u>29,130,802.55</u>

The distribution of cash dividends of RMB29,130,802.55 to the Company was reviewed and approved at the Board meeting of General Machine on 31st December 2011.

(2) The amount of long-term equity investment income under equity method:

Invested company	2012	Unit: RMB 2011
Kunming TOS	1,131,147.36	7,534,798.57
Xi'an Ruite	(75,826.63)	(199,976.77)
Total	<u>1,055,320.73</u>	<u>7,334,821.80</u>



# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XI). NOTES TO PRINCIPLE ITEMS OF THE PARENT COMPANY'S FINANCIAL STATEMENTS

(Continued)

### 6. Related information of cash flow statement

(1) Supplementary information of the cash flow statement

Supplemental information	2012	2011
<i>Unit: RMB</i>		
<b>1. Reconciliation of net profit ("()" for net loss) to cash flows from operating activities:</b>		
Net profit ("()" for net loss)	(62,585,333.32)	74,831,789.76
Add: Provision for impairment of assets	31,778,078.70	61,489,436.88
Depreciation of fixed assets	38,219,852.02	32,780,206.96
Amortization of intangible assets	2,063,049.17	2,741,409.28
Amortization of long-term deferred expenses	426,098.88	122,044.57
Amortization of deferred income	(205,300.00)	(205,300.20)
Loss on disposal of fixed assets ("()" for gain)	494,930.32	(1,442,999.72)
Financial expenses ("()" incomes)	(182,576.38)	2,418,248.06
Investment gain	(1,055,320.73)	(37,115,911.24)
Decrease in deferred tax assets ("()" for increase)	(15,186,488.12)	9,551,910.99
Increase in inventories	(18,396,429.41)	(244,262,507.33)
Increase in operating receivable	(119,453,867.27)	(65,530,028.58)
Increase in operating payable	154,493,051.21	158,264,235.15
Net cash flows from operating activities	<u>10,409,745.07</u>	<u>(6,357,465.42)</u>
<b>2. Net movements in cash and cash equivalents:</b>		
Closing balance of cash	71,927,250.50	143,087,572.52
Less: Opening balance of cash	143,087,572.52	248,304,966.05
Net increase of cash and cash equivalents ("()" for decrease)	<u>(71,160,322.02)</u>	<u>(105,217,393.53)</u>

(2) Composition of cash and cash equivalents

Items	2012	2011
<i>Unit: RMB</i>		
1. Cash	71,927,250.50	143,087,572.52
Including: cash on hand	295,446.95	440,099.83
bank deposits available on demand	<u>71,631,803.55</u>	<u>142,647,472.69</u>

Note: the above disclosed cash do not include the amounts of monetary funds with restricted usage and short-term investments.

# NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

## (XII). NET CURRENT ASSETS

Items	Unit: RMB			
	2012 The Group	2011 The Group	2012 The Company	2011 The Company
Current assets	1,535,239,783.32	1,658,789,391.49	1,222,382,929.57	1,367,095,530.03
Less: current liabilities	<u>1,091,593,503.93</u>	<u>1,025,911,421.35</u>	<u>797,303,103.68</u>	<u>768,950,641.39</u>
Net current assets	<u>443,646,279.39</u>	<u>632,877,970.14</u>	<u>425,079,825.89</u>	<u>598,144,888.64</u>

## (XIII). TOTAL ASSETS LESS CURRENT LIABILITIES

Items	Unit: RMB			
	2012 The Group	2011 The Group	2012 The Company	2011 The Company
Total assets	2,548,752,225.10	2,558,664,361.12	2,187,269,380.31	2,214,523,709.43
Less: current liabilities	<u>1,091,593,503.93</u>	<u>1,025,911,421.35</u>	<u>797,303,103.68</u>	<u>768,950,641.39</u>
Total assets less current liabilities	<u>1,457,158,721.17</u>	<u>1,532,752,939.77</u>	<u>1,389,966,276.63</u>	<u>1,445,573,068.04</u>

# SUPPLEMENTAL INFORMATION

## 1. EXTRAORDINARY GAINS AND LOSSES FOR THE YEAR 2012

<b>Items</b>	<i>Unit: RMB</i> <b>Amount</b>
Disposal of non-current assets	(464,751.55)
Government grants recognized through profit and loss (excluding those having close relationship with the Group's operation and enjoyed in fixed amount or quantity according to uniform national standard)	15,369,410.00
Other non-operating income and expenses besides items above	(781,197.64)
Effect of income tax	(2,118,519.12)
Effect of minority interests (after tax)	(291,691.00)
Total	<u>11,713,250.69</u>

## 2. RETURN ON NET ASSETS AND EARNINGS PER SHARE

The return on net assets and earnings per share prepared in accordance with No.9 of Rules for the Compilation and Submission of Information Disclosure by Public Offering Companies issued by China Securities Regulatory Commission (2010 revised) and regulations of relevant accounting standards are as follows:

<b>Earnings during the reporting period</b>	<b>Weighted average of return on net assets (%)</b>	<b>Earnings per share</b>	<b>Diluted earnings per share</b>
Net earnings attributable to the ordinary shareholders of the Company	(5.39)	(0.14)	(0.14)
Net earnings attributable to the ordinary shareholders of the Company excluding extraordinary gains and losses	(6.25)	(0.16)	(0.16)

## DOCUMENTS AVAILABLE FOR INSPECTION

- (I) Financial statements signed and stamped by legal representative and financial officer of the Company
- (II) Original copy of Auditors' Report bearing the signatures and seals of the Accounting Firm and Certified Public Accountants
- (III) Original copy of all documents and the drafts of announcements as disclosed in newspapers as specified by the CSRC during the reporting period
- (IV) 2012 Annual Report
- (V) Written confirmation for the 2012 Annual Report by directors and senior management officers
- (VI) Written approval by supervisory committee for 2012 Annual Report prepared by the Board

**Shenji Group Kunming Machine Tool Co., Ltd.**  
**Wang Xing**  
*Chairman*  
27th March 2013

*ENCL:* Written confirmation by directors and senior management officers for the 2012 Annual Report

## DECLARATION

The board of directors (the "Board"), directors and senior management officers of the Company warrant that there are no false representations, misleading statements and material omissions in the 2012 annual report of the Company, and are severally and jointly responsible for the authenticity, accuracy and completeness of the content herein.

### Signature of declaratory persons:

#### Directors:

Wang Xing	Zhang Xiaoyi	Li Zhenxiong	Guan Xin
Gao Minghui	Ye Nong	Li Shunzhen	Zhang Tao
Liu Minghui	Li Dongru	Chen Fusheng	Xiao Jianming

#### Senior management officers:

Zhu Xiang	Zhou Guoxing	Xu Kunping	Luo Tao
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**Shenji Group Kunming Machine Tool Co., Ltd.**  
Board of directors  
27th March 2013

*ENCL:* Written approval by supervisory committee for 2012 Annual Report prepared by the Board

# DOCUMENTS AVAILABLE FOR INSPECTION

## OPINIONS OF THE SUPERVISORY COMMITTEE

Regarding the 2012 Annual Report (hereafter as the “Annual Report”) prepared by the Board, we have the following opinions:

1. The preparation of the Annual Report and the auditing procedures are in strict compliance with laws and regulations, the Articles of Association and rules of the Company’s internal management system;
2. The content and format of the Annual Report were in strict compliance with the regulations of the China Securities Regulatory Commission and Shanghai Stock Exchange. The information included in the Annual Report can truly reflect in all respects the Company’s operating management and financial status and other matters of the year;
3. Before providing the above opinions, we did not discover any person involved in the preparation of the Annual Report nor has any auditing personnel violated the rule of confidentiality.

### Supervisors:

Shao Li

Tang Hua

Fan Hong

Cai Zhemin

Qin Jianzhong

**Shenji Group Kunming Machine Tool Co., Ltd.**

Supervisory Committee

27th March 2013