



昆明机床
KUNMING MACHINE TOOL

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**

Annual Report 2014

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. Ten directors of the Company attended the Board meeting (the "Meeting"). Independent non-executive director Mr. Yang Xiongsheng could not attend the Meeting due to official duties and he appointed independent non-executive director Mr. Chen Fusheng to vote on his behalf at the Meeting.
3. KPMG Huazhen (Special General Partnership) has issued standard and unqualified opinions in their auditors' report for the financial statements of the Company.
4. Wang Xing, Chairman, Jin Xiaofeng, 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 of directors of the Company
No
6. Risk declaration for the forward-looking statements
No
7. Any appropriation of non-operating fund by the controlling shareholder and its related parties?
No
8. Any external guarantee provided not in compliance with the required decision-making procedures?
No
9. 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

In this report, unless the context requires otherwise, the following terms and expressions shall have the following meanings:

| | |
|------------------------------------|--|
| “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 (Company secretary) | 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, the PRC |
| Post code of business address | 650203 |
| Website | www.kmtcl.com.cn |
| E-mail | www.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, 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股 | The Stock Exchange of Hong Kong Limited | Kunming Machine | 0300 |

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

1. Basic information

| | |
|------------------------------|--|
| Date of registration | 10 August 2011 |
| Place of registration | Yunnan Province Administration for Industry and Commerce |
| Business registration number | 530000400000458 |
| Tax registration number | 530111622602196 |
| Organization code | 62260219-6 |

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

Please refer to the basic information in 2011 Annual Report for the first business registration of the Company.

3. Changes in the main business since the listing

No

4. 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.

COMPANY PROFILE

VII. OTHER RELEVANT INFORMATION

| | | |
|--|--------------------------|--|
| Appointed Auditor of the Company (domestic) | Name | KPMG Huazhen (Special General Partnership) |
| | Address | Beijing China |
| | Signature of accountants | Peng Jing, Ma Yuchong |

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 | 2014 | 2013 (restated) | Increase/ Decrease as compared with the corresponding period last year (%) | 2012年 (restated) | 2011 | 2010 |
|--|-----------------------------|-----------------------------|--|-----------------------------|-----------------------------|-----------------------------|
| | As at the end of 2014 | As at the end of 2013 | As compared with the corresponding period last year (%) | As at the end of 2012 | As at the end of 2011 | As at the end of 2010 |
| Operating income | 867,889,305.64 | 1,029,488,879.74 | (15.70) | 1,086,311,095.78 | 1,804,857,564.29 | 1,597,705,267.19 |
| Net profit attributable to equity shareholders of the Company | (204,091,306.53) | 8,521,796.32 | (2,494.93) | (102,851,352.78) | 54,567,125.16 | 178,324,801.52 |
| Net profit (excluding extraordinary gains and losses) attributable to equity shareholders of the Company | (224,165,737.61) | (24,012,543.98) | 833.54 | (114,564,603.47) | 51,897,930.57 | 167,747,132.71 |
| Net cash flow from operating activities | (132,256,016.53) | (77,588,452.04) | 70.46 | 7,571,011.30 | 654,756.70 | 129,272,783.34 |
| Net assets attributable to equity shareholders of the Company | 1,085,557,573.82 | 1,297,187,170.90 | (16.31) | 1,288,665,374.58 | 1,402,138,349.42 | 1,374,125,279.42 |
| Total assets | 2,815,121,513.91 | 2,764,961,985.20 | 1.81 | 2,519,121,043.85 | 2,558,664,361.12 | 2,247,730,361.63 |

2. Principal financial data

| | 2014 | 2013 | Increase/ Decrease as compared with the corresponding period last year (%) | 2012 | 2011 | 2010 |
|--|---------|--------|--|--------|------|-------|
| Basic earnings per share (RMB/share) | (0.38) | 0.02 | (2,494.93) | (0.19) | 0.1 | 0.34 |
| Diluted earnings per share (RMB/share) | (0.38) | 0.02 | (2,494.93) | (0.19) | 0.1 | 0.34 |
| Basic earnings per share excluding extraordinary gains and losses (RMB/share) | (0.42) | (0.05) | 833.54 | (0.22) | 0.1 | 0.32 |
| Return on net assets (weighted average) (%) | (17.08) | 0.66 | decreased by 17.74 percentage points | (7.65) | 3.93 | 13.75 |
| Return on net assets based on net profit excluding extraordinary gains and losses (weighted average) (%) | (18.92) | (1.88) | decreased by 17.04 percentage points | (8.52) | 3.74 | 12.98 |

Explanation on the principal accounting data and financial highlights for the latest three years up to the end of the reporting period

No

SUMMARY OF ACCOUNTING DATA AND FINANCIAL INDICATORS

II. EXTRAORDINARY GAINS AND LOSSES AND AMOUNTS

✓applicable □not applicable

| Extraordinary gains and losses | Amount 2014 | Amount 2013 | <i>Unit: RMB</i> Amount 2012 |
|--|-----------------------------|-----------------------------|--|
| Disposal of non-current assets | (117,122.40) | 1,123,606.41 | (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) | 7,315,597.49 | 4,222,272.70 | 15,369,410.00 |
| Other non-operating income and expenses besides items above | 394,706.37 | (2,630,478.37) | (781,197.64) |
| Gain on financial liabilities adjustment | 7,657,445.80 | 21,472,524.42 | - |
| Gain on transfer of accounts receivable | 0 | 14,555,496.15 | - |
| Investment income on disposal of long-term equity investment | 7,538,290.55 | - | - |
| Effect of non-controlling interests | (426,892.64) | (5,811,513.20) | (291,691.00) |
| Effect of income tax | (2,287,594.09) | (397,567.81) | (2,118,519.12) |
| Total | <u>20,074,431.08</u> | <u>32,534,340.30</u> | <u>11,713,250.69</u> |

DIRECTORS' REPORT

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

In 2014, China's machine tool industry was faced with a mix of unprecedented challenges. Fundamental changes were seen in economic climate, competitive landscape and market demand: in the context of a sluggish global recovery, China's economy headed into a new normal; and the serious overcapacity of traditional products amid the rapidly evolving needs led to intensifying international competition and radical changes in profit model. At the same time, a new round of technology innovations is burgeoning worldwide, backed by the emerging tides of Internet-based integrated intelligent manufacturing.

Against the backdrop of sluggishness in the machine tool industry in general, the management actively responded to the gloomy market environment by transforming itself into an industrial service provider under a market-oriented approach. New orders increased by 2.6% over last year. In particular, gantry boring and milling machine tool and horizontal machining center, two stronghold products of the Company, became new growth drivers which posted year-on-year growths of 103% and 248% respectively in new orders. Remanufacturing contracts secured in the year amounted to RMB11.86 million, demonstrating an initial success in our transformation towards an industrial service provider.

Major business activities in 2014:

1. Marketing: Deepened the marketing system reform to seize contract orders and accelerate collection of receivables, extending our business to all segments of the machine tool market; improved service quality, reduced product failures and enhanced user confidence under a sound after-sale service system; innovatively introduced one-stop solutions for users to support the marketing front, opening a new leaf in pre-sale promotion; and leveraged on the reputational "Kunji" brand for precision machining and integrated channel advantages to plan for long-term growth.
2. Production: Improve the rationality of production scheduling through reasonable resource allocation, to ensure that machine tool products were delivered on time and up to quality standards and quantity requirements; adopted lean management concept to improve onsite production conditions and product quality; made every effort in installation and commissioning; and attached great importance to production safety along with sound production scheduling.
3. Technology: Vigorously cultivated technical personnel through product development and ongoing upgrades; successfully launched KiMi series products that were well recognized in market; re-positioned series 62 products to embark on the replacement of ordinary horizontal boring products with an aim at the existing TK62 and TJK62 series CNC floor-type boring and milling machine tools; completed trial manufacturing of 160 floor-type boring machine tool and turntable; completed design and development of new products such as XK2416, XK2418, XK2420S, XK2740, XH2530 gantry boring and milling machine tools; started R&D of gantry flexible production line; and completed new product development for KHC160-5A and KHC125-5A five-axes horizontal machining centers, KiKi50 and KiKi50s boring and milling centers, and THM4680 μ high precision horizontal machining centers.
4. Quality control: Accomplished the quality task for the year by well handling the relationship between quality and cost and striking a balance in the quality control process, in the principle of "improving quality of physical goods and reinforcing fundamental management through continuous quality improvements". Quality management tasks were carried out effectively through various tools and means, focusing on brand and stronghold products underpinned by systematic organization and mechanism.
5. Finance: The recovery of receivables in 2014 was inadequate and consisted of a majority of bank acceptances, leading to a serious shortage of cash and the difficulties in turnover of working capital. Our credit facilities were also affected by the decline in business performance. Given the hiking bank financing costs and the increasingly stringent lending conditions, the Company made its best efforts to seek bank loans to finance its working capital through rational financing.

DIRECTORS' REPORT

1. Analysis of principal activities

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

| Item | 2014 | 2013 (restated) | Unit: RMB |
|--|------------------|--------------------|----------------------------|
| | | | Percentage of change(%) |
| Operating income | 867,889,305.64 | 1,029,488,879.74 | (15.70) |
| Operating costs | 702,862,972.16 | 802,498,075.25 | (12.42) |
| Net cash flow from operating activities | (132,256,016.53) | (77,588,452.04) | 70.46 |
| Net cash flow from investing activities | (16,624,353.67) | (99,201,147.21) | (83.24) |
| Net cash flow from financing activities | 134,210,715.91 | 226,762,076.74 | (40.81) |
| R&D expenses | 54,553,457.55 | 46,162,646.60 | 18.18 |
| Impairment losses | 36,349,437.09 | (2,353,342.17) | (1,644.59) |
| Non-operating income | 18,744,552.71 | 41,746,283.98 | (55.10) |
| Non-operating expense | 383,925.45 | 3,002,862.67 | (87.21) |
| Income tax ("()") for income tax benefits) | 36,970,917.88 | (469,494.12) | (7,974.63) |
| Net profit attributable to equity shareholders of the Company ("()") for loss) | (204,091,306.53) | 8,521,796.32 | (2,494.93) |

- A. The decrease in operating income was primarily attributable to the price competition pattern dominating machine tool manufacturers, as a result of serious homogeneity of domestic products and a slump in market demand due to the decreased total demand and change in demand structure from the downstream sectors;
- B. The decrease in operating costs was corresponding to but slower than the decrease in operating income. This is attributable to the relatively higher labor and manufacturing costs in unit product cost, as a result of lower equipment utilization due to the substantially diminished business scale with a still large asset base;
- C. Net cash outflow from operating activities recorded an increase, primarily attributable to the decreased sales revenue versus the increased rigid costs such as operating expenses and labor costs compared to last year, partially offset by the contribution to collection of receivables due to the clearance and transfer of certain debts in 2014;
- D. Net cash outflow from investing activities recorded a decrease, due to a year-on-year decrease in capital expenditures as the heavy machinery assembly plant and the 110KV substation in our Yanglin Base and other projects were completed and passed acceptance inspection;
- E. Net cash inflow from financing activities recorded a decrease, mainly due to i) our honoring of bank acceptances upon maturity in the value of RMB47.23 million which were issued in 2014; and ii) a year-on-year increase in book value and interest payments arising from the expanded financing scale in order to mitigate financial pressure, given a larger working capital shortfall compared to last year;
- F. R&D expenses increased slightly from last year, mainly to finance the following R&D projects: "THM-μ series precision horizontal machining center", "Key technologies for digital design, development of tools and typical product applications of high-end CNC machine tools" and other major national special projects, and new products self developed by the Company;
- G. The increase in impairment losses was attributable to a provision for bad debts of RMB22.48 million given the increased balance of receivables during the period, whilst in the previous year, the Company transferred certain debt to expedite the recovery of capital, leading to a decrease in the balance of receivables and a RMB2.35 million write-off of the provision for bad debts. As a result, impairment losses surged by -1,645%;
- H. The decrease in non-operating income decreased was due to less income from debt restructuring compared with the same period last year;
- I. The decrease in non-operating expenses was due to the absence of litigation loss for the current period, as compared with a loss of RMB2.37 million accrued for the litigation with Yancheng Xinde last year;
- J. The increase in income tax expense was primarily attributable to a reversal of deferred tax assets as the economic interests related to deferred income tax assets were not expected to be fully achieved, due to the fact that taxable income available within the required period for reversal of the previously provided deferred income tax assets was inadequate to be applied against the deductible temporary differences;
- K. Net loss attributable to shareholders of the Company recorded a substantial increase, mainly attributable to the decreases in sales and debt restructuring, the increased provision for bad debts and the reversal of deferred income tax assets.

DIRECTORS' REPORT

2. Revenue

- (1) Analysis of factors causing changes in operating income
Affected by market, price and inventory factors, the changes in operating income of the Company were mainly attributable to the sales revenue of the machine tool products.
 - 1) Market factors
As China's machine tool market was still in a weak recovery course lacking a meaningful growth in fixed assets in 2014, the depressed demand led to a drop in machine tool orders. Due to the 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, the Company recorded an increase in inventory and a decrease in sales revenue.
 - 2) Price factors
The unit selling price of machine tools was lower than that of last year as the Company rolled out a series of promotional policies in a bid to capture market share and seize orders given the intensified market competition. Sales volume was also dampened by market environment, 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 the increased inventory capital and affected re-investment in production and operation. In order to reduce inventory, some finished products were sold at discounts, 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, which were also affected by the above factors.
- (3) Analysis of orders
As at 31 December 2014, the newly secured contract amount of orders was RMB831 million, of which orders for CNC machine tools accounted for 91%. Floor-type boring and milling machine tools orders constituted a majority or 27.32% of the CNC product orders, with order amount increasing by 11.04% year-on-year as well as a higher proportion of orders which reflected the increase in demand and product competitiveness. The order amount for gantry boring and milling machine tools increased by 110% year-on-year, with proportion of orders basically unchanged from that of last year. Digital display horizontal boring machine tools, with proportion of orders of 9% in total orders, recorded a decrease in order amount, which reflected the increased demand for middle- to high-end products due to market factors as witnessed by the significantly higher order demand for CNC machine tools than that for digital display machine tools.
- (4) Analysis of impacts of new products and new services
 1. The Company launched KiMi series CNC horizontal boring and milling machine tools, a new product line which achieved sound response through publicity events at exhibitions and a string of promotional campaigns. As at 31 December 2014, the KiMi series secured sales orders of more than RMB83.82 million, laying a sound foundation for replacement of ordinary boring products.
 2. Completed trial manufacturing of 160 floor-type boring machine tool and turntable;
 3. Completed design and development of new products such as XK2416, XK2418, XK2420S, XK2740, XH2530 gantry boring and milling machine tools;
 4. Started R&D of gantry flexible production line;
 5. Completed new product development for KHC160-5A and KHC125-5A five-axes horizontal machining centers, KiKi50 and KiKi50s boring and milling centers, and THM4680μ high precision horizontal machining centers.

These newly developed products will provide an impetus for the Company to explore market and broaden the niche.

DIRECTORS' REPORT

- (5) Information on the major customers
As at 31st December 2014, the total sales revenue of the top 5 customers amounted to RMB158 million, which accounted for 18.21% of the total sales revenue for the year.

3. Costs

- (1) Changes in costs of principal activities

Unit: RMB'000

| | 2014 | Proportion (%) | 2013 | Proportion (%) | Increase/Decrease (%) |
|------------------------------|------------|----------------|------------|----------------|-----------------------|
| Raw materials | 473,190.73 | 67.32 | 551,774.12 | 68.76 | (14.24) |
| Direct labor costs | 106,341.71 | 15.13 | 100,884.38 | 12.57 | 5.41 |
| Benefits expenses | 37,563.57 | 5.35 | 35,619.27 | 4.44 | 5.46 |
| Fuel and power | 8,636.14 | 1.23 | 9,856.70 | 1.23 | (12.38) |
| Manufacturing costs | 44,149.06 | 6.28 | 54,245.67 | 6.76 | (18.61) |
| External processing expenses | 32,981.75 | 4.69 | 50,117.94 | 6.24 | (34.19) |
| Total | 702,862.96 | 100.00 | 802,498.08 | 100.00 | (12.42) |

The diminished sales of machine tools resulted in a drop in total cost of production during the year. According to market demand, the Company adjusted product mix, leading to a lower weight of raw materials cost. In the absence of fully utilized production capacity, the Company's fuel and power costs, manufacturing costs and outsourcing expenses, albeit with a decline in absolute value, recorded a higher weight in total cost. The Company's labor costs for manufacturing workers also increased along with the hiking social labor cost.

- (2) Major suppliers
The total purchase from the top 5 suppliers for 2014 amounted to RMB85 million, representing 13.75% of the total purchase for the year.

4. Expenses

| Item | 2014 | 2013 (restated) | Percentage of change (%) |
|-------------------------------------|----------------|--------------------|-----------------------------|
| Selling and distribution expenses | 116,018,784.59 | 81,664,578.31 | 42.07 |
| General and administrative expenses | 185,208,914.45 | 162,670,709.85 | 13.86 |
| Financial expenses | 17,591,439.64 | 7,118,065.55 | 147.14 |

- A. Responding to the grim situation, the Company stepped up restructuring of its market fronts by setting up new regional sales centers, increasing marketing efforts, and introducing engineering and technical personnel to regional centers to provide integrated solutions for customers. As a result, selling expenses recorded a substantial increase;
- B. The increase in general and administrative expenses was primarily attributable to the increased expenditures in self-initiated R&D, as well as the provision of additional retirement benefits due to a change in salary base of retirees;
- C. The increase in interest expense was due to the increased loans to meet a notable shortfall of working capital during the reporting period.

DIRECTORS' REPORT

5. R&D expenses

(1) Table of R&D expenses

| | |
|--|------------------|
| | <i>Unit: RMB</i> |
| R&D expenses expensed for the current period | 54,553,457.55 |
| R&D expenses capitalized for the current period | 0 |
| Total R&D expenses | 54,553,457.55 |
| Percentage of total R&D expenses to net assets (%) | 4.66 |
| Percentage of total R&D expenses to operating income (%) | 6.29 |

(2) Explanation:

In 2014, the Company had no capitalized R&D projects and all R&D costs were accounted for as expenses, to mainly fund the following projects: "THM-μ series precision horizontal machining center", "Key technologies for digital design, development of tools and typical product applications of high-end CNC machine tools" and other major national special projects, and new products self developed by the Company.

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 cost | Gross profit margin (%) | Percentage change in operating income (%) | Percentage change in operating cost (%) | Percentage change in gross profit margin (%) |
|-------------------|------------------|----------------|-------------------------|---|---|--|
| Machine tools | 760,037,380.01 | 624,452,738.70 | 17.84% | (13.89%) | (10.09%) | decreased by 3.48 percentage points |
| Turbo machines | 107,851,925.63 | 78,410,233.46 | 27.30% | (26.55%) | (27.39%) | decreased by 0.84 percentage points |

Analysis of principal activities by products

| Products | Operating income | Operating cost | Gross profit margin (%) | Percentage change in operating income (%) | Percentage change in operating cost (%) | Percentage change in gross profit margin (%) |
|---|------------------|----------------|-------------------------|---|---|--|
| Horizontal boring and milling machine tools | 182,327,596.38 | 178,210,611.96 | 2.26 | (31.67) | (31.54) | decreased by 0.18 percentage points |
| Floor-type boring and milling machine tools | 274,922,006.86 | 211,625,945.84 | 23.02 | (2.99) | (0.12) | decreased by 2.22 percentage points |
| Table-type boring and milling machine tools | 97,347,319.95 | 73,712,459.37 | 24.28 | (30.82) | (27.91) | decreased by 3.06 percentage points |
| Horizontal products machining center | 32,653,846.17 | 22,981,905.21 | 29.62 | 21.44 | 63.81 | decreased by 18.21 percentage points |
| Gantry boring and milling machine tools | 101,021,367.55 | 78,648,382.88 | 22.15 | 24.11 | 25.93 | decreased by 1.13 percentage points |
| Turbo machines | 107,851,925.63 | 78,410,233.46 | 27.30 | (26.55) | (27.39) | increased by 0.84 percentage points |
| Others | 71,765,243.10 | 59,273,433.44 | 17.41 | (13.96) | 36.03 | decreased by 30.35 percentage points |

DIRECTORS' REPORT

Principal business by industry and by product

The gross profit margin of the machine tool segment declined by 3.48 percentage points year-on-year, mainly attributable to: i) lower product selling prices given the more intensified market competition in 2014; and ii) an increase in unit operating cost due to a shrinkage of sales, in contrast with no reduction in labor costs and total fixed assets. The adverse changes both in product selling prices and operating costs led to a year-on-year decrease in gross profit margin of the machine tool segment.

3. Assets and liabilities

1. Table of assets and liabilities

| Item | Closing balance for 2014 | Percentage of total assets % | Closing balance for 2013 (restated) | Percentage of total assets (%) | Unit: RMB |
|--|-----------------------------|------------------------------------|---|--------------------------------------|---|
| | | | | | Percentage change in closing balance (%) |
| Cash at bank and on hand | 163,027,997.62 | 5.79 | 181,805,670.00 | 6.58 | (10.33) |
| Bills receivable | 65,234,659.97 | 2.32 | 193,617,520.47 | 7.00 | (66.31) |
| Accounts receivable | 573,067,324.65 | 20.36 | 388,303,316.56 | 14.04 | 47.58 |
| Other receivables | 18,029,993.23 | 0.64 | 12,645,899.89 | 0.46 | 42.58 |
| Inventories | 896,675,761.84 | 31.85 | 838,202,834.59 | 30.32 | 6.98 |
| Long-term equity investment | 14,384,564.38 | 0.51 | 57,890,592.43 | 2.09 | (75.15) |
| Fixed assets | 549,614,786.49 | 19.52 | 502,762,114.81 | 18.18 | 9.32 |
| Intangible assets | 140,625,241.11 | 5.00 | 79,861,501.87 | 2.89 | 76.09 |
| Deferred tax assets | 34,856,402.41 | 1.24 | 69,326,643.49 | 2.51 | (49.72) |
| Employee benefits payable | 12,709,724.16 | 0.45 | 10,505,114.49 | 0.38 | 20.99 |
| Taxes payable | 6,877,214.09 | 0.24 | 24,202,207.26 | 0.88 | (71.58) |
| Long-term borrowings | 200,000,000.00 | 7.10 | - | - | - |
| Non-current liabilities due within one year | 19,747,105.78 | 0.70 | 418,509.00 | 0.02 | 4,618.44 |
| Long-term payables | 11,445,098.47 | 0.41 | 1,492,463.90 | 0.05 | 666.86 |
| Deferred income | 121,303,008.63 | 4.31 | 104,702,441.79 | 3.79 | 15.85 |

Notes:

- A. The decrease in cash at bank and on hand was due to a significant decrease year-on-year in sales revenue, as well as the notable expenses and R&D costs;
- B. The decrease in bills receivable was attributable to a decrease in settlement of trade receivables while operating expenses were essentially unchanged from last year;
- C. The increase in accounts receivable was attributable to the broader scope and terms of customer credit to stimulate sales, as well as the consolidation of Kunming TOS Machine Tool Manufacturing Co., Ltd. ("Kunming TOS") during the reporting period;
- D. The increase in other receivables was attributable to the provision of contract deposits including RMB3.88 million for mortgage loan granted to Far Eastern International Leasing Co., Ltd. and RMB1.54 million for financial leasing by Zhejiang Huijin Leasing Co., Ltd.;
- E. The increase in inventories was attributable to the increases in raw material purchase and commodity inventories to better cater for subsequent orders in the second half of the year, as well as the consolidation of Kunming TOS during the period;
- F. The substantial decrease in long-term equity investments was attributable to the consolidation of Kunming TOS as the Company obtained a majority of its voting rights and hence the long-term equity investment in Kunming TOS was derecognized with effect from 15 May 2014;
- G. Fixed assets recorded a year-on-year increase, as the heavy machinery assembly plant and the 110KV substation in our Yanglin Base and other projects passed acceptance inspection and commenced operation during the period;

DIRECTORS' REPORT

- H. The increase in intangible assets was due to the inclusion of land use right for site area of 338.49 Mu acquired by our Yanglin Base during the period;
- I. The decrease in deferred tax assets was primarily attributable to a reversal as the economic interests related to deferred income tax assets were not expected to be fully achieved, due to the fact that taxable income available within the required period for reversal of the previously provided deferred income tax assets was inadequate to be applied against the deductible temporary differences;
- J. The increase in employee benefits payable was due to the provision of additional retirement benefits due to a change in salary base of retirees during the period;
- K. Taxes payable decreased by RMB17.32 million from the end of last year, primarily attributable to a drop in VAT payable due to the decrease in sales revenue during the period;
- L. The increase in long-term borrowings was attributable to an increase of RMB200 million in two-year working capital loans as a result of the expanded financing scale and a change in financing structure;
- M. Non-current liabilities due within one year increased by RMB19.33 million over last year, primarily consisting of the mortgage loan repayable to Far Eastern International Leasing Co., Ltd. within the next year;
- M. Long-term payables increased by RMB9.95 million over last year, primarily consisting of the mortgage loan repayable to Far Eastern International Leasing Co., Ltd. with maturity over one year;
- O. The increase in deferred income was attributable to the scientific research grants for R&D projects including "Dual-post precision horizontal machining center" from the Ministry of Finance and the Provincial Science and Technology Department.

4. Analysis of core competitiveness

1. *Technical advantages of products:*

Horizontal boring and milling machine tool series, jig boring machine tool series, and CNC floor-type boring and milling machine tool series are major products of the Company. Horizontal machining center series and gantry boring and milling machine tool series are products recently developed by the Company, which are in a ramp-up stage with the increasing market share. Our boring and milling machine tool series, with the most comprehensive and expanding models and specifications, rank ahead as a whole among domestic similar products and make the Company one of the most competitive manufacturers.

2. *Technical R&D advantages:*

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 was the main in-charge unit for 4 major national special science and technology projects, 1 project of "863 Program", and a participant to 4 major national special science and technology projects, and 2 projects of "863 Program". The Company and Yunnan CY (Group) Co., Ltd. were jointly responsible for developing the major national special project on intelligent manufacturing equipment – development and demonstration of high-end CNC lathe manufacturing digital workshop (the "Project"). The Project was approved by the Reply Regarding the Implementation Plan of 2013 Intelligent Manufacturing Equipment Development Project (Fa Gai Ban Gao Ji [2013] No. 2519) issued by the National Development and Reform Committee, the Ministry of Finance and the Ministry of Industry and Information Technology.

In order to leverage on its technical strengths in precision manufacturing, speed up the adjustment of product structure and narrow the gap with international advanced level, KMTCL has reached an agreement with SCHIESS GmbH, a Germany enterprise, to introduce

DIRECTORS' REPORT

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. *Precision manufacturing advantages:*

The motto of "to take innovation as the priority, take quality as the foundation and take precision as the soul" is the concentrated reflection of the spirit of Kunji. From the original precision jig- boring machine to recent years, the company has been extended precision manufacturing advantages. For example, the THM46100 high precision horizontal products machining center developed by the Company in recent years 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; the tool machine is capable to process high precision products at high speed in the case of heavy load and high torque and is the latest research result of the generic technology such as structure optimization, heat distortion, vibration control etc., providing powerful technology support to the outstanding performance indicators and high reliability of the machine tools.

5. Investment Analysis

1. *External Equity Investment Analysis*

- (1) Investment in securities
There was no investment in securities during the year.
- (2) Holding shares in other listed companies:
The Company did not hold shares of other listed companies
- (3) Holding shares in non-listed financial enterprises
The Company did not hold any shares in non-listed financial enterprises or intended listed companies.
- (4) Trading of shares in other listed companies:
The Company did not trade shares of other listed companies during the reporting period.

2. *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.
- (3) Other wealth management and derivatives investment
There was no other wealth management and derivatives investment project.

3. *Use of funds raised*

There was no proceeds from fund raised investment project during the reporting period.

DIRECTORS' REPORT

4. Information of major subsidiaries and invested companies

| Name | Place of registration | Scope of business | Registered capital RMB'0000 | 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 | Subsidiary |
| Changsha Ser Turbine Machinery Co., Ltd. ("Changsha Ser") | 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 |
| 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 |

5. Use of proceeds from non-raised fund

During the reporting period, there were no proceeds from non-raised funds.

6. Information of special purpose entities controlled by the Company

No

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

From January to December 2014, the metal cutting machine tool segment recorded drops of 3.5% in new orders and 1.5% in backlog orders year-on-year. The Company's total export increased by 22.1% year-on-year to US\$11.63 billion, in which the metal cutting machine tool segment accounted for US\$2.27 billion, an increase of 20.6% year-on-year; and total import increased by 10.8% year-on-year to US\$17.78 billion, in which the metal cutting machine tool segment accounted for US\$8.84 billion, an increase of 11.1% year-on-year. In contrast with the declined demand for investment-related metal cutting machine tools, metal forming machine tools for manufacturing consumer products sustained the growth.

More economic downsides are envisaged ahead in 2015. However, the escalating efforts in economic reforms, especially those on investment and financing systems with regional development strategies to gradually take effect, are expected to fuel domestic investment momentum and hence accelerate the investments both in infrastructure construction and services. Meanwhile, domestic and foreign machine tool players have greatly enhanced their capability in tapping on potential demand, given their increasing adaptability to the changing market demand structure over the years. On this ground, machine tool import in 2015 is expected to remain a modest growth, whilst domestic machine tool sales are anticipated for increment.

2. Development strategies of the Company

(1) *Establishing a sound market-oriented mechanism*

Based on the completed organization restructuring and aiming at a market-oriented mechanism, the Company will launch business model transformation to transit its businesses from the divisional structure to the corporation system. An internal market-oriented mechanism will be established across the Company, with the ancillary business units to spearhead.

(2) *Optimizing the human resource structure*

- 1) To strengthen the main machine division, we will optimize the existing workforce with a focus on improving technical, assembly and installing and testing service capabilities. Based on its actual operations, the ancillary division will exercise strict control over the proportion of managerial and supporting staff, adopt outsourcing and other measures for non-core production units, and explore on a hybrid ownership and management model.
- 2) Under a talent-empowered strategy, we will actively introduce technical and managerial professionals, and engage foreign technical experts to upgrade competency and performance of our R&D team.

(3) *Pressing ahead with the adjustments to product mix*

- 1) On gantry boring and milling machine tools: we will optimize the general gantry series, while vigorously developing industry-specific products mainly including automobile moulds and structural parts of airplanes.
- 2) On horizontal machining centers: product series will be expanded to cover automobile engines, aerospace and aviation structural parts, precision horizontal machining centers, small horizontal machining centers (flow-type) and general horizontal machining centers.
- 3) On common boring machine tools: we will develop economical CNC boring machine tools (KIMI) to substitute for common boring machine tools, focusing on industry demand and exploring international market with resource expenditures under control.

DIRECTORS' REPORT

- 4) On CNC machine tools: we will seek to enhance reliability and stability of our flagship products while minimizing production costs to sharpen market competitiveness.
- 5) For key components (turntable, tool magazine and milling head), we will introduce advanced technologies through joint ventures and partnerships with an aim at self production.
- 6) For internal and external protection, hydraulic, electrical, cooling/chip-removing/dedusting systems, we will set up dedicated research teams respectively in a bid to upgrade product quality and reliability.

(4) *Improving the market share acquisition capability*

- 1) To maximize the market service function of our user engineering center, we will commit more technical resources and, with a focus on user demand, customize and implement complete set solutions on a practical and effective basis to lay a foundation for securing orders.
- 2) Through the "Brand Polishing" and "Excellent Project" campaigns, we strive to boost product quality and give full play to our product competitiveness.
- 3) The "Lean Improvement" campaign will be carried forward to reduce costs, shorten delivery time and improve quality.
- 4) Financial vehicles such as financial leasing and corporate mortgage will be incorporated into our marketing, offering financing solutions to customers to expedite collection of receivables and expand product sales.
- 5) To tap on new businesses, we will take efforts in remanufacturing and industrialization of components to create new growth drivers.
- 6) A research institution on industry processing techniques will be established to systematically translate actual and potential user needs in segment markets to R&D goals, with a focus on key sectors such as automobile, aerospace and aviation, mould and national defense industries.
- 7) We will step up exploration of export market, aiming to achieve new breakthroughs.

(5) *Improving operational quality*

- 1) Special measures on "recovery of accounts receivable ageing three or more years" will be developed for strict implementation and assessment.
- 2) Inventories will be trimmed down to reduce capital occupation and accelerate capital turnover.
- 3) Asset disposal schemes will be worked out and implemented to streamline idle assets and reinvigorate the existing assets.
- 4) Through supply chain integration, we expect to cut down procurement costs and improve manufacturing efficiency.
- 5) Under an overall budget, we will exercise strict control over various costs and expenses.
- 6) Management approaches will be upgraded in order to eliminate ineffectiveness and improve overall management efficiency.
- 7) We will strengthen management over subsidiaries, seeking to improve their profitability or minimize losses.

DIRECTORS' REPORT

3. Operating plan

The business targets for 2015: to achieve a revenue of RMB1.374 billion and an aggregate profit of RMB120 million.

4. Potential risks

According to statistics, during the first 11 months of 2014, metal-cutting machine tools closely related to fixed asset investment and heavy industrial investment recorded year-on-year decreases of 4% in new orders, 2.3% in production volume and 2% in sales together with an increase of 4.6% in inventories, where 41% enterprises were in loss making. In contrast, metal forming machine tools related to manufacturing and processing of consumer products posted year-on-year increases of 8.6% in new orders, 1.5% in production volume, 1.1% in sales and 2.3% in inventories, where only 13% enterprises were in loss making. It indicated that the changes in China's economic structure, especially the slower investment growth and the increasing contribution of consumption to GDP, are casting structural influences on internal segments of the machine tool industry. As China's economy headed into a new normal, heavy chemical industry witnessed significantly slower investment growth and low level repetitive investments have been effectively curbed, leading to a slowdown in demand for heavy machine tools. In this regard, uncertainties will remain in the business environment for machine tools in 2015.

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

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

applicable not applicable

The Group adopted the following new standards and revised standards from 1 January 2014: Accounting Standards for Business Enterprises No. 2 – Long-term Equity Investments ("CAS 2 (2014)"); and Accounting Standards for Business Enterprises No. 41 – Disclosure of Interests in Other Entities ("CAS 41")

In addition, the Company has adopted Accounting Rules on Classification between Financial Liabilities and Equity Instruments as well as the Related Accounting Treatment since 17 March 2014 and Accounting Standards for Business Enterprises No. 37 – Financial Instruments: Presentation and Disclosures ("CAS 37 (2014)") in the 2014 annual financial statements.

The Group has early adopted Accounting Standards for Business Enterprises No. 9 – Employee Benefits ("CAS 9 (2014)") and Accounting Standards for Business Enterprises No. 30 – Presentation of Financial Statements ("CAS 30 (2014)") since 1 January 2013. The application guidance of CAS 9 (2014) and CAS 30 (2014) were subsequently revised and became effective since 1 July 2014. The Group has adopted those application guidances since 1 July 2014.

The items of the consolidated income statement and income statement for 2014 as prepared after adopting the amended accounting policies are not affected, when compared to those prepared on the assumption of adopting the pre-amended accounting policies.

DIRECTORS' REPORT

When the items of the consolidated balance sheet and balance sheet as at 31 December 2014 prepared after adopting the amended accounting policies are compared with those prepared on the assumption of adopting the pre-amended accounting policies, the increases or decreases in the affected items are as follows:

| | <i>Unit: RMB</i> | |
|-------------------------------------|--|--------------------|
| | Increase amount ("()") for decrease) of presentation items after change accounting policies adopted | |
| | The Group | The Company |
| Long-term equity investments | (1,145,000.00) | – |
| Available-for-sale financial assets | 1,145,000.00 | – |
| Employee benefits payable | (5,110,774.06) | (5,110,774.06) |
| Long-term employee benefits payable | 5,110,774.06 | 5,110,774.06 |
| Deferred income | 121,303,008.63 | 121,063,008.63 |
| Other non-current liabilities | (121,303,008.63) | (121,063,008.63) |

Effects of the above changes in accounting policies on consolidated balance sheet and balance sheet as at 31 December 2013 are summarised as follows:

The Group

| | <i>Unit: RMB</i> | | |
|-------------------------------------|--------------------------|-------------------|-------------------------|
| | Before adjustment | Adjustment | After adjustment |
| Long-term equity investments | 59,035,592.43 | (1,145,000.00) | 57,890,592.43 |
| Available-for-sale financial assets | – | 1,145,000.00 | 1,145,000.00 |
| Employee benefits payable | 12,787,886.41 | (2,282,771.92) | 10,505,114.49 |
| Long-term employee benefits payable | – | 2,282,771.92 | 2,282,771.92 |
| Deferred income | – | 104,702,441.79 | 104,702,441.79 |
| Other non-current liabilities | 104,702,441.79 | (104,702,441.79) | – |

The Company

| | <i>Unit: RMB</i> | | |
|-------------------------------------|--------------------------|-------------------|-------------------------|
| | Before adjustment | Adjustment | After adjustment |
| Employee benefits payable | 10,997,980.36 | (2,282,771.92) | 8,715,208.44 |
| Long-term employee benefits payable | – | 2,282,771.92 | 2,282,771.92 |
| Deferred income | – | 104,702,441.79 | 104,702,441.79 |
| Other non-current liabilities | 104,702,441.79 | (104,702,441.79) | – |

DIRECTORS' REPORT

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

applicable not applicable

1. Accounting treatment of moulding flask as at 31 December 2012

Moulding flask is one of the ancillary materials being used in the Company's production, and according to the Company's accounting policy, the carrying amount of moulding flask should be fully charged to profit or loss upon usage. As at 31 December 2012, the Company recorded certain moulding flasks, which had been used in production and charged to profit or loss, within in work-in-progress at amount of RMB 34,860,213.24, with a corresponding reversal of cost of revenue at the same amount. This accounting treatment is not consistent with the Company's accounting policy.

As a result of this accounting error, cost of revenue was understated by RMB34,860,213.24, and income tax benefits was understated by RMB5,229,031.99 both in the Company's consolidated and company-level income statements for the year ended 31 December 2012. Moreover, inventory balance was overstated by RMB34,860,213.24 and deferred tax assets was understated by RMB5,229,031.99 both on the Company's consolidated and company-level balance sheet as at 31 December 2012. With respect to the statement of changes in equity for the year ended 31 December 2013, the accounting error resulted in an overstatement of RMB29,631,181.25 on the opening and closing balances of the Company's shareholders' equity both at consolidated and company level.

2. Accounting treatment for the repair transaction of moulding flask in the year ended 31 December 2013

In 2013, the Company employed a third party to repair the above-mentioned moulding flasks. The Company entered into two separate agreements for this repair transaction, including an agreement to sell the moulding flasks to the party who was to carry out the repair work, and another agreement to re-purchase these moulding flasks back upon completion of the repair work. For accounting purpose, the Company recorded these two agreements as separate sales and purchase transactions. The Company recorded revenue and cost of revenue in respect of the sales agreement in 2013, and then recorded purchase of moulding flasks in inventories in respect of the purchase agreement in 2014. In 2014, pursuant to the requirement of the relevant accounting standards, and in order to reflect the commercial substance of the underlying transaction, the Company considered that these 2 agreements should be accounted for as a repair transaction, and the related repair & maintenance cost should be recorded in profit or loss in 2013.

As a result of this accounting error, revenue was overstated by RMB33,346,375.53, cost of revenue was overstated by RMB34,618,883.73, and income tax benefits was overstated by RMB190,876.22 both in the Company's consolidated and company-level income statements for the year ended 31 December 2013. Moreover, accounts receivable was overstated by RMB33,346,375.53, other payables was understated by RMB241,329.51, and deferred tax assets was overstated by RMB190,876.22 both on the Company's consolidated and company-level balance sheet as at 31 December 2013. With respect to the statement of changes in equity for the year ended 31 December 2013, the accounting error resulted in an understatement of RMB1,081,631.98 in both the Company's consolidated and company-level shareholders' equity at 31 December 2013.

DIRECTORS' REPORT

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

1. 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 ("()") for loss | Percentage of the net profits attributable to the shareholders of the listed Company in the consolidated financial statement (%) |
|-----------------|--|--|--|--|---|--|
| 2014 | 0 | 0 | 0 | 0 | (204,091) | 0 |
| 2013 (restated) | 0 | 0 | 0 | 0 | 8,522 | 0 |
| 2012 (restated) | 0 | 0 | 0 | 0 | (111,927) | 0 |

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) and the website of Shanghai Stock Exchange (www.sse.com.cn) on 31st March 2015 for details).

2. Explanation on environmental information of heavy pollution listed companies and their subsidiaries as required by the state environmental protection department

The Company does not belong to the heavy pollution industry as required by the state environmental protection department.

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 2014 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 2014, the Group had long-term borrowings of RMB200,000,000 and the Group had borrowings due within one year of RMB284,500,000. 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 2014, the shareholders' equity of the Group was RMB1,170,798,000 compared to RMB1,344,366,000 as at the end of 2013.

VI. GEARING RATIO

The shareholders' equity to debt ratio of the Group for 2014 was 0.71, compared to 0.95 in 2013.

VII. CONTINGENT LIABILITIES

Details of contingent liabilities of the Company as at 31st December 2014 are set out in the notes to the financial statements.

SIGNIFICANT EVENTS

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

applicable not applicable

The Company and its distributor Beijing Hanhai Hongzheng Machinery Co., Ltd. (“Beijing Hanhai”) signed a Machine Tool Sales Contract in August 2011, and the Company signed a Manufacturer Authorization Letter authorizing Beijing Hanhai to participate in a tender exercise conducted by Jilin Haoyu Electrical Co., Ltd. (“Jilin Haoyu”) using the tool machine, and the Company undertook to assume responsibility for quality assurance of the tool machine. Subsequent to being awarded the tender, Beijing Hanhai signed a Machine Tool Sales Contract with the end-user, Jilin Haoyu. Jilin Haoyu instituted legal proceedings in November 2013 whereby Beijing Hanhai and the Company was named the 1st and 2nd defendants, respectively. Jilin Haoyu considered that Beijing Hanhai and the Company were unable to resolve product quality issues effectively within the product warranty period, and requested that the product be returned and the amount of RMB11.7325 million paid to Beijing Hanhai be refunded, and liquidated damages of RMB1.235 million be paid; and at the same time requested that the Company assume joint and several liabilities for payment. The Company pointed out in its defence at the trial of first instance that the Company had performed its quality assurance obligations, and that in accordance with the confirmed Service Invoice and Work Completion Invoice for the maintenance service of the Company, it could basically be confirmed that the tool machine under dispute had been functioning normally. Therefore, the Company did not commit any act in breach of the contract and should not assume joint and several liabilities. On 24 July 2014, as requested by the plaintiff, the court commissioned the identification organization to identify the machine. On 18 December 2014, identification organization issued a report that the main entrusted identified issues of the machine did not have the identification conditions.

As at the date of this financial report, the trial of first instance of the above litigation was still in progress. Having sought legal advice, the management considered that it was unlikely for the litigation to be ruled in favour of Jilin Haoyu. Therefore, the above controversy resulted in significant economic benefits outflow from the Group is unlikely. The Group did not make provision in respect of the above lawsuit in the financial statements.

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

applicable Not applicable

X. BANKRUPTCY AND RESTRUCTURING RELATED MATTERS

None

SIGNIFICANT EVENTS

XI. ASSETS TRANSACTIONS AND MERGER OF COMPANIES

applicable not applicable

1. The issues of acquisition, sale of assets and merger matters disclosed in the provisional announcements and the subsequent implementation unchanged

| Summary and type of event | Index for details |
|--|--|
| The Company's joint venture subsidiary Kunming TOS signed the 2013 amendment to the Constitution. The Company would change the scope of consolidation to include the statements of Kunming TOS in the Company's consolidated statements with effective from the approval date. | For details, please refer to the announcement published on 30 April, 2014 on China Securities Daily, Shanghai Securities News and Securities Times; and on the websites of www.sse.com.cn, www.hkex.com.hk and www.kmtcl.com.cn. |

XII. EQUITY INCENTIVES OF THE COMPANY AND ITS EFFECT

applicable Not applicable

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

applicable Not applicable

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 "Land Use Rights Rental Agreement" and the "Premise Rental Agreement" signed between the People's Government of Yunnan Province and the Company on 12 November 2001. On 31 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 12 November 2010 to 11 November 2013. On 28 August 2014, the Company and Kunming Kunji Group Co., Ltd. renewed the said land use rights and premise rental agreements at unchanged rents for the period from 12 November 2013 to 11 November 2016.

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 2014.

2. At the 28th meeting of the seventh session of the Board of the Company held on 29 May 2014, the related party transaction of the Company regarding provision of jig boring machine tool upgrading services to Shenyang Machine Tool Holding Company Limited was approved.

Set out below are name of equipment, type/specification, description of maintenance, quantity, amount and delivery time:

| Name of equipment | Type/specification | Quantity | Unit: RMB'000 | |
|-------------------------|--------------------|----------|---------------|---------------|
| | | | Price | Delivery time |
| Jig boring machine tool | DIXI75AN | 1 | 78.00 | 120 days |
| Jig boring machine tool | M310Y | 1 | 78.00 | 120 days |
| Jig boring machine tool | DIXI75 | 1 | 78.00 | 120 days |
| Jig boring machine tool | M310R | 1 | 78.00 | 120 days |
| Total | | 4 | 312.00 | |

As at 31 December 2014, the upgrading work for two jig boring machine tools was completed.

SIGNIFICANT EVENTS

3. On 4 August 2014, the Company entered into 1) the Master Purchase Agreement with Yunnan CY Group Company Limited (“Yunnan CY Group”) regarding the sale of machine tool parts; 2) the Master Supply Agreement with Yunnan CY Group Jinhui Coating Factory (“Jinhui”) regarding the purchase of packaging materials for lathes; 3) the Master Supply Agreement with Shenyang Machine Tool Holding Company Limited regarding the purchase of vertical lathes, radial drilling lathes and casting products for VMC series; and 4) the Master Purchase Agreement with Shenyang Machine Tool Holding Company Limited (“Shenyang”) regarding the sale of parts for VMC series to the counterparty on an ongoing basis respectively. The term of the agreements was effective from the date approved at the general meeting to 31 December 2016 (the Framework Agreement signed with Shenyang Machine Tool Holding Company Limited is also subject to the approval at its general meeting) and the annual caps of purchasing are set out as follows:

Unit: RMB0'000

| Related party | Yunnan CY Group | Jinhui | Purchase from Shenyang | Sale to Shenyang | Total |
|------------------------|--------------------|--------|------------------------------|---------------------|-------|
| As at 31 December 2014 | 70 | 600 | 1000 | 1200 | 2870 |
| As at 31 December 2015 | 70 | 600 | 1000 | 1200 | 2870 |
| As at 31 December 2016 | 70 | 600 | 1000 | 1200 | 2870 |
| Total | 210 | 1800 | 3000 | 3600 | 8610 |

4. The Company entered into the leasing contract with Yunnan State-owned Assets Property Management Company Limited (“Property Management Co.”), which is a 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 1 January 2011 to 31 December 2013.

On 1 January 2014, the Company entered into an agreement for rental adjustment with Property Management Co., pursuant to which the annual rent was adjusted to RMB537,219.60 for the period from 1 January 2014 to 31 December 2015.

5. In December 2011, the Company entered into an agreement with SCHIESS GmbH to purchase assembly parts of VMG6 prototype machine, amounting to €4,481,309.00. In April 2012, according to the terms of the agreement, the Company paid €2,240,654.50 to SCHIESS GmbH for VMG6 prototype machine. In September 2013, according to the agreement, the Company paid the remaining amount of €2,227,024.50 for VMG6 prototype machine. As at 31 December 2014, the Company received the VMG6 prototype machine but the installation is yet to be completed.
6. At the 26th meeting of the seventh session of the Board and the 1st meeting of the eighth session of the Board of the Company, the related transaction between the Company and Tos Varnsdorf (a foreign related party) during years 2014 and 2015 in relation to purchase of goods, receipt of services, sales of goods and provision of services was approved.

Unit: RMB0'000

| Related party | Kunming Machine Tool and Tos Varnsdorf | Total |
|------------------|--|--------|
| Proposed in 2014 | 500.00 | 500.00 |
| Proposed in 2015 | 500.00 | 500.00 |

SIGNIFICANT EVENTS

XIV. MATERIAL CONTRACTS AND THEIR PERFORMANCE

1. Escrow agency, contracting and lease matters

applicable Not applicable

2. Guarantee

applicable Not applicable

3. Other material contracts

None

XV. PERFORMANCE OF COMMITMENTS

applicable not applicable

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 | | |

SIGNIFICANT EVENTS

XVI. APPOINTMENT AND REMOVAL OF AUDITORS

Unit: RMB

| | | |
|---|--|---|
| Any change of auditor: | No | |
| Domestic auditor | Previously engaged | Currently engaged KPMG Huazhen (Special General Partnership) |
| Domestic accounting firm remuneration | | 3,400,000 |
| Domestic accounting firm auditing years | | 4 |
| Internal control auditor | Name KPMG Huazhen (Special General Partnership) | Remuneration Included in the remuneration for domestic accounting firm |

Explanation on appointment and dismissal of accounting firm

None

Explanation on change appointment of accounting firm during the audit period

None

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. FACED WITH THE RISK OF SUSPENSION OF LISTING AND TERMINATION OF LISTING

- 1. Reasons for suspension of listing or termination of listing and measures that the Company adopted to eliminate the suspension or termination of listing**
✓ Not applicable
- 2. Arrangement and plans of investors relation management after termination of listing**
✓ Not applicable

XIX. INFORMATION OF CONVERTIBLE BONDS

applicable ✓ Not applicable

SIGNIFICANT EVENTS

XX. IMPACT OF IMPLEMENTATION OF THE NEW ACCOUNTING STANDARDS ON THE CONSOLIDATED FINANCIAL STATEMENTS

1. Impact of changes in long-term equity investment guidelines on consolidated financial statements

Unit: RMB

| Invested company | Basis information of transaction | As at | As at 31 December 2013 | | Equity attributable to the shareholders of parent(+/-) |
|---|--|---|-----------------------------------|--|--|
| | | 1 January 2013, equity attributable to shareholders of the parent (+/-) | Long-term equity investment (+/-) | Available-for-sale financial assets(+/-) | |
| Hangzhou Ser Gas Equipment Engineering Co., Ltd. (Hangzhou Ser) | the Company holds 11.45% shareholdings of Hangzhou Ser | 0 | (1,145,000) | 1,145,000 | 0 |
| Total | / | 0 | (1,145,000) | 1,145,000 | 0 |

2. Impact of changes in employee benefits guidelines

Unit: RMB

| | |
|--|---|
| Employee benefits payable as at 1 January 2014 (+/-) | Equity attributable to the shareholders of parent as at 1 January 2014(+/-) |
| 2,282,771.92 | 0 |

Explanation on impact of changes in employee benefits guidelines: long-term employee benefits after reclassification

3. impact of other changes in the guidelines

Please refer to note (III).32 to the financial statements for details.

4. Others

None

XXI. OTHER SIGNIFICANT EVENTS

applicable Not applicable

1. Construction progress of Yanglin Industrial Base

The second EGM of 2011 of the Company approved the resolution to start up the investment proposal of the first stage of construction of heavy casting workshop of the second phase Yanglin CNC precision machine tool manufacturing and heavy casting base. Since the adjustment of the proposal, the project has not started up. On 10 February 2015, the adjustment proposal was passed at the 4th Board meeting of the 8th term of board of directors of the Company. The original proposal was adjusted as: from original investing RMB414,630,000 for 60,000 tons production capacity decreased to invest RMB286,420,000 for 30,000 tons production capacity.

The above adjustment proposal pending the approval by the first extraordinary general meeting of the Company to be held on 31 March, 2015.

SIGNIFICANT EVENTS

2. Major national special project

The Company and Yunnan CY (Group) Co., Ltd. were jointly responsible for developing the major national special project on intelligent manufacturing equipment – development and demonstration of high-end CNC lathe manufacturing digital workshop (the “Project”). The Project was approved by the Reply Regarding the Implementation Plan of 2013 Intelligent Manufacturing Equipment Development Project (Fa Gai Ban Gao Ji [2013] No. 2519) issued by the National Development and Reform Committee, the Ministry of Finance and the Ministry of Industry and Information Technology, which stated that the Company would be the manufacturer and CY Group would be the demonstrator of the Project.

The government intends to grant RMB40 million for the Project, of which the Company as the manufacturer will receive a grant of RMB20 million and the CY Group Co. Ltd. as the demonstrator will receive a grant of RMB20 million. Part of the grant amounting to RMB14 million has already been transferred to the Company’s account at present.

3. Issue of medium-term notes

At the third extraordinary general meeting of 2012, the Board of directors was approved and authorized to handle the issue of medium-term notes. On 15 May 2013, the Company amended the proposal of the issue of medium-term notes, which determined the Medium-term Notes Prospectus, and determined to issue, after announcement, 5-year notes in two tranches with an aggregate principal amount of no more than RMB500 million for the purpose of supplementing working capital and repaying bank loans. The Company plans to issue the first tranche of 5-year medium-term notes with principal amount of RMB300 million for the period, and has reported it through lead underwriter to the National Association of Financial Market Institutional Investors for approval.

4. Asset-backed loans

- 1) At the 2013 third extraordinary general meeting of the Company on 12 December 2013, the Company was approved to apply to banks for mortgage loans secured by assets of RMB470 million, and the Board was authorized to determine and deal with at its sole discretion the specific matters.
- 2) At the 4th meeting of the eighth session of the Board on 11 February 2015, the Company was approved to apply to the Export-Import Bank of China for mortgage loan secured by its assets in Yanglin Base.

Currently, the Company has reached the intent on a loan of RMB320 million with the Export-Import Bank of China. The loan is proposed to be secured mainly by the project land and plants of the Company’s CNC heavy and precision machine tool manufacturing and casting base in Yanglin, as well as guarantees from related parties for the shortfall. As approved recently by Yunnan Branch of the Export-Import Bank of China, major terms of the project loan include: total principal amount of loans is RMB320 million; the term of loan is 8.5 years, including a grace period of 2 years; and a prime interest rate for the category of project loans will be granted to the Company. Accordingly, the Company will get through the procedures with the Export-Import Bank of China for the mortgage loan secured by assets of Yanglin Base.

5. Financial leasing

To meet the financing needs of certain customers for purchase of products, the Company plans to expand the scope of cooperation with a number of financial institutions on financing services. In order to facilitate the plan, at the 29th meeting of the seventh session of the Board, a total limit up to RMB100 million for selling products to lessees by way of financial leasing was approved, and the management was authorized to determine and deal with at its sole discretion the specific matters of financial leasing. The above matter was considered and approved at the 2014 second extraordinary general meeting of the Company.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

I. CHANGES IN SHARE CAPITAL

1. Table of changes in share capital of the Company

During the reporting period, the total number of shares and share capital structure of the Company has not changed.

II. SHAREHOLDERS AND BENEFICIAL CONTROLLERS

1. Number of shareholders

Total number of Shareholders as at the end of the reporting period 49626, among which, 49,504 are holders of A Shares, 122 are holders of H Shares

Total number of shareholders of A Shares at the date of 5 trading days before annual report disclosed 48959

2. As at the end of the reporting period, table of shareholdings of top ten shareholders or top ten circulating shareholders (or shareholders with selling unrestricted shares)

Unit: share

Shareholdings of the top ten shareholders

| Name of shareholders | Increase/decrease during the reporting period | Total number of shares held at the end of the reporting period | Percentage (%) | Number of shares pledged or frozen | | Nature of shareholders |
|--|---|--|----------------|--|-------------------------|---------------------------------------|
| | | | | Number of selling restricted shares held | Number of shares status | |
| HKSCC NOMINEES LIMITED | | 133,976,900 | 25.27 | Nil | Unknown | Unknown |
| Shenyang Machine Tool (Group) Co., Ltd. | | 133,222,774 | 25.08 | Nil | Unknown | State-owned legal person |
| Yunnan Industrial Investment Holding Group Co., Ltd. | | 36,062,110 | 6.79 | Nil | Unknown | State-owned legal person |
| CHAN KWOK TAI EDDIE | | 3,050,000 | 0.57 | Nil | Unknown | Foreign natural person |
| Guangdong Finance Trust Co.,Ltd – securities investment and capital trust plan | | 1,839,900 | 0.35 | Nil | Unknown | Domestic non-state-owned legal person |
| XU Congpeng | | 1,452,004 | 0.27 | Nil | Unknown | Domestic nature person |
| SU Xiaojian | | 1,146,525 | 0.21 | Nil | Unknown | Domestic nature person |
| CAI QINGSHAN | | 1,083,806 | 0.20 | Nil | Unknown | Foreign natural person |
| Zhou Wei | | 1,030,181 | 0.19 | Nil | Unknown | Domestic nature person |
| China Everbright Bank Co., Ltd - Everbright Pramerica quantify the core of securities investment funds | | 1,000,292 | 0.19 | Nil | Unknown | Domestic non-state-owned legal person |

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Selling unrestricted shares held by the top ten shareholders

| Name of shareholders | Number of selling unrestricted circulating shares held | Type and quantity of shares Type |
|--|--|----------------------------------|
| 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. | 36,062,110 | RMB ordinary shares |
| CHAN KWOK TAI EDDIE | 3,050,000 | Overseas listed foreign shares |
| Guangdong Finance Trust Co.,Ltd – securities investment and capital trust plan | 1,839,900 | RMB ordinary shares |
| XU Congpeng | 1,452,004 | RMB ordinary shares |
| SU Xiaojian | 1,146,525 | RMB ordinary shares |
| CAI QINGSHAN | 1,083,806 | Overseas listed foreign shares |
| Zhou Wei | 1,030,181 | RMB ordinary shares |
| China Everbright Bank Co., Ltd - Everbright Pramerica quantify the core of securities investment funds | 1,000,292 | RMB ordinary shares |

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

Except for no connected relationship between state-owned legal person shareholders, the Company was not notified of any connected relationship or acting in concert relationship regulated by “Information Disclosure Management Procedure to Changes of Shareholding of Listed Company” among the top ten shareholders. Other than the substantial shareholders disclosed above, as at 31 December 2014, 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.

Explanation of preferred shareholders of recovery voting rights and shareholdings

No

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Notes:

- 1) HKSCC (Nominees) Limited holds shares on behalf of clients. The Company did not receive any notification that any H shareholder held more than 10% in total share capital of the Company. Holders of H Shares who held more than 5% of total issued H Shares were as follows: nil.
- 2) Save as disclosed above, the Directors were not notified by any person (who is not a Director or a chief executive officer) who owns the interest or short position in the shares or underlying shares of the Company 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 31 December 2014, none of the Directors and the Supervisors had any interests or short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which have been notified to the Company and the Hong Kong Stock Exchange pursuant to Division 7 and 8 of Part XV of the SFO, including interests or short positions which the Directors or the Supervisors are taken or deemed to have under such provisions of the SFO, or which are required to be and are recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code.

This issue was announced in 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.

III. CONTROLLING SHAREHOLDER AND BENEFICIAL CONTROLLER

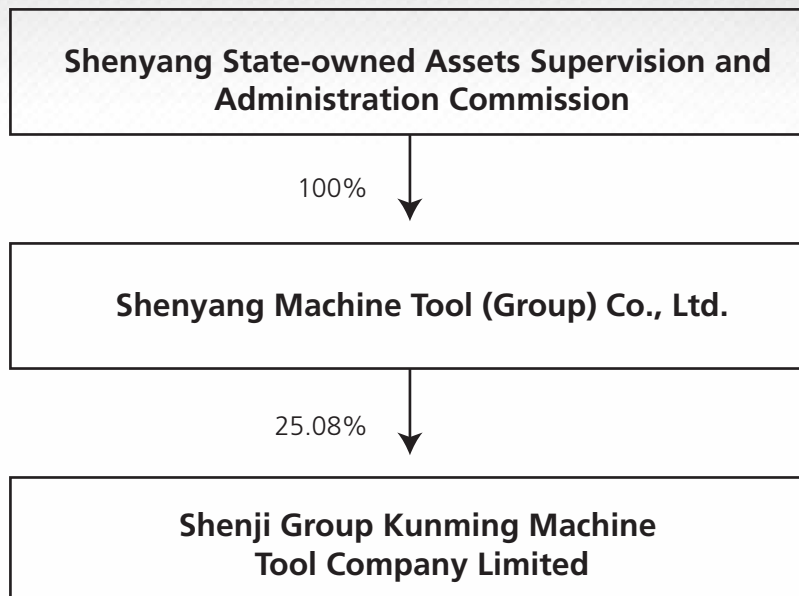
1. Beneficial controller

1. Legal person

| | |
|---|--|
| | <i>Unit: RMB'000</i> |
| 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. |
| Future development strategy | |
| 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 |
| Explanation on other information | |

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

2. *Diagram of the ownership and controlling relationship between the Company and its beneficial controller*



2. **Other information of controlling shareholder and beneficial controller**

None

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

There was no other legal person shareholder holding over 10% shares of the Company.

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

Unit: share

| Name | Title (note) | 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 number of shares held during the year | Reason for change | Total emoluments received from the Company during the reporting period (RMB ten thousand) (before tax) | |
|-----------------|--|--------|-----|--------------------------------------|--|--|--|---|-------------------|--|--------|
| | | | | | | | | | | Received salaries from the shareholder during the reporting period | |
| Wang Xing | Chairman, Executive director | Male | 49 | 28th July 2011 | 31st October 2017 | - | - | - | - | 43.51 | - |
| Zhang Xiaoyi | Vice chairman, Executive director | Male | 50 | 31st October 2008 | 31st October 2017 | - | - | - | - | 39.22 | - |
| Zhang Tao | Non-executive director | Male | 44 | 31st October 2008 | 31st October 2017 | - | - | - | - | 0 | - |
| Chang Baoqiang | Executive director General manager | Male | 48 | 31st October 2014 28th March 2013 | 31st October 2017 31st October 2017 | - - | - - | - - | - - | 35.91 | - - |
| Zhang Zeshun | Executive director Chief financial officer | Male | 35 | 18th March 2014 28th January 2014 | 31st October 2017 31st October 2017 | - - | - - | - - | - - | 29.21 | - |
| Liu Yan | Non-executive director | Male | 50 | 31st October 2014 | 31st October 2017 | - | - | - | - | 0.95 | - |
| Liu Haijie | Non-executive director | Female | 48 | 31st October 2014 | 31st October 2017 | - | - | - | - | 0.95 | - |
| Yang Xiongsheng | Independent non-executive director | Male | 54 | 23rd March 2013 | 31st October 2017 | - | - | - | - | 14.30 | - |
| Chen Fusheng | Independent non-executive director | Male | 49 | 16th June 2011 | 31st October 2017 | - | - | - | - | 20 | - |
| Tang Chunsheng | Independent non-executive director | Male | 49 | 18th March 2014 | 31st October 2017 | - | - | - | - | 11.30 | - |
| Liu Qiang | Independent non-executive director | Male | 52 | 15th May 2014 | 31st October 2017 | - | - | - | - | 9.70 | - |
| Shao Li | Chairman of supervisory committee | Male | 56 | 31st October 2008 | 31st October 2017 | - | - | - | - | 37.25 | - |
| Fan Hong | Supervisor | Male | 51 | 31st October 2008 | 31st October 2017 | - | - | - | - | 0 | - |
| Cai Zhemin | Supervisor | Male | 51 | 10th May 2011 | 31st October 2017 | - | - | - | - | 4.26 | - |
| Jiang Jingying | Supervisor | Female | 38 | 31st October 2014 | 31st October 2017 | - | - | - | - | 0.60 | - |
| Zhou Guoxing | Employee Supervisor Vice general manager | Male | 52 | 31st October 2014 10th April 2006 | 31st October 2017 31st October 2014 | - - | - - | - - | - - | 27.20 | - - |
| Ye Nong | Executive director Vice general manager | Male | 54 | 23rd June 2010 30th December 2006 | 31st October 2014 31st October 2017 | - - | - - | - - | - - | 34.39 | - - |
| Zhu Xiang | Vice general manager | Male | 48 | 20th August 2007 | 31st October 2017 | - | - | - | - | 28.13 | - |
| Jin Xiaofeng | Vice general manager | Male | 48 | 28th February 2014 | 31st October 2017 | - | - | - | - | 23.73 | - |
| Luo Tao | Secretary to the Board, company secretary | Male | 39 | 28th May 2008 | 31st October 2017 | - | - | - | - | 26.47 | - |
| Li Zhenxiong | Vice chairman, | Male | 52 | 23rd March 2007 | 28th January 2014 | - | - | - | - | 0 | - |

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

| Name | Title (note) | 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 number of shares held during the year | Reason for change | Total emoluments received from the Company during the reporting period (RMB ten thousand) (before tax) | Received salaries from the shareholder during the reporting period |
|---------------|------------------------------------|--------|-----|---------------------|-------------------------|--|--|---|-------------------|--|--|
| Li Shunzhen | Executive director | Female | 42 | 31st October 2011 | 28th January 2014 | - | - | - | - | 2.77 | - |
| | Chief financial officer | | | 31st October 2011 | 28th January 2014 | - | - | - | - | | |
| Gao Minghui | Non-executive director | Male | 51 | 28th July 2011 | 11th February 2015 | - | - | - | - | 40.26 | - |
| Guan Xin | Non-executive director | Male | 46 | 23rd June 2010 | 31st October 2014 | - | - | - | - | 4.80 | - |
| Xiao Jianming | Independent non-executive director | Male | 68 | 31st October 2011 | 27th January 2014 | - | - | - | - | 1.20 | - |
| Zhou Donghong | Non-executive director | Male | 45 | 18th March 2014 | 31st October 2014 | - | - | - | - | 0 | - |
| Qin Jianzhong | Employee supervisor | Male | 60 | 31st October 2011 | 31st October 2014 | - | - | - | - | 21.93 | - |
| Xu Kunping | Vice general manager | Male | 45 | 10th February 2009 | 31st October 2014 | - | - | - | - | 27.80 | - |
| Total | / | / | / | / | / | - | - | - | / | - | - |

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 2017.

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 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 to May 2013, he was the general manager of the Company. From 31st October 2008, he has been a director of the Company. His tenure of appointment will expire on 31st October 2017.

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 general manager of Investment Department of Yunnan Industrial Investment Holding Group Co., Ltd. From 31st October 2008, he has been a director of the Company. From 18th March 2014, he has been the vice chairman of the Company. His tenure of appointment will expire on 31st October 2017.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

Chang Baoqiang, male, born in 1966, graduated at Harbin University of Science of Technology with major in equipment and process of precision machinery manufacturing, holding master degree, senior engineer. Currently, he is the general manager of the Company. Mr. Chang started his career in 1988. He was a designer of Shenyang Third Machine Tool Plant; chief designer of Shenyang Machine Tool Center; deputy chief engineer of Shenyang CNC Machine Tool Plant; head of development department, manufacturing department, and deputy general manager of Shenyang CNC Machine Tool Co., Ltd.; head of engineering department of Shenyang Machine Tool (Group) Co., Ltd.; head of manufacturing coordinating department, manufacturing and supply department of Shenyang Machine Tool Co., Ltd.; Deputy general manager of Shenyang First Machine Tool Plant; general manager and party secretary of Shenyang Machine Tool Co., Ltd. Shen Yi Lathe Factory. From March 2013, he has been the general manager of the Company. His tenure of appointment will expire on 31st October 2017.

Zhang Zeshun, male, Han nationality, born in June 1979, university graduate, senior accountant, certified public accountant. Currently, he is a director of the Company. Mr. Zhang graduated from Jiangxi University of Science and Technology in accounting auditing major in 2002. From August 2002 to July 2004, he worked as an auditor in the auditor department for Yunda Technologies Co., Ltd.. From July 2004 to July 2007, he was the accounting supervisor, financial manager of the finance department of Yunda Technologies Co., Ltd.. From July 2007 to October 2007, he worked for Yunnan Investment Guarantee Co., Ltd. business development department; from October 2007 to now, he has worked as the manager of the finance department of Yunnan State-owned Kunming Economic Development Zone Industrial Development Co., Ltd.. From 18th March 2014, he has been a director of the Company. His tenure of appointment will expire on 31st October 2017.

Liu Yan, male, born in September 1964, holding a master degree, senior economist. Mr. Liu started his career in December 1980. In September 2008, he was appointed as the general manager, secretary to the Committee of CPC of Zhong Jie Drilling and Boring Machine Factory. In August 2011, he was also appointed as the special assistant to the general manager of Shenyang Machine Tool (Group) Co., Ltd. and project manager of Foxconn joint venture. In October 2012, he was appointed as the head of financial department and the special assistant to the general manager of Shenyang Machine Tool (Group) Co., Ltd.. In February 2013, he was appointed as the vice general manager of Shenyang Machine Tool (Group) Co., Ltd.. From July 2013 to now, he has been the senior vice president and COO, vice General Manager of Shenyang Machine Tool (Group) Co., Ltd.. His tenure of appointment will expire on 31st October 2017.

Liu Haijie, female, born in December 1966, holding a master degree. She started her career in July 1989. In February 2006, she was a chief judge of Shenyang City Intermediate People's Court. In July 2009, she was appointed as the general legal counsel of Shenyang Machine Tool (Group) Co., Ltd.. From July 2013 to now, she has been the senior vice president and CLO, general legal counsel, secretary to the board of directors and head of legal affairs of Shenyang Machine Tool (Group) Co., Ltd.. Her tenure of appointment will expire on 31st October 2017.

Yang Xiongsheng (independent non-executive director), male, born in February 1960, chair of the accounting department of the school of business of Nanjing University, professor, doctoral tutor. Mr. Yang was graduated at Xuzhou Normal University in 1981, and he has doctorate of accounting at Dongbei University of Finance and Economics. He had worked for Lianyungang Finance School and Lianyungang audit bureau. From 1995, he has worked at the accounting department of Nanjing University. Presently, he is the chair of the accounting department of Nanjing University, the vice president of the fifth council of Chinese Institute of Finance and Cost for Young and mid-career professionals, deputy secretary-general of Accounting Society of China, vice president of Accounting Society of Jiangsu Province, advisory expert of accounting standards for China Accounting Standards Committee under the Ministry of Finance; adjunct doctoral tutor at Nanjing University of Science and Technology, adjunct professor at Anhui University of Finance and Economics. The main research areas of Mr. Yang: internal control, basic theory of accounting, financial management and management accounting. Presently, he has published more than 200 papers, monographs and more than 20 textbooks. He directly involved in the research of specific control criterion and drafting work of the Internal Accounting Control Standards-Basic Standards by the Ministry of Finance, and he undertook a number of key scientific researches for the Ministry of Finance. From 22nd March 2013, he has been an independent non-executive director of the Company. His tenure of appointment will expire on 31st October 2017.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

Chen Fusheng (independent non-executive director), 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. From 18th July 2011, he has been an independent non-executive director of the Company. His tenure of appointment will expire on 31st October 2017.

Tang Chunsheng (independent non-executive director), male, born in 1966, Ni nationality, holding a master degree, senior accountant, China CPA, China CPV, Certified Valuation Analyst (CVA), vice chairman of Yunnan assets valuation association, director of Yunnan CPA association, member of evaluation expert group of major asset restructuring projects for Yunnan State-owned Assets Supervision and Commission ("SASAC"), member of senior accountant professional title judging panel of department of human resources and social security of Yunnan Province, financial expert of the financial office of Yunnan provincial government, outside campus graduate mentor of Yunnan Financial and Economics and, Yunnan University. From 1985 to 1998, he took the positions of manager of financial department, manager of audit department, chief accountant at Chuxiong Autonomous Prefectures Power Industry Company. From 1999 to October 2000, he worked in Kunming High-tech Industrial Development Zone. From November 2000 to 2008, he worked as senior manager, chief appraiser, vice general manager in Yunnan Tianying accounting firm, and the chairman of Yun Tianying Appraisal Co., Ltd. From 2009 to now, he is the partner of Zhonghe Appraisal Company Limited and general manager of Zhonghe Appraisal Company Limited south-west branch. From 18th March 2014, he has been an independent non-executive director of the Company. His tenure of appointment will expire on 31st October 2017.

Liu Qiang (independent non-executive director), male, born in March 1963, doctor of engineering, professor at School of Mechanical Engineering & Automation – BUAA, doctoral supervisor, director of National Defense Industry Efficient CNC Machining Technology Research And Application Center, leader of "Advanced Manufacturing Technology" Innovation Team and a member of the University Academic Committee. Mr. Liu graduated at Central South Institute of Mining Metallurgy with a bachelor degree in 1983. In 1989, he has his master's degree in engineering at Beihang University. From 1996 to 1998, he studied in Canada at the University of British Columbia as a visiting scholar and joint training doctoral student. In 2000, he has his doctoral degree at Beihang University. He was selected in former National Defense "511 Talents Project" and became an academic leader. Presently, he also handles the important academic work: subject matter expert in the field of Advanced Manufacturing Technology under National "863 Project"; expert of the CNC first general application demonstration project overall group under the Ministry of Science and Technology; team leader of expert group of technology and equipment; chairman of Machinery Industry Automation Branch under Chinese Mechanical Engineering Society; vice chairman of the national numerical control system technology standardization committee; consultant of the fourth expert group on technology to China Aerospace Science & Industry Corporation; member of professional and technical committee under AVIC aviation special equipment R & D Engineering Center; member of academic committee of Mathematics and Advanced Manufacturing Cross Research Department under Mathematics and Interdisciplinary Science Center; editor of Journal of Mechanical Engineering etc.. His main research direction: CNC machining process simulation and optimization; CNC machine dynamics and control; CNC machine dynamics and control; High-performance motion control etc.. He has hosted more than 30 various kinds of important research projects; gained a second prize of National Defense Science and Technology Award, two second prize of China Aviation Industry Corporation (ministerial level) Technology Progress Award, a first prize of Aeronautical Science and Technology Award, and China Instrument Invention Award/National Invention Exhibition Gold Award; published more than 100 academic papers; granted more than 20 patents and software copyrights; also won the title of outstanding teacher in Beijing, outstanding young backbone teacher in Beijing, won American UTC Rong Hong Science and Technology Education Award and the top ten best teachers of Beihang University etc. From 15 May 2014, he has been appointed as an independent non-executive director of the Company. His tenure of appointment will expire on 31st October 2017.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

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 March 1982 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 June 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. From 31st October 2008, he has been a supervisor of the Company. His tenure of appointment will expire on 31st October 2017.

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.. From 31st October 2008, he has been a supervisor of the Company. His tenure of appointment will expire on 31st October 2017.

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 2017.

Jiang Jingying, female, born in June 1977, holding a master degree. She started her career in March 2002. She was an accountant of Shenyang Machine Tool Co., Ltd. Shenzhen Branch, head of budget and accounting division of financial department of Shenyang First Machine Tool Factory. In June 2008, she was appointed as the vice general manager of Shenyang Machine Tool Yin Feng Foundry Co., Ltd.. In November 2009, she was appointed as the vice general manager of Shenyang Machine Tool Co., Ltd. Shenyi Lathe Factory. From July 2013 to now, she has been the head of investment department of Shenyang Machine Tool (Group) Co., Ltd.. Her tenure of appointment will expire on 31st October 2017.

Zhou Guoxing, male, born in November 1962, holding a master degree and is a senior engineer. He is currently the chairman of the union and employee supervisor 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 vice general manager of the Company. From October 2014, he has been an employee supervisor of the Company. His tenure of appointment will expire on 31st October 2017.

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. From 30th December 2006, he has been the vice general manager of the Company. His tenure of appointment will expire on 31st October 2017.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

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, he has been the vice general manager of the Company. His tenure of appointment will expire on 31st October 2017.

Jin Xiaofeng, male, born in November 1966, CPC member, having postgraduate education, accountant. Currently, he is the vice general manager, chief financial officer of the Company. From August 1986 to May 2004 Mr. Jin worked for Shenyang First Machine Tool Factory as a staff for costing in financial department, team leader, assistant department director, vice department director, assistant general manager and vice general manager. From May 2004 to June 2008, Mr. Jin was the vice director of financial department, director of treasury management department and director of fund settlement center of Shenyang Machine Tool (Group) Co. Ltd.. From June 2008 to November 2009, he was the director of financial and assessment department of Shenyang Machine Tool Co. Ltd. From November 2009 up to now, he has been the director of investment department, accounting department of Shenyang Machine Tool (Group) Co. Ltd. From 28th February 2014, he has been the vice general manager of the Company. From 8 March 2015, he also has been the chief financial officer of the Company. His tenure of appointment will expire on 31st October 2017.

Luo Tao, male, born in July 1975, holding a master degree and postgraduate qualification. He is currently the secretary to the Board, company secretary of the Company. 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. From November 2014, he has been the company secretary of the Company. His tenure of appointment will expire on 31st October 2017.

Li Zhenxiang, male, born in May 1962, holding master postgraduate qualification and is an assistant economist. 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. Mr. Li was the vice chairman of the Company and he has resigned.

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. From June 2011 to October 2011, she has worked at Shaoyang Industrial Development Co., Ltd. under Yunnan Industrial Investment Holding Group Company Limited as a chief financial officer. From October 2011 to January 2014, she was the chief financial officer of the Company. She was appointed as a director, chief financial officer of the Company and she has resigned.

Guan Xin, male, born in May 1968, holding a master post-graduate diploma, senior economist. Mr. Guan started his career in August 1990. From February 2005 to August 2009, Mr. Guan was the director of securities unit, general manager assistant, head of financial department, secretary to the board, vice general manager of Shenyang Machine Tool Co., Ltd. Meanwhile, he was the director of the Strategic Investment Unit of Shenyang Machine Tool (Group) Co., Ltd. From August 2009 to November 2009, he was the general manager assistant and the head of finance and investment unit of Shenyang Machine Tool (Group) Co., Ltd. Since November 2009, he has been the vice general manager of Shenyang Machine Tool (Group) Co., Ltd. From 23rd June 2010, he had been appointed as the director of the Company. His tenure of appointment expired on 31st October 2014 and he has resigned.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

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 expired on 11th February 2015 and he has resigned.

Zhou Donghong, male, Han nationality, born in June 1970, university graduate, senior human resources management professional, politic official. He worked for Kunming Cement Company Limited from 1988, experiencing Youth League officer, deputy secretary of Youth League, secretary of the Communist Party branch of finished product workshop. From April 2003 to July 2006, he worked for Yunnan State-owned Cement Kunming Co., Ltd. as the deputy secretary of the Communist Party, secretary of the Discipline Committee and deputy general manager of the company. From July 2006 to March 2008, he was the vice director of the retirement management center of Yunnan State-owned Assets Operation Co., Ltd. From February 2007, he was the manager of the human resources department; from March 2008 to August 2011, he worked as the manager of the human resources department of Yunnan Industrial Investment Holding Group Co., Ltd., and from September 2008 to now, he has been the general manager of Yunnan State-owned Property Management Ltd. From 18 March 2014, he was appointed as the director of the Company. His tenure of appointment expired on 31st October 2014 and has resigned.

Qin Jianzhong, male, born in September 1954, holding a postgraduate qualification, senior economist. He is currently the chairman of the labor union and the employee supervisor 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 vice secretary to the Committee of CPC of the Company. His tenure of appointment expired on 31st October 2014 and has resigned.

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 general manager of the precision horizontal machine tool department 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 had been the vice general manager of the Company, responsible for the marketing. His tenure of appointment expired on 31st October 2014.

Explanation on other information

None

2. Equity incentives granted to directors, supervisors and senior management officers of the Company during the reporting period

applicable Not applicable

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

applicable Not applicable

| Name | Shareholder's business unit | Position | Date of appointment | End date of appointment |
|---|--|--|---------------------|-------------------------|
| Liu Yan | Shenyang Machine Tool (Group) Co., Ltd. | Senior general manager and Co | | |
| Liu Haijie | Shenyang Machine Tool (Group) Co., Ltd. | Senior general manager, CLO, legal adviser, secretary to the Board, head of legal affairs department | | |
| Zhang Tao | Yunnan Industrial Investment Holding Group Co., Ltd. | General manager of investment department | | |
| Cai Zhemin | Shenyang Machine Tool (Group) Co., Ltd. | Director of strategy planning | | |
| Jiang Jingying | Shenyang Machine Tool (Group) Co., Ltd. | Director of investment department | | |
| Fan Hong | Yunnan Equity Exchange Co. Ltd. | Chairman | | |
| Guan Xin | Shenyang Machine Tool (Group) Co., Ltd. | Vice general manager | | |
| Explanation on position held in the shareholder's business unit | | | | |

2. Positions in other companies

applicable Not applicable

| Name | Other Companies | Position | Date of appointment | End date of appointment |
|---|---|---------------------------------|---------------------|-------------------------|
| Wang Xing | 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 | | |
| Zhang Xiaoyi | Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. | Vice chairman | | |
| | Kunming TOS Machine Tool Manufacturing Co., Ltd. | Vice chairman | | |
| | Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. | Director | | |
| Yang Xiongsheng | the accounting department of the school of business of Nanjing University | Department head | | |
| Chen Fusheng | the Faculty of Business at the Hong Kong University of Science and Technology | Associate professor, editor | | |
| Tang Chunsheng | ZhongHe Appraisal Co., Ltd. | | | |
| Liu Qiang | Beihang University | Professor | | |
| Zhou Guoxing | Kunming TOS Machine Tool Manufacturing Co., Ltd. | Member of controlling committee | | |
| Ye Nong | Kunming TOS Machine Tool Manufacturing Co., Ltd. | Director | | |
| Zhu Xiang | Kunming Kunji General Machine Co., Ltd. | Director, general manager | | |
| | Xi'an Ser Turbo Machinery Manufacturing Co., Ltd. | Director | | |
| Luo Tao | Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. | Director | | |
| Zhou Donghong | Yunnan state-owned assets property management company limited | General manager | | |
| Explanation on position held in other companies | | | | |

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

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.

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;

Information of emoluments payable to directors, supervisors and senior management officers

Total actual emoluments received by directors, supervisors and senior management officers of the Company at the end of the reporting period

IV. CHANGE OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OFFICERS

| Name | Position | Change | Reasons for change |
|----------------|------------------------------------|-------------|--------------------|
| Li Zhenxiong | Vice chairman | Resignation | Job reason |
| Li Shunzhen | Director, chief financial officer | Resignation | Job reason |
| Zhang Zeshun | Director, chief financial officer | Appointment | |
| Xiao Jianming | Independent non-executive director | Resignation | Personal reason |
| Liu Yan | Non-executive director | Appointment | |
| Liu Haijie | Non-executive director | Appointment | |
| Chang Baoqiang | Non-executive director | Appointment | |
| Liu Qiang | Independent non-executive director | Appointment | |
| Tang Chunsheng | Independent non-executive director | Appointment | |
| Zhou Donghong | Non-executive director | Resignation | |
| Guan Xin | Non-executive director | Resignation | |
| Ye Nong | executive director | Resignation | |
| Gao Minghui | Non-executive director | Resignation | |
| Jiang Jingying | Supervisor | Appointment | |
| Zhou Guoxing | Employee supervisor | Appointment | |
| Qin Jianzhong | Employee supervisor | Resignation | |
| Jin Xiaofeng | Vice general manager | Appointment | |
| Xu Kunping | Vice general manager | Resignation | |

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

V. STAFF OF THE PARENT AND MAJOR SUBSIDIARIES

1. Staff

| | |
|--|-------|
| No. of existing staff of the parent | 2,053 |
| No. of existing staff of the main subsidiaries of the Company | 291 |
| Total existing staff | 2,344 |
| No. of retired staff whose retirement expenses undertaken by the parent and its major subsidiaries | 130 |

| Areas of specialization | Areas of specialization | Number of employees |
|--------------------------|-------------------------|---------------------|
| Production | | 1,459 |
| Sales and marketing | | 132 |
| Technology | | 475 |
| Finance | | 74 |
| Administration | | 162 |
| General services | | 42 |
| Early retirement | | 82 |
| Staff pending for duties | | 44 |
| Others | | 4 |
| Total | | 2,474 |

| Education level | Education level | Number of employees |
|----------------------------------|-----------------|---------------------|
| Postgraduate or above | | 37 |
| University graduate | | 532 |
| College diploma | | 457 |
| Diploma | | 676 |
| High school or vocational school | | 354 |
| Junior high school or below | | 418 |
| Total | | 2,474 |

2. Remuneration Policy

In June 2013, the Company issued the Remuneration Management Measures of Shenji Group Kunming Machine Tool Co., Ltd., pursuant to which a sound remuneration management system has been established, with clearly defined constituents of total remuneration, post-specific and performance-based salaries, remuneration management and distribution, settings of post-specific salaries, and the principles and measures for assessment and adjustments.

Starting from the fourth quarter of 2014, the Company strengthened control and management over total remuneration, reducing the weight of hour-based salary model which is replaced by the determination, assessment and management of the performance of departmental tasks and the corresponding work load.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

3. Training Programme

Under the two-level training system, we organize common, major and key management training at company level, as well as post-specific skill training at department level. Annual training plans for both levels are developed at the year beginning, to govern the training activities during the year, subject to centralized management, monitoring and assessment by the human resources department of the Company.

The training plan for 2015 includes:

1. *Training at company level*

- (1) One Task Force — Training course for mechatronics composite highly skilled assembly workers
- (2) Three Priorities:
 - 1) Training course for backup salespersons;
 - 2) Training course for cutting workers of customers; and
 - 3) Basic management capability building course for work group and team leaders.

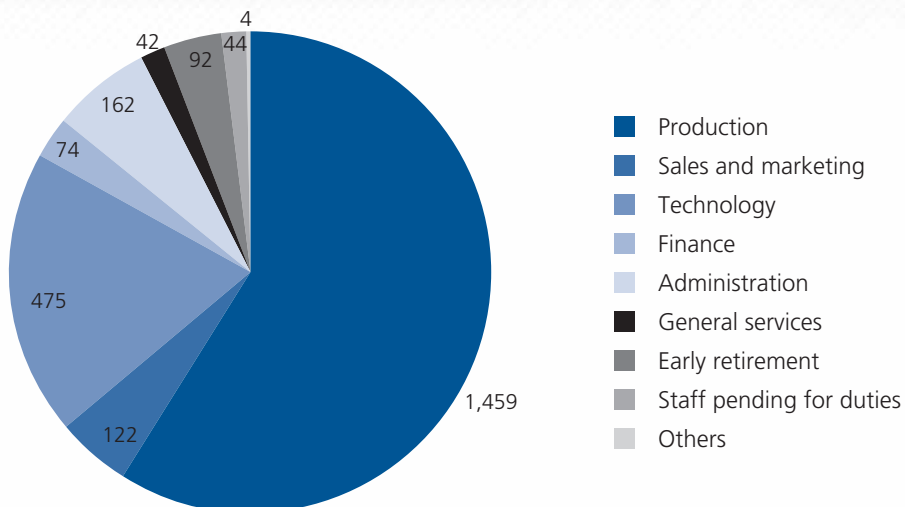
2. *Training at department level*

There will be approximately 80 training courses held by departments, covering 70% posts and employees.

DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

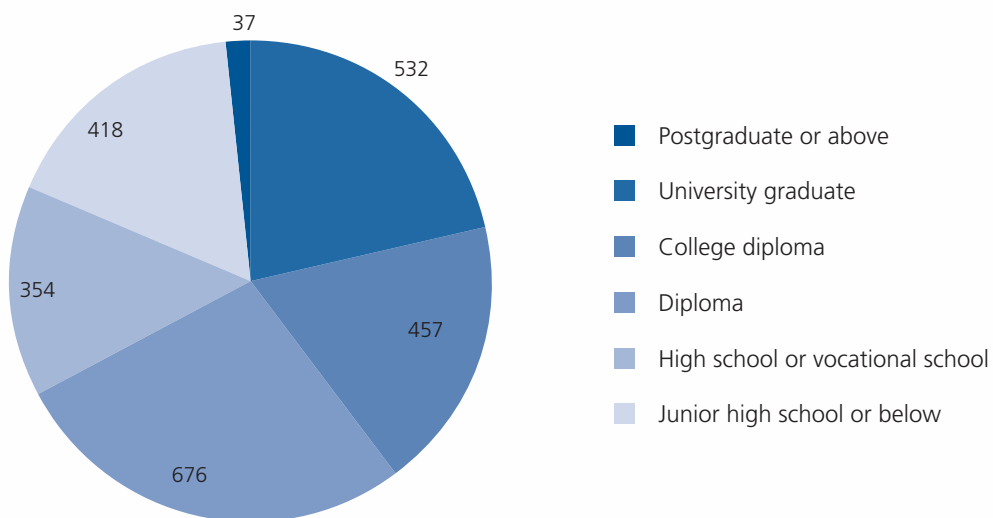
4. Chart of Specialization:

Areas of Specialization



5. 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. Through 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.

There was no difference between the corporate governance of the Company and requirements under “Company Law” and the relevant provisions of the China Securities Regulatory Commission.

CORPORATE GOVERNANCE

II. SHAREHOLDERS' MEETING

| Meeting session | Meeting Date | Name of resolutions of the meeting | Results of resolutions | Designated websites for publishing | Publishing date resolved for disclosure |
|--|---------------------|---|--|---|---|
| The first extraordinary general meeting of 2014 | 18th March 2014 | <ol style="list-style-type: none"> To consider and approve Mr. Zhang Zeshun as the director of the seventh board of directors of the Company; To consider and approve Mr. Zhou Donghong as the director of the seventh board of directors of the Company; To consider and approve Mr. Tang Chunsheng as the independent non-executive director of the seventh board of directors of the Company. | All resolutions were passed at the meeting | www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn | 19th March 2014 |
| Annual general meeting of 2013 | 15th May 2014 | <ol style="list-style-type: none"> the report of the board of directors of the Company for the year 2013; the report of the supervisory committee of the Company for the year 2013; the annual report of the Company for the year 2013; the profit distribution of the Company for the year ended 31 December 2013; the financial budget for the year ending 31 December 2014; proposed to consider and approve the resolution of the financial leasing secured by 150 million machinery assets at the annual general meeting of 2013 and authorizing the Board to take the sole responsibility for this matter and make decisions for specific financial leasing; re-appointing KPMG Huazhen (Special General Partnership) as the auditor of the Company for the year 2014 and authorize the Board to decided the audit fee; the independent non-executive directors' work report for the year 2013. Daily connected transactions of 2014 entered into between the Company and its JV company Kunming TOS and its foreign shareholder; To consider and approve Mr. Liu Qiang as the independent non-executive director of the seventh board of director of the Company To consider and approve the issue of changing scope of consolidation statements pursuant to the amendments to the articles of association of the JV company Kunming TOS. | All resolutions were passed at the meeting | www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn | 16th May 2014 |
| The second extraordinary general meeting of 2014 | 26th September 2014 | <ol style="list-style-type: none"> To consider and approve the 2014 amendment to the articles of the association of the Company to change the scope of business To consider and approve the daily continuing connected transactions (related shareholders avoid voting) To consider and approve the authorization issue of selling products to lessee(s) by way of financial lease | All resolutions were passed at the meeting | www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn | 27th September 2014 |

CORPORATE GOVERNANCE

| Meeting session | Meeting Date | Name of resolutions of the meeting | Results of resolutions | Designated websites for publishing | Publishing date resolved for disclosure |
|--|--------------------|---|--|---|---|
| The third extraordinary general meeting of 2014 | 31st October 2014 | <ol style="list-style-type: none"> 1. To approve Mr. Yang Xiongsheng as an independent non-executive director of the 8th term of board of directors of the Company; 2. To approve Mr. Chen Fusheng as an independent non-executive director of the 8th term of board of directors of the Company; 3. To approve Mr. Tang Chunsheng as an independent non-executive director of the 8th term of board of directors of the Company; 4. To approve Mr. Liu Qiang as an independent non-executive director of the 8th term of board of directors of the Company; 5. To approve the standard allowance of the directors of the 8th term of board of directors and supervisors of the 8th term of supervisory committee; 6. To approve Mr. Wang Xing as a member of the 8th term of board of directors of the Company; 7. To approve Mr. Zhang Xiaoyi as a member of the 8th term of board of directors of the Company; 8. To approve Mr. Gao Minghui as a member of the 8th term of board of directors of the Company; 9. To approve Mr. Liu Yan as a member of the 8th term of board of directors of the Company; 10. To approve Ms. Liu Haijie as a member of the 8th term of board of directors of the Company; 11. To approve Mr. Chang Baoqiang as a member of the 8th term of board of directors of the Company; 12. To approve Mr. Zhang Tao as a member of the 8th term of board of directors of the Company; 13. To approve Mr. Zhang Zeshun as a member of the 8th term of board of directors of the Company; 14. To approve Mr. Shao Li as a member of the 8th term of supervisory committee of the Company; 15. To approve Mr. Fan Hong as a member of the 8th term of supervisory committee of the Company; 16. To approve Mr. Cai Zheming as a member of the 8th term of supervisory committee of the Company; 17. To approve Ms. Jiang Jingying as a member of the 8th term of supervisory committee of the Company; | All resolutions were passed at the meeting | www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn | 1st November 2014 |
| The fourth extraordinary general meeting of 2014 | 19th December 2014 | <ol style="list-style-type: none"> 1. To consider and approve the daily connected transactions of 2015 being entered into between the Company and Kunming TOS Machine Tool Manufacturing Company Limited. | All resolutions were passed at the meeting | www.sse.com.cn, www.hkex.com.hk, kmtcl.com.cn | 20th December 2014 |

CORPORATE GOVERNANCE

III. DIRECTORS AND THEIR DUTIES

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

| Name of director | Whether independent non-executive director | Required attendance | Attendance at board meeting | | | | Failed to be present at two meetings in a row | Attendance at general meeting |
|------------------|--|---------------------|-----------------------------|---------------------------------------|----------------------------|---------|---|---|
| | | | Attended in person | Attended via electronic communication | Attended by representative | Absence | | Number of attendance at general meeting |
| | | | | | | | | |
| Wang xing | No | 12 | 12 | 9 | 0 | 0 | No | 5 |
| Zhang Xiaoyi | No | 12 | 12 | 9 | 0 | 0 | No | 3 |
| Zhang Tao | No | 12 | 12 | 9 | 0 | 0 | No | 5 |
| Chang Baoqiang | No | 2 | 1 | 1 | 1 | 0 | No | 0 |
| Zhang Zeshun | No | 9 | 9 | 6 | 0 | 0 | No | 4 |
| Liu Yan | No | 2 | 1 | 1 | 1 | 0 | No | 0 |
| Liu Haijie | No | 2 | 2 | 1 | 0 | 0 | No | 0 |
| Yang Xiongsheng | Yes | 12 | 12 | 9 | 0 | 0 | No | 0 |
| Chen Fusheng | Yes | 12 | 11 | 9 | 1 | 0 | No | 0 |
| Tang Chunsheng | Yes | 9 | 9 | 6 | 0 | 0 | No | 0 |
| Liu Qiang | Yes | 7 | 7 | 5 | 0 | 0 | No | 0 |
| Ye Nong | No | 10 | 9 | 8 | 1 | 0 | No | 0 |
| Li Zhenxiang | No | 2 | 2 | 2 | 0 | 0 | No | 0 |
| Li Shunzhen | No | 2 | 2 | 2 | 0 | 0 | No | 0 |
| Gao Minghui | No | 12 | 12 | 9 | 0 | 0 | No | 0 |
| Guan Xin | No | 10 | 10 | 8 | 0 | 0 | No | 0 |
| Xiao Jianming | Yes | 3 | 2 | 2 | 1 | 0 | No | 0 |
| Yu Chengting | Yes | 5 | 5 | 4 | 0 | 0 | No | 0 |
| Zhou Donghong | No | 7 | 6 | 5 | 1 | 0 | No | 0 |

Explanation on failed to be present at two meetings in a row

No

| | |
|--|----|
| No. of board meetings held during 2014 | 12 |
| Including: No. of meetings held on-site | 3 |
| No. of meetings held via electronic communication | 9 |
| No. of meetings held on-site with electronic communication | 0 |

2. Objections raised by Independent Directors

| Name of independent director | objections raised by independent directors | Contents of objections | Whether be adopted | Note |
|------------------------------|---|---|--------------------|------|
| Tang Chunsheng | Appointment of the vice general manager Mr. Jin Xiaofeng as chief financial officer to replace Mr. Zhang Zeshun | Reminded to consider the impact of changing chief financial officer before the annual financial statements disclosure | Yes | |

Explanation on objection raised by independent director

Regarding the resolution considered in the 5th meeting of the board of directors of the Company, independent non-executive director raised objection and abstained from voting.

3. Others

None

CORPORATE GOVERNANCE

IV. IMPORTANT OPINIONS AND SUGGESTIONS PROVIDED BY SPECIALIZED COMMITTEES UNDER THE BOARD IN THE PERFORMANCE OF THEIR DUTIES DURING THE REPORTING PERIOD

None

V. EXPLANATION ON DISCOVERY OF COMPANY RISKS BY THE SUPERVISORY COMMITTEE

None

VI. EXPLANATION ON THE COMPANY EXISTING NOT ENSURING THE INDEPENDENCE AND NOT MAINTAINING THE ABILITY TO OPERATE INDEPENDENTLY WITH THE CONTROLLING SHAREHOLDER IN RESPECT OF BUSINESS, PERSONNEL, ASSETS, ORGANIZATION AND FINANCE ETC. ASPECTS

None

VII. THE ESTABLISHMENT AND IMPLEMENTATION OF APPRAISAL AND INCENTIVES SYSTEM TO THE SENIOR MANAGEMENT OFFICER DURING THE REPORTING PERIOD

None

VIII. OTHERS

None

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. As at 31 December 2014, the following material weakness were identified in the Company's internal controls over financial reporting: The internal controls over non-recurring transactions on moulding flask (an ancillary material), spare parts and castings (a work in progress) have not been established. When a transaction occurs, it lacks adequate communication between financial function and business units, and the relevant review control in the subsequent financial reporting process is malfunctioned. This weakness may have a material impact on inventories, accounts receivable, other payables, operating income and operating costs in financial statements. |
| 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. |
| 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 conducted special audit work on the Company and commenced self-assessment for internal control system in 2014. Based on the results of review of internal control over financial reporting, as at the reference date of the internal control assessment report, the Company had a material weakness in internal control over financial reporting. The management and relevant departments conducted a review and summarization in order to strengthen the controls and improve the awareness and level of management. The weakness was relating to the business process with non-recurring transaction, and was primarily due to lack of internal control in place at the time of the transaction. The Company identified such material weakness, and has been carrying out remediation steps to improve the related internal control. The Company also paid attention to the area which gave rise to the material weakness in preparation of its 2014 annual financial statements to avoid/correct the possible re-occurrence of same/similar transaction. |

INTERNAL CONTROL

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. Subsequent arrangements of the board of directors and management of the Company: (1) Established internal control system related to non-recurring transactions, and revised and improved employee position operation training system (The plan will be finished at the end of June, 2015); (2) When major adjustment occurred in the internal organization of the Company in the later days, establishing a sound business training system to strengthen systematic training for the key links or key positions; (3) Establishing effective monitoring and control measures, adding supervision departments, increasing review and improving the awareness and level of management.

Improvement of internal control system associated with financial reporting

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, however, the internal control relating to non-recurring transactions is not yet established.

Whether disclosing the report of self-assessment on internal control: Yes.

The board of directors of the Company has conducted self-assessment for internal control system in 2014. For details, please refer to 2014 self-assessment report for internal control which published as appendix to the annual report on the company's website www.kmtcl.com.cn and the website of Shanghai Stock Exchange www.sse.com.cn on 31st March 2015.

II. RELEVANT INFORMATION ABOUT AUDIT REPORT ON INTERNAL CONTROL

Whether disclosing the internal control audit report: Yes.

The Company engaged the auditor to audit the effectiveness of internal control over financial report as at 31st December 2014, and the auditor has issued the audit report on the internal controls over financial report as at 31st December 2014 according to the requirements. (See the appendix to the annual report published on the website of the Company (www.kmtcl.com.cn) and the website of Shanghai Stock Exchange (www.sse.com.cn) on 30 March 2015 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.

AUDITORS' REPORT

畢馬威華振審字第1501039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 2014, 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' judgement, 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 2014, 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
Ma Yuchong
30th March 2015

CONSOLIDATED BALANCE SHEET

As at 31st December 2014

Unit: RMB
2013

| Item | Note | 2014 | (restated) |
|---|-------|-------------------------|-------------------------|
| CURRENT ASSETS: | | | |
| Cash at bank and on hand | V. 1 | 163,027,997.62 | 181,805,670.00 |
| Bills receivable | V. 2 | 65,234,659.97 | 193,617,520.47 |
| Accounts receivable | V. 3 | 573,067,324.65 | 388,303,316.56 |
| Prepayments | V. 4 | 35,318,463.55 | 49,867,554.97 |
| Other receivables | V. 6 | 18,029,993.23 | 12,645,899.89 |
| Inventories | V. 7 | 896,675,761.84 | 838,202,834.59 |
| Other current assets | V. 8 | 1,724,042.72 | 71,326.31 |
| TOTAL CURRENT ASSETS | | 1,753,078,243.58 | 1,664,514,122.79 |
| NON-CURRENT ASSETS: | | | |
| Available-for-sale financial assets | V. 9 | 1,145,000.00 | 1,145,000.00 |
| Long-term equity investments | V. 10 | 14,384,564.38 | 57,890,592.43 |
| Fixed assets | V. 11 | 549,614,786.49 | 502,762,114.81 |
| Construction in progress | V. 12 | 268,623,936.12 | 299,490,159.28 |
| Intangible assets | V. 13 | 140,625,241.11 | 79,861,501.87 |
| Goodwill | V. 14 | 7,296,277.00 | 7,296,277.00 |
| Long-term deferred expenses | V. 15 | 915,696.54 | 1,307,187.73 |
| Deferred tax assets | V. 16 | 34,856,402.41 | 69,326,643.49 |
| Other non-current assets | V. 17 | 44,581,366.28 | 81,368,385.80 |
| TOTAL NON-CURRENT ASSETS | | 1,062,043,270.33 | 1,100,447,862.41 |
| TOTAL ASSETS | | 2,815,121,513.91 | 2,764,961,985.20 |
| CURRENT LIABILITIES: | | | |
| Short-term loans | V. 18 | 284,500,000.00 | 299,279,000.00 |
| Bills payable | V. 19 | 75,048,188.00 | 67,742,506.00 |
| Accounts payable | V. 20 | 503,704,466.15 | 503,339,606.04 |
| Advances from customers | V. 21 | 229,755,546.36 | 256,365,206.37 |
| Employee benefits payable | V. 22 | 12,709,724.16 | 10,505,114.49 |
| Taxes payable | V. 23 | 6,877,214.09 | 24,202,207.26 |
| Dividends payable | V. 24 | 135,898.49 | 135,898.49 |
| Other payables | V. 25 | 144,228,412.53 | 122,009,581.95 |
| Non-current liabilities due within one year | V. 26 | 19,747,105.78 | 418,509.00 |
| TOTAL CURRENT LIABILITIES | | 1,276,706,555.56 | 1,283,997,629.60 |
| NON-CURRENT LIABILITIES: | | | |
| Long-term borrowings | V. 27 | 200,000,000.00 | – |
| Long-term payables | V. 28 | 11,445,098.47 | 1,492,463.90 |
| Long-term employee benefits payables | V. 29 | 5,110,774.06 | 2,282,771.92 |
| Special payables | V. 30 | 20,947,539.29 | 20,947,539.29 |
| Provisions | V. 31 | 8,811,020.12 | 7,172,981.31 |
| Deferred income | V. 32 | 121,303,008.63 | 104,702,441.79 |
| TOTAL NON-CURRENT LIABILITIES | | 367,617,440.57 | 136,598,198.21 |
| TOTAL LIABILITIES | | 1,644,323,996.13 | 1,420,595,827.81 |

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

As at 31st December 2014

Unit: RMB
2013

| Item | Note | 2014 | (restated) |
|--|-------|--------------------------------|--------------------------------|
| Shareholders' equity: | | | |
| Share capital | V. 33 | 531,081,103.00 | 531,081,103.00 |
| Capital reserve | V. 34 | 19,765,031.17 | 27,303,321.72 |
| Surplus reserve | V. 35 | 117,077,019.33 | 117,077,019.33 |
| Retained earnings | V. 36 | 417,634,420.32 | 621,725,726.85 |
| Total equity attributable to shareholders of the Company | | 1,085,557,573.82 | 1,297,187,170.90 |
| Non-controlling interests | | <u>85,239,943.96</u> | <u>47,178,986.49</u> |
| TOTAL SHAREHOLDERS' EQUITY | | <u>1,170,797,517.78</u> | <u>1,344,366,157.39</u> |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | | <u>2,815,121,513.91</u> | <u>2,764,961,985.20</u> |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

BALANCE SHEET

As at 31st December 2014

Unit: RMB
2013

| Item | Note | 2014 | (restated) |
|---|-------|-------------------------|-------------------------|
| CURRENT ASSETS: | | | |
| Cash at bank and on hand | V. 1 | 121,630,513.96 | 167,060,232.54 |
| Bills receivable | V. 2 | 34,238,097.87 | 170,824,626.17 |
| Accounts receivable | V. 3 | 480,258,094.00 | 298,578,760.89 |
| Prepayments | V. 4 | 27,403,859.44 | 33,096,378.41 |
| Dividends receivable | V. 5 | 11,000,000.00 | 11,000,000.00 |
| Other receivables | V. 6 | 24,243,433.72 | 15,690,264.77 |
| Inventories | V. 7 | 694,522,222.73 | 631,067,009.95 |
| TOTAL CURRENT ASSETS | | 1,393,296,221.72 | 1,327,317,272.73 |
| NON-CURRENT ASSETS: | | | |
| Available-for-sale financial assets | V. 9 | — | — |
| Long-term equity investments | V. 10 | 82,510,801.24 | 82,583,858.28 |
| Fixed assets | V. 11 | 508,007,021.93 | 467,223,213.57 |
| Construction in progress | V. 12 | 265,728,246.26 | 299,113,212.28 |
| Intangible assets | V. 13 | 126,922,443.86 | 68,309,304.39 |
| Long-term deferred expenses | V. 15 | 884,035.54 | 1,165,250.73 |
| Deferred tax assets | V. 16 | 23,655,654.95 | 59,281,392.52 |
| Other non-current assets | V. 17 | 44,581,366.28 | 81,368,385.80 |
| TOTAL NON-CURRENT ASSETS | | 1,052,289,570.06 | 1,059,044,617.57 |
| TOTAL ASSETS | | 2,445,585,791.78 | 2,386,361,890.30 |
| CURRENT LIABILITIES: | | | |
| Short-term loans | V. 18 | 263,500,000.00 | 284,279,000.00 |
| Bills payable | V. 19 | 63,000,000.00 | 47,230,000.00 |
| Accounts payable | V. 20 | 387,551,083.95 | 355,444,252.73 |
| Advances from customers | V. 21 | 124,342,908.17 | 134,336,955.44 |
| Employee benefits payable | V. 22 | 9,294,491.58 | 8,715,208.44 |
| Taxes payable | V. 23 | 3,314,136.98 | 22,465,561.65 |
| Other payables | V. 25 | 144,934,488.09 | 123,335,615.75 |
| Non-current liabilities due within one year | V. 26 | 19,747,105.78 | 418,509.00 |
| TOTAL CURRENT LIABILITIES | | 1,015,684,214.55 | 976,225,103.01 |
| NON-CURRENT LIABILITIES: | | | |
| Long-term borrowings | V. 27 | 200,000,000.00 | — |
| Long-term payables | V. 28 | 11,445,098.47 | 1,492,463.90 |
| Long-term employee benefits payables | V. 29 | 5,110,774.06 | 2,282,771.92 |
| Special payables | V. 30 | 20,947,539.29 | 20,947,539.29 |
| Provisions | V. 31 | 5,728,400.42 | 7,172,981.31 |
| Deferred income | V. 32 | 121,063,008.63 | 104,702,441.79 |
| TOTAL NON-CURRENT LIABILITIES | | 364,294,820.87 | 136,598,198.21 |
| TOTAL LIABILITIES | | 1,379,979,035.42 | 1,112,823,301.22 |

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

BALANCE SHEET

As at 31st December 2014

Unit: RMB
2013

| Item | Note | 2014 | (restated) |
|---|-------|-------------------------|-------------------------|
| Shareholders' equity: | | | |
| Share capital | V. 33 | 531,081,103.00 | 531,081,103.00 |
| Capital reserve | V. 34 | 27,303,321.72 | 27,303,321.72 |
| Surplus reserve | V. 35 | 117,077,019.33 | 117,077,019.33 |
| Retained earnings | V. 36 | 390,145,312.31 | 598,077,145.03 |
| TOTAL SHAREHOLDERS' EQUITY | | 1,065,606,756.36 | 1,273,538,589.08 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | | 2,445,585,791.78 | 2,386,361,890.30 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CONSOLIDATED INCOME STATEMENT

For the year 2014

Unit: RMB
2013

| Item | Note | 2014 | (restated) |
|--|-------|-------------------------|-------------------------|
| 1. Operating income | V. 37 | 867,889,305.64 | 1,029,488,879.74 |
| 2. Less: Operating costs | V. 37 | 702,862,972.16 | 802,498,075.25 |
| Business taxes and surcharges | V. 38 | 7,066,020.66 | 7,286,164.47 |
| Selling and distribution expenses | V. 39 | 116,018,784.59 | 81,664,578.30 |
| General and administrative expenses | V. 40 | 185,208,914.45 | 162,670,709.85 |
| Financial expenses | V. 41 | 17,591,439.64 | 7,118,065.55 |
| Provision/(reversal) of impairment losses | V. 42 | 36,349,437.09 | (2,353,342.17) |
| Add: Investment income | V. 43 | 9,465,233.51 | 589,379.17 |
| Including: Income from investments in associates and joint ventures | | 1,926,942.96 | 589,379.17 |
| 3. Operating loss | | (187,743,029.44) | (28,805,992.34) |
| Add: Non-operating income | V. 44 | 15,634,552.71 | 41,746,283.98 |
| Including: Gains from disposal of non-current assets | | 196,298.44 | 1,270,162.87 |
| Less: Non-operating expenses | V. 45 | 383,925.45 | 3,002,862.67 |
| Including: Losses from disposal of non-current assets | | 313,420.84 | 146,556.46 |
| 4. (Loss)/Profit before income tax | | (172,492,402.18) | 9,937,428.97 |
| Less: Income tax expenses/(benefits) | V. 46 | 36,970,917.88 | (469,494.12) |
| 5. Net (loss)/profit for the year | | (209,463,320.06) | 10,406,923.09 |
| Attributable to: | | | |
| Shareholders of the Company | | (204,091,306.53) | 8,521,796.32 |
| Non-controlling interests | | (5,372,013.53) | 1,885,126.77 |
| 6. Other comprehensive income, net of tax | | - | - |
| Other comprehensive income, net of tax attributable to equity shareholders of the Company | | - | - |
| Other comprehensive income that will never be reclassified to profit or loss | | - | - |
| Other comprehensive income that may be reclassified to profit or loss thereafter when specified conditions are met | | - | - |
| Other comprehensive income, net of tax attributable to non-controlling interests | | - | - |
| 7. Total comprehensive income for the year | | (209,463,320.06) | 10,406,923.09 |
| Attributable to: | | | |
| Shareholders of the Company | | (204,091,306.53) | 8,521,796.32 |
| Non-controlling interests | | (5,372,013.53) | 1,885,126.77 |
| 8. (Loss)/earnings per share: | | | |
| - basic | V. 47 | (0.38) | 0.02 |
| - diluted | V. 47 | (0.38) | 0.02 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

INCOME STATEMENT

For the year 2014

Unit: RMB
2013

| Item | Note | 2014 | 2013 (restated) |
|--|-------|-------------------------|------------------------|
| 1. Operating income | V. 37 | 707,934,093.30 | 883,232,955.09 |
| Less: Operating costs | V. 37 | 595,863,312.18 | 694,774,153.93 |
| Business taxes and surcharges | V. 38 | 5,334,962.40 | 6,492,294.09 |
| Selling and distribution expenses | V. 39 | 105,033,646.49 | 74,693,987.80 |
| General and administrative expenses | V. 40 | 146,579,120.26 | 139,159,453.46 |
| Financial expenses | V. 41 | 16,304,186.75 | 5,462,079.74 |
| Provision / (reversal) of impairment losses | V. 42 | 27,341,544.80 | (5,371,878.70) |
| Add: Investment income | V. 43 | 1,926,942.96 | 589,379.17 |
| Including: Income from investments in associates and joint ventures | | 1,926,942.96 | 589,379.17 |
| 2. Operating loss | | (186,595,736.62) | (31,387,756.06) |
| Add: Non-operating income | V. 44 | 14,499,142.22 | 40,689,528.74 |
| Including: Gains from disposal of non-current assets | | 196,298.44 | 506,407.63 |
| Less: Non-operating expenses | V. 45 | 209,500.75 | 2,796,519.85 |
| Including: Losses from disposal of non-current assets | | 139,661.71 | 115,863.64 |
| 3. (Loss)/Profit before income tax | | (172,306,095.15) | 6,505,252.83 |
| Less: Income tax expenses/(benefits) | V. 46 | 35,625,737.57 | (266,546.49) |
| 4. Net (loss)/profit for the year | | (207,931,832.72) | 6,771,799.32 |
| 5. Other comprehensive income, net of tax | | - | - |
| Other comprehensive income that will never be reclassified to profit or loss | | - | - |
| Other comprehensive income that may be reclassified to profit or loss thereafter when specified conditions are met | | - | - |
| 6. Total comprehensive income for the year | | (207,931,832.72) | 6,771,799.32 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year 2014

Unit: RMB
2013

| Item | Note | 2014 | 2013 |
|---|-----------|------------------|-----------------|
| 1. Cash flows from operating activities: | | | |
| Proceeds from sale of goods and rendering of services | | 903,419,864.00 | 823,104,077.28 |
| Refund of taxes | | – | 5,779,973.42 |
| Proceeds from transferring accounts receivable | | – | 16,384,200.00 |
| Proceeds relating to other operating activities | V. 49 (1) | 25,451,108.74 | 41,251,265.10 |
| Sub-total of cash inflows from operating activities | | 928,870,972.74 | 886,519,515.80 |
| Payment for goods and services | | 643,918,892.71 | 565,968,339.19 |
| Payment to and for employees | | 295,830,872.46 | 268,260,623.97 |
| Payment for all types of taxes | | 74,529,565.63 | 89,523,166.64 |
| Payment relating to other operating activities | V. 49(2) | 46,847,658.47 | 40,355,838.04 |
| Sub-total of cash outflows from operating activities | | 1,061,126,989.27 | 964,107,967.84 |
| Net cash flows from operating activities | V. 50 (1) | (132,256,016.53) | (77,588,452.04) |
| 2. Cash flows from investing activities: | | | |
| Investment returns received | | – | 678,688.42 |
| Net cash received from disposal of fixed assets, intangible assets and other long-term assets | | 458,338.84 | 1,945,344.19 |
| Net proceeds from acquisition of a subsidiary | V. 50 (2) | 22,569,575.21 | – |
| Proceeds from security deposits | | 115,221,777.02 | 3,759,527.95 |
| Sub-total of cash inflows from investing activities | | 138,249,691.07 | 6,383,560.56 |
| Payment for acquisition of fixed assets, intangible assets and other long-term assets | | 43,248,333.56 | 68,620,411.97 |
| Payment for security deposits | | 111,625,711.18 | 36,964,295.80 |
| Sub-total of cash outflows from investing activities | | 154,874,044.74 | 105,584,707.77 |
| Net cash flows from investing activities | | (16,624,353.67) | (99,201,147.21) |

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year 2014

Unit: RMB
2013

| Item | Note | 2014 | 2013 |
|--|-----------|------------------------|-----------------------|
| 3. Cash flows from financing activities: | | | |
| Proceeds from borrowings | | 554,020,000.00 | 339,279,000.00 |
| Proceeds relating to other financing activities | V. 49 (3) | – | 47,230,000.00 |
| Sub-total of cash inflows from financing activities | | 554,020,000.00 | 386,509,000.00 |
| Repayments of borrowings | | 343,193,447.35 | 145,000,000.00 |
| Payment for distribution of dividends, profit or repayment of interest | | 29,385,836.74 | 14,746,923.26 |
| Payment relating to other financing activities | V. 49 (4) | 47,230,000.00 | – |
| Sub-total of cash outflows from financing activities | | 419,809,284.09 | 159,746,923.26 |
| Net cash flows from financing activities | | 134,210,715.91 | 226,762,076.74 |
| 4. Effect of foreign exchange rate changes on cash and cash equivalents | | (511,952.25) | (258,616.07) |
| 5. Net increase in cash and cash equivalents ("()" for net decrease) | | (15,181,606.54) | 49,713,861.42 |
| Add: Cash and cash equivalents at the beginning of the year | V. 50 (1) | 139,391,654.25 | 89,677,792.83 |
| 6. Cash and cash equivalents at the end of the year | | 124,210,047.71 | 139,391,654.25 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CASH FLOW STATEMENT

For the year 2014

| Item | Note | 2014 | Unit: RMB 2013 |
|---|-----------|-------------------------|-------------------------|
| 1. Cash flows from operating activities: | | | |
| Proceeds from sale of goods and rendering of services | | 722,004,008.27 | 687,568,386.28 |
| Refund of taxes | | – | 5,779,973.42 |
| Proceeds from transferring accounts receivable | | – | 16,384,200.00 |
| Proceeds relating to other operating activities | V. 49 (1) | <u>23,611,514.19</u> | <u>40,830,659.90</u> |
| Sub-total of cash inflows from operating activities | | <u>745,615,522.46</u> | <u>750,563,219.60</u> |
| Payment for goods and services | | 518,380,272.93 | 471,087,921.35 |
| Payment to and for employees | | 262,209,706.15 | 242,173,266.91 |
| Payment for all types of taxes | | 68,145,613.71 | 79,014,481.00 |
| Payment relating to other operating activities | V. 49 (2) | <u>32,502,111.21</u> | <u>24,052,767.00</u> |
| Sub-total of cash outflows from operating activities | | <u>881,237,704.00</u> | <u>816,328,436.26</u> |
| Net cash flows from operating activities | V. 50 (1) | <u>(135,622,181.54)</u> | <u>(65,765,216.66)</u> |
| 2. Cash flows from investing activities: | | | |
| Investment returns received | | 2,000,000.00 | 678,688.42 |
| Net cash received from disposal of fixed assets, intangible assets and other long-term assets | | 256,538.84 | 153,800.00 |
| Proceeds from security deposits | | <u>92,421,799.12</u> | – |
| Sub-total of cash inflows from investing activities | | <u>94,678,337.96</u> | <u>832,488.42</u> |
| Payment for acquisition of fixed assets, intangible assets and other long-term assets | | 42,941,159.22 | 67,679,108.44 |
| Net Payment for acquisition of a subsidiary | | – | – |
| Payment for security deposits | | <u>87,040,674.95</u> | <u>35,398,295.80</u> |
| Sub-total of cash outflows from investing activities | | <u>129,981,834.17</u> | <u>103,077,404.24</u> |
| Net cash flows from investing activities | | <u>(35,303,496.21)</u> | <u>(102,244,915.82)</u> |

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CASH FLOW STATEMENT

For the year 2014

Unit: RMB
2013

| Item | Note | 2014 | 2013 |
|--|-----------|------------------------|-----------------------|
| 3. Cash flows from financing activities: | | | |
| Proceeds from borrowings | | 528,500,000.00 | 324,279,000.00 |
| Proceeds relating to other financing activities | V. 49 (3) | – | 47,230,000.00 |
| Sub-total of cash inflows from financing activities | | 528,500,000.00 | 371,509,000.00 |
| Repayments of borrowings | | 323,673,447.35 | 130,000,000.00 |
| Payment for distribution of dividends, profit Or repayment of interest | | 26,221,348.74 | 13,505,565.21 |
| Payment for relating to other financing activities | V. 49 (4) | 47,230,000.00 | – |
| Sub-total of cash outflows from financing activities | | 397,124,796.09 | 143,505,565.21 |
| Net cash flows from financing activities | | 131,375,203.91 | 228,003,434.79 |
| 4. Effect of foreign exchange rate changes on cash and cash equivalents | | (498,120.57) | (258,616.07) |
| 5. Net increase in cash and cash equivalents ("()" for net decrease) | | (40,048,594.41) | 59,734,686.24 |
| Add: Cash and cash equivalents at the beginning of the year | V. 50 (1) | 131,661,936.74 | 71,927,250.50 |
| 6. Cash and cash equivalents at the end of the year | V. 50 (3) | 91,613,342.33 | 131,661,936.74 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Unit: RMB

| Item | Note | 2014 | | | | | | 2013 (restated) | | | | | | Total | |
|---|---------|---|-----------------|----------------------------|-----------------|-------------------|--------------------------|---|-----------------|----------------------------|-----------------|-------------------|--------------------------|---------------|------------------|
| | | Attributable to shareholders of the Company | | | | | | Attributable to shareholders of the Company | | | | | | | |
| | | Share capital | Capital reserve | Other comprehensive income | Surplus reserve | Retained earnings | Non-controlling interest | Share capital | Capital reserve | Other comprehensive income | Surplus reserve | Retained earnings | Non-controlling interest | | |
| 1. Balance at the end of last year | | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 650,275,276.12 | 47,178,986.49 | 1,372,915,706.66 | 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 |
| Add: corrections of prior period errors | III. 33 | - | - | - | - | (28,549,549.27) | - | (28,549,549.27) | - | - | - | - | (29,631,181.25) | - | (29,631,181.25) |
| 2. Balance at the beginning of the year | | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 621,725,726.85 | 47,178,986.49 | 1,344,366,157.39 | 531,081,103.00 | 27,303,321.72 | - | 116,508,002.60 | 613,772,947.26 | 45,293,859.72 | 1,333,959,234.30 |
| 3. Changes in equity for the year (*)(*) for decrease) | | | | | | | | | | | | | | | |
| (1) Total comprehensive income | | - | - | - | - | (204,091,306.53) | (5,372,013.53) | (209,463,320.06) | - | - | - | - | 8,521,796.32 | 1,885,126.77 | 10,406,923.09 |
| (2) Appropriation of profits | V. 36 | - | - | - | - | - | - | - | - | - | - | 569,016.73 | (569,016.73) | - | - |
| Appropriation of surplus reserve | V. 35 | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| (3) Others | | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Impact of getting control over a subsidiary to Non-controlling interests | | - | (7,538,290.55) | - | - | - | 43,432,971.00 | 35,894,680.45 | - | - | - | - | - | - | - |
| 4. Balance at the end of the year | | 531,081,103.00 | 19,765,031.17 | - | 117,077,019.33 | 417,634,420.32 | 85,239,949.96 | 1,170,797,517.78 | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 621,725,726.85 | 47,178,986.49 | 1,344,366,157.39 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 form part of these financial statements.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Unit: RMB

| Item | Note | 2014 | | | | | | 2013 (restated) | | | | | |
|--|------|----------------|-----------------|----------------------------|-----------------|-------------------|------------------|-----------------|-----------------|----------------------------|-----------------|-------------------|------------------|
| | | Share capital | Capital reserve | Other comprehensive income | Surplus reserve | Retained earnings | Total | Share capital | Capital reserve | Other comprehensive income | Surplus reserve | Retained earnings | Total |
| 1. Balance at the end of last year | | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 626,626,694.30 | 1,302,088,138.35 | 531,081,103.00 | 27,303,321.72 | - | 116,508,002.60 | 621,505,543.69 | 1,296,397,971.01 |
| Add: corrections of prior period errors | 三-33 | - | - | - | - | (28,549,549.27) | (28,549,549.27) | - | - | - | - | (29,631,181.25) | (29,631,181.25) |
| 2. Balance at the beginning of the year | | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 598,077,145.03 | 1,273,538,589.08 | 531,081,103.00 | 27,303,321.72 | - | 116,508,002.60 | 591,874,362.44 | 1,266,766,789.76 |
| 3. Changes in equity for the year (*()) for decrease) | | | | | | | | | | | | | |
| (1) Total comprehensive income | | - | - | - | - | (207,931,832.72) | (207,931,832.72) | - | - | - | - | 6,771,799.32 | 6,771,799.32 |
| (2) Appropriation of profits | 五-36 | | | | | | | | | | | | |
| Appropriation of surplus reserve | 五-35 | | | | | | | | | | 569,016.73 | (569,016.73) | |
| 4. Balance at the end of the year | | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 390,145,312.31 | 1,065,606,756.36 | 531,081,103.00 | 27,303,321.72 | - | 117,077,019.33 | 598,077,145.03 | 1,273,538,589.08 |

The financial statements were approved by the Board of Directors of the Company on 30th March 2015.

Legal representative of the Company:
Wang Xing

The person in charge of accounting affairs:
Jin Xiaofeng

The head of the accounting department:
Li Hongning

(Seal of the Company)

Notes to financial statements set out on pages 68 to 195 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.

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(I) CORPORATE INFORMATION *(Continued)*

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. The term of operation of the Company will expire on 31st October 2050. Please refer to note VII to the financial statements for the information of the subsidiaries of the Company.

Please refer to note VII to the financial statements for the information of the Group's new subsidiary during the reporting period.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(II) BASIS OF PREPARATION OF FINANCIAL STATEMENTS

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

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES

The accounting policies on recognition and measurement of provision for bad debts in receivables, measurement of inventories, depreciation of fixed assets, amortization of intangible assets, qualifying R&D expenses for capitalization and recognition and measurement of revenue are adopted according to the Group's business characteristics, details of which are set out in the relevant notes.

1. 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" issued by the Ministry of Finance. These financial statements provide a true and complete presentation of the consolidated financial position and financial position as at 31st December 2014, the consolidated results of operations and results of operations and the consolidated cash flows and cash flows of the Company for the year 2014.

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 2014 in relation to the disclosure requirements of the financial statements and their accompanying notes.

These financial statements also comply with the disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and the Hong Kong Companies Ordinance, which for this financial year and the comparative period continue to be those of the predecessor Hong Kong Companies Ordinance (Cap. 32), in accordance with transitional and saving arrangements for Part 9 of the new Hong Kong Companies Ordinance (Cap. 622), "Accounts and Audit", which are set out in sections 76 to 87 of Schedule 11 to that Ordinance.

2. Accounting period

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

3. Operating cycle

The Company takes the period from the acquisition of assets for processing to the realization of cash or cash equivalents as a normal operating cycle. The operating cycles of the Company's principal businesses are usually shorter than 12 months.

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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

(1) *Business combinations involving enterprises under common control*

A business combination involving enterprises under common control is a business combination in which all of the combining enterprises are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. The assets acquired and liabilities assumed are measured based on their carrying amounts in the consolidated financial statements of the ultimate controlling party at the combination date. The difference between the carrying amount of the net assets acquired and the consideration paid for the combination (or the total par value of shares issued) is adjusted against share premium in the capital reserve, with any excess adjusted against retained earnings. Any costs directly attributable to the combination are recognised in profit or loss when incurred. The combination date is the date on which one combining enterprise obtains control of other combining enterprises.

(2) *Business combinations involving enterprises not under common control*

A business combination involving enterprises not under common control is a business combination in which all of the combining enterprises are not ultimately controlled by the same party or parties both before and after the business combination. Where (1) the aggregate of the acquisition-date fair value of assets transferred (including the acquirer's previously held equity interest in the acquiree), liabilities incurred or assumed, and equity securities issued by the acquirer, in exchange for control of the acquiree, exceeds (2) the acquirer's interest in the acquisition-date fair value of the acquiree's identifiable net assets, the difference is recognised as goodwill (see Note III.17). If (1) is less than (2), the difference is recognised in profit or loss for the current period. The costs of issuing equity or debt securities as a part of the consideration for the acquisition are included in the carrying amounts of these equity or debt securities upon initial recognition. Other acquisition-related costs are expensed when incurred. Any difference between the fair value and the carrying amount of the assets transferred as consideration is recognised in profit or loss. The acquiree's identifiable asset, liabilities and contingent liabilities, if the recognition criteria are met, are recognised by the Group at their acquisition-date fair value. The acquisition date is the date on which the acquirer obtains control of the acquiree.

For a business combination involving enterprises not under common control and achieved in stages, the Group remeasures its previously-held equity interest in the acquiree to its acquisition-date fair value and recognises any resulting difference between the fair value and the carrying amount as investment income for the current period. In addition, any amount recognised in other comprehensive income that may be reclassified to profit or loss, in prior reporting periods relating to the previously-held equity interest, and any other changes in the owners' equity under equity accounting, are transferred to investment income in the period in which the acquisition occurs (see Note III.12(2)(b)).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

6. Preparation of consolidated financial statements

(1) *General principles*

The scope of consolidated financial statements is based on control and the consolidated financial statements comprise the Company and its subsidiaries. Control exists when the investor has all of following: power over the investee; exposure, or rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. When assessing whether the Group has power, only substantive rights (held by the Group and other parties) are considered. The financial position, financial performance and cash flows of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Non-controlling interests are presented separately in the consolidated balance sheet within shareholders' equity. Net profit or loss attributable to non-controlling shareholders is presented separately in the consolidated income statement below the net profit line item. Total comprehensive income attributable to non-controlling shareholders is presented separately in the consolidated income statement below the total comprehensive income line item.

When the amount of loss for the current period attributable to the non-controlling shareholders of a subsidiary exceeds the non-controlling shareholders' portion of the opening balance of owners' equity of the subsidiary, the excess is still allocated against the non-controlling 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 unrealised profit or loss arising from intra-group transactions, are eliminated when preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, unless they represent impairment losses that are recognised in the financial statements.

(2) *Subsidiaries acquired through a business combination*

Where a subsidiary was acquired during the reporting period, through a business combination involving enterprises 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 the ultimate controlling party first obtained control. The opening balances and the comparative figures of the consolidated financial statements are also restated. In the preparation of the consolidated financial statements, the subsidiary's assets and liabilities based on their carrying amounts in the financial statements of the ultimate controlling party are included in the consolidated balance sheet, and financial performance is included in the consolidated income statement, respectively, from the date that the ultimate parent company of the Company obtains the control of the subsidiary to be consolidated.

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

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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

(3) Disposal of subsidiaries

When the Group loses control of a subsidiary, the Group derecognizes assets, liabilities, non-controlling interests and other related items in shareholders' equity in relation to that subsidiary. The remaining equity investment is remeasured at its fair value at the date when control is lost. Any resulting gains or losses are recognized as investment income of the current period when control is lost.

When the Group loses control of a subsidiary in multiple transactions in which it disposes of its long-term equity investment in the subsidiary in stages, the following are considered to determine whether the Group should account for the multiple transactions as a bundled transaction:

- arrangements are entered into at the same time or in contemplation of each other;
- arrangements work together to achieve an overall commercial effect;
- the occurrence of one arrangement is dependent on the occurrence of at least one other arrangement; and
- one arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements.

If each of the multiple transactions does not form part of a bundled transaction, the transactions conducted before the loss of control of the subsidiary are accounted for in accordance with the accounting policies for partial disposal of equity investment in subsidiaries where control is retained (see Note III.6(4)).

If each of the multiple transactions forms part of a bundled transaction which eventually results in the loss of control in the subsidiary, these multiple transactions are accounted for as a single transaction. In the consolidated financial statements, the difference between the consideration received and the corresponding proportion of the subsidiary's net assets (subsequently measured since the acquisition date) in each transaction prior to the loss of control is recognized in other comprehensive income and transferred to profit or loss when the parent eventually loses control of the subsidiary.

(4) Change in non-controlling interests

Where the Company acquires a non-controlling interest from a subsidiary's non-controlling 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.

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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.

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 III. 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.

9. Financial instruments

Financial instruments of the Group comprise cash at bank and on hand, equity investment except for long-term equity investment (see Note III. 12), 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, receivables, available-for-sale financial assets 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.

– Available-for-sale financial assets

Non-derivative financial assets designated as available-for-sale at initial recognition and financial assets not classified in other categories are classified as available-for-sale financial assets by the Group.

Available-for-sale investments in equity instruments whose fair value cannot be measured reliably are measured at cost subsequent to initial recognition. Cash dividends from available-for-sale investments in equity instruments are recognized in profit or loss for the period when the investee announces distribution of dividends.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

9. Financial instruments *(Continued)*

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

- 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) 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.

(4) 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:

- significant financial difficulty of the issuer or borrower;
- a breach of contract by the borrower, such as a default or delinquency in interest or principal payments;
- strong probability that the borrower will enter bankruptcy or go through another type of financial reorganisation;

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

Equity instrument investment not quoted in an active market or its fair value not be reliably measured will not be reversed.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

9. Financial instruments *(Continued)*

(5) Equity instruments

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

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, should the credit risk characteristics are consistent with other receivables, the accounts receivable should combine with other receivables to provide bad debt provision by credit risk characteristic combination (see (c) below). If the impairment not being incurred after the individual test, should the credit risk characteristics are not consistent with other receivables, then no additional impairment test will be carried out.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

10. Impairment of receivables *(Continued)*

(b) *Insignificant single receivables which are provided for bad and doubtful debts:*

| | |
|--|--|
| Reasons for and method of provision for bad and doubtful debts for receivables that are individually insignificant | Individual impairment test will be conducted to insignificant single receivables if there is any objective evidence which shows that such receivables incur impairment or there is any change in their credit risk characteristics which makes them different from those of other receivables in the same group, and provision for bad and doubtful debts will be made according to the difference between the present value of future cash flow and the book value. |
|--|--|

(c) *Bad debt provision for accounts receivable by combination with credit risk characters*

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

Bad debt provision for accounts receivable by combination with credit risk characters

| | |
|----------------------------------|-----------------------|
| Receivables from third parties | Ageing analysis |
| Receivables from related parties | Individual assessment |

In group of receivables from third parties, provision for bad debts made by ageing analysis:

| Aging | Percentage of provision for accounts receivable (%) | Percentage of provision for other receivables (%) |
|----------------------------------|--|--|
| 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 of receivables from related parties, 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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

11. Inventories

(1) *Classification and cost*

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.

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.

(2) *Determination of cost of inventories*

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

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.

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

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.

12. Long-term equity investments

(1) *Investment cost of long-term equity investments*

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

- The initial cost of a long-term equity investment acquired through a business combination involving enterprises under common control is the Company's share of the carrying amount of the subsidiary's equity in the consolidated financial statements of the ultimate controlling party at the combination date. The difference between the initial investment cost and the carrying amount of the consideration given is adjusted to the share premium in the capital reserve, with any excess adjusted against retained earnings.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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

(1) Investment cost of long-term equity investments *(Continued)*

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

- For a long-term equity investment obtained through a business combination not involving enterprises under common control, the initial cost comprises the aggregate of the fair value of assets transferred, liabilities incurred or 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 through multiple transactions in stages which do not form a bundled transaction, the initial cost comprises the carrying amount of the 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

- A long-term equity investment acquired other than through a business combination is initially recognised at the amount of cash paid if the Group acquires the investment by cash, or at the fair value of the equity securities issued if an investment is acquired by issuing equity securities.

(2) Subsequent measurement of long-term equity investment

(a) Investments in subsidiaries

In the Company's separate financial statements, long-term equity investments in subsidiaries are accounted for using the cost method for subsequent measurement. Except for cash dividends or profit distributions declared but not yet distributed that have been included in the price or consideration paid in obtaining the investments, the Company recognises its share of the cash dividends or profit distributions declared by the investee as investment income in the current period.

The investments in subsidiaries are stated in the balance sheet at cost less accumulated impairment losses.

For the impairment of the investments in subsidiaries, refer to Note III.19.

In the Group's consolidated financial statements, investments in subsidiaries are accounted for in accordance with the policies described in Note III.6.

(b) Investment in joint ventures and associates

A joint venture is an arrangement whereby the Group and other parties have joint control (see Note III.12(3)) and rights to the net assets of the arrangement.

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

An investment in a joint venture or an associate is accounted for using the equity method for subsequent measurement.

Under the equity method:

- Where the initial 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 recognised at cost. Where the initial investment cost is less than the Group's interest in the fair value of the investee's identifiable net assets at the date of acquisition, the investment is initially recognised at the investor's share of the fair value of the investee's identifiable net assets, and the difference is recognised in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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

(2) *Subsequent measurement of long-term equity investment (Continued)*

(b) Investment in joint ventures and associates *(Continued)*

- After the acquisition of the investment, the Group recognises its share of the investee's profit or loss and other comprehensive income as investment income or losses and other comprehensive income respectively, and adjusts the carrying amount of the investment accordingly. Once the investee declares any cash dividends or profit distributions, the carrying amount of the investment is reduced by that amount attributable to the Group. Changes in the Group's share of the investee's owners' equity, other than those arising from the investee's net profit or loss, other comprehensive income or profit distribution ("other changes in owners' equity"), is recognised directly in the Group's equity, and the carrying amount of the investment is adjusted accordingly.
- In calculating its share of the investee's net profits or losses, other comprehensive income and other changes in owners' equity, the Group recognises investment income and other comprehensive income after making appropriate adjustments to align the accounting policies or accounting periods with those of the Group based on the fair value of the investee's identifiable net assets at the date of acquisition. Unrealised profits and losses resulting from transactions between the Group and its associates or joint ventures are eliminated to the extent of the Group's interest in the associates or joint ventures. Unrealised losses resulting from transactions between the Group and its associates or joint ventures are eliminated in the same way as unrealised gains but only to the extent that there is no impairment.
- The Group discontinues recognising its share of further 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 joint venture or associate is reduced to zero, except to the extent that the Group has an obligation to assume additional losses. If the joint venture or associate subsequently reports net profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

For the impairment of the investments in joint ventures and associates, refer to Note III.19.

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

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (activities with significant impact on the returns of the arrangement) require the unanimous consent of the parties sharing control.

The following factors are usually considered when assessing whether the Group can exercise joint control over an investee:

- Whether no single participant party is in a position to control the investee's related activities unilaterally
- Whether strategic decisions relating to the investee's related activities require the unanimous consent of all participant parties that sharing of control

Significant influence is the power to participate in the financial and operating policy decisions of an investee but does not have control or joint control over those policies.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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 III.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.

(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.

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 III.19.

(4) For the recognition, measurement and depreciation of fixed assets acquired under finance leases, refer to the accounting policy set out in Note III.26 (2).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

13. Fixed assets *(Continued)*

(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 III.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 III.19).

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

15. Borrowing costs *(Continued)*

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 (limited to intangible assets with finite useful life) and impairment losses (see Note III.19). For intangible assets with finite useful life, 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.

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

| <u>Item</u> | <u>Amortization period</u> |
|------------------|----------------------------|
| Land use rights | 50 years |
| Various software | 3 – 10 years |
| Others | 5 – 10 years |

An intangible asset is regarded as having an indefinite useful life and is not amortised when there is no foreseeable limit to the period over which the asset is expected to generate economic benefits for the Group. As at the balance sheet date, the Group did not have any intangible assets with indefinite useful lives.

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 III.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 III.19). Goodwill is transferred when its related assets or assets group is disposed, and recognized in profit or loss for the period.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

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 and financial assets

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
- Intangible assets
- Long-term equity investment
- Long-term deferred expenses
- Goodwill

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 benefits 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 (see Note III.20) 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.

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

20. Fair value measurement

Unless otherwise stated, the Group measures the fair value according to the following principles:

Fair value is the price which the market participants can receive from sale of an asset or shall pay for the transfer a liability in an orderly transaction occurring on the measurement date.

When estimating fair value, the Group considers the characteristics (including status and location of assets, restrictions on the sale or use of assets, etc.) considered by market participants when they determine the price of relevant assets or liabilities on the measurement date, and adopts valuation techniques which are applicable in the current situation and supported by sufficient available data and other information. The valuation techniques mainly include market approach, income approach and cost approach.

21. 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.

A provision is initially measured at the best estimate of the expenditure required to settle the related present obligation. Where the effect of time value of money is material, provisions are determined by discounting the expected future cash flows. Factors pertaining to a contingency such as the risks, uncertainties and time value of money are taken into account as a whole in reaching the best estimate. Where there is a continuous range of possible outcomes for the expenditure required, and each possible outcome in that range is as likely as any other, the best estimate is the mid-point of that range. Otherwise, the best estimate is determined based on the following circumstances:

- Where the contingency involves a single item, the best estimate is the most likely outcome.
- Where the contingency involves multiple items, the best estimate is determined by weighting all possible outcomes by their associated probabilities.

The Group reviewed the carrying amount of a provision at the balance sheet date and adjusted the carrying amount to the current best estimate.

22. Revenue

Revenue is the gross inflow of economic benefits 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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

22. Revenue *(Continued)*

(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.

23. Employee benefits

(1) *Short-term employee benefits*

Employee wages or salaries, bonuses, social security contributions such as medical insurance, work injury insurance, maternity insurance and housing fund, measured at the amount incurred or at the applicable benchmarks and rates, are recognised as a liability as the employee provides services, with a corresponding charge to profit or loss or included in the cost of assets where appropriate.

(2) *Post-employment benefits – defined contribution plans*

Pursuant to the relevant laws and regulations of the People's Republic of China, the Group participated in a defined contribution basic pension insurance in the social insurance system established and managed by government organisations. The Group makes contributions to basic pension insurance plans based on the applicable benchmarks and rates stipulated by the government. Basic pension insurance contributions are recognised as part of the cost of assets or charged to profit or loss as the related services are rendered by the employees.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

23. Employee benefits *(Continued)*

(3) Termination benefits

When the Group terminates the employment with employees before the employment contracts expire, or provides compensation under an offer to encourage employees to accept voluntary redundancy, a provision is recognised with a corresponding expense in profit or loss at the earlier of the following dates:

- When the Group cannot unilaterally withdraw the offer of termination benefits because of an employee termination plan or a curtailment proposal
- When the Group has a formal detailed restructuring plan involving the payment of termination benefits and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

(4) 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.

24. 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.

A government grant obtained by the Group for acquisition or construction or in the form of long-term asset is deemed to be related to an asset. A government grant obtained by the Group other than asset-related government grants is deemed to be related to income. A government grant related to an asset is recognized initially as deferred income and equally amortized to profit or loss in the same period over the useful life of the asset. A government grant related to income 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 period in which the expenses are recognized. A government grant that compensates the Group for expenses or losses incurred is recognized in profit or loss immediately.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

25. 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 benefits 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)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

26. 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 III.13 (2) and III.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 III.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.

(3) *Sale and leaseback*

Sale and leaseback refers to the arrangement where the seller (being the lessee) of a self-developed or externally-acquired asset leases back the same asset from the purchaser (being the lesser). Where a leaseback transaction is determined to be accounted for under a finance lease, the difference between the sale price and the carrying amount of the involving asset is deferred and amortised over the useful lives of the leased asset as an adjustment to the depreciation expenses. Where a leaseback transaction is determined to be accounted for under an operating lease and there is conclusive evidence that the leaseback transaction is established at fair value, the difference between the sale price and the carrying amount of the involving asset shall be included in profit or loss. Where a leaseback transaction is not established at fair value, relevant profit or losses shall be recognized in the current period. However, where relevant losses will be offset by future lease payment which is less than the market price, such losses shall be deferred and amortised over the expected useful lives of the involving asset using the same method as applied in recognizing rental expenses. Where the sale price is higher than the fair value, such excess shall be deferred and amortised over the expected useful lives of the asset.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

27. Assets held for sale

The non-current assets (or disposal group, same below) which meet both of the following conditions, are classified as held for sale. A disposal group is a group of assets that are handled collectively through disposals or other approaches in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

- Such assets in their current condition may be sold immediately only in accordance with the usual terms of sales of such assets;
- The Group has resolved on the disposal of such assets;
- The Company has signed the Irrevocable transfer agreement with the transferee, and the transfer will be completed within one year.

Non-current assets classified as held for sale (excluding financial assets (refer to Note III. 9) and deferred tax assets (refer to Note III. 25)) are measured at carrying amount or fair value (refer to Note III. 20) less disposal cost, whichever is lower. The excess of their carrying amount over their fair value (refer to Note III. 20) less disposal cost are recognized as impairment loss on assets.

No provisions for depreciation are made in respect of fixed assets classified as held for sale.

28. 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.

29. 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) joint ventures of the Group, including subsidiaries of joint ventures;
- (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;

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

29. Related parties *(Continued)*

- (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.

30. 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.

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

31. 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. 14 and Note IX, other key sources of estimation uncertainty are as follows:

(a) *Impairment of receivables*

As described in Note III.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 III. 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.

(c) *Impairment of other assets excluding inventories and financial assets*

As described in Note III.19, other assets excluding inventories and financial assets 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, and the fair value of the asset cannot be estimated reliably. Therefore, the present value of the estimated future cash flows will be as recoverable amount. 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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

31. Significant accounting estimates and judgments *(Continued)*

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

As described in Notes III.11, 13 and 15, 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. 31, 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.

(f) *Deferred tax assets*

When assessing whether there will be sufficient future taxable profits available against which the deductible temporary differences can be utilised, the Group recognises deferred tax assets to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences can be utilised, using tax rates that would apply in the period when the asset would be utilised. In determining the amount of deferred tax assets, the Group makes reasonable judgements and estimates about the timing and amount of taxable profits to be utilised in the following periods, and of the tax rates applicable in the future according to the existing tax policies and other relevant regulations. If the actual timing and amount of future taxable profits or the actual applicable tax rates differ from the estimates made by management, the differences affect the amount of deferred tax assets.

32. Changes of accounting policies

(1) *Description of and reasons for changes in accounting policies*

The Group early adopted the following new standards and revised standards from 1 January 2014:

- (i) Accounting Standards for Business Enterprises No. 2 – Long-term Equity Investments (“CAS 2 (2014)”)
- (ii) Accounting Standards for Business Enterprises No. 41 – Disclosure of Interests in Other Entities (“CAS 41”)

In addition, the Company has adopted Accounting Rules on Classification between Financial Liabilities and Equity Instruments as well as the Related Accounting Treatment (“Cai Kuai [2014] No. 13”) since 17 March 2014 and Accounting Standards for Business Enterprises No. 37 – Financial Instruments: Presentation and Disclosures (“CAS 37 (2014)”) in the 2014 annual financial statements.

The Group has early adopted Accounting Standards for Business Enterprises No. 9 – Employee Benefits (“CAS 9 (2014)”) and Accounting Standards for Business Enterprises No. 30 – Presentation of Financial Statements (“CAS 30 (2014)”) since 1 January 2013. The application guidance of CAS 9 (2014) and CAS 30 (2014) were subsequently revised and became effective since 1 July 2014. The Group has adopted those application guidances since 1 July 2014.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

32. Changes of accounting policies *(Continued)*

(1) *Description of and reasons for changes in accounting policies (Continued)*

The principal accounting policies which adopt the above Accounting Standards for Business Enterprises are shown in notes III. In the preparation of the consolidated financial statements, the accounting policies adopted by subsidiaries are consistent with those adopted by the Company.

Impacts of the adoption of the above accounting standards and regulations mentioned above are discussed follows:

- (i) Long-term equity investments
Before adopting CAS 2 (2014), 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, are recognised as other long-term equity investments. Such investments are then accounted for using the cost method. After adopting CAS 2 (2014), such investments are now accounted for using the accounting policy related to financial instruments(see note III.9). The relevant comparative amounts have been retrospectively adjusted.

In addition, the Group has revised its accounting policies in relation to the equity method as a result of the revision brought about by CAS 2 (2014)(see note III.12). The relevant comparative items have been retrospectively adjusted.

CAS 2 (2014) also revised some requirements with respect to the scope, recognition and measurement of long-term equity investments, and the disclosure requirements have been stipulated in CAS 41. The Group has reassessed the effect of the revisions and concluded that the revisions do not have any material impact on the Group's financial statements (including current and comparative periods).

- (ii) Disclosures of interests in other entities
CAS 41 modifies and specifies disclosure requirements relevant to an enterprise's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The Group has provided disclosures accordingly in related notes in accordance with this standard.
- (iii) Presentation of financial statements
In accordance with CAS 9 (2014) and CAS 30 (2014) and the application guidance, the Group has modified the presentation of its financial statements, including presenting separately the items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that will never be reclassified to profit or loss in its income statement.

The presentation of the comparative information has been adjusted.

(2) *The effect of changes on the financial statements*

Effects of the above changes in accounting policies on Group's and the Company's financial statements are summarised as follows:

The effect of changes on the financial statements of the current year

The items of the consolidated income statement and income statement for 2014 as prepared after adopting the changed accounting policies are not affected, when compared to those prepared on the assumption of adopting the pre-changed accounting policies.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (Continued)

32. Changes of accounting policies (Continued)

(2) The effect of changes on the financial statements (Continued)

When the items of the consolidated balance sheet and balance sheet as at 31 December 2014 prepared after adopting the changed accounting policies are compared with those prepared on the assumption of adopting the pre-changed accounting policies, the increases or decreases in the affected items are as follows:

| | Unit: RMB | |
|-------------------------------------|--|------------------|
| | Increase in amount ("()" for decrease) of presentation items after adopting changed accounting policies | |
| | The Group | The Company |
| Long-term equity investments | (1,145,000.00) | – |
| Available-for-sale financial assets | 1,145,000.00 | – |
| Employee benefits payable | (5,110,774.06) | (5,110,774.06) |
| Long-term employee benefits payable | 5,110,774.06 | 5,110,774.06 |
| Deferred income | 121,303,008.63 | 121,063,008.63 |
| Other non-current liabilities | (121,303,008.63) | (121,063,008.63) |

Effects of the above changes in accounting policies on consolidated balance sheet and balance sheet as at 31 December 2013 are summarised as follows:

The Group

| | Note | Unit: RMB | | |
|-------------------------------------|-------------------|----------------------|------------------|---------------------|
| | | Before adjustment | Adjustment | After adjustment |
| Long-term equity investments | III.32 (1) (i) | 59,035,592.43 | (1,145,000.00) | 57,890,592.43 |
| Available-for-sale | III.32 (1) (i) | – | 1,145,000.00 | 1,145,000.00 |
| Employee benefits payable | III. 32 (1) (iii) | 12,787,886.41 | (2,282,771.92) | 10,505,114.49 |
| Long-term employee benefits payable | III. 32 (1) (iii) | – | 2,282,771.92 | 2,282,771.92 |
| Deferred income | III. 32 (1) (iii) | – | 104,702,441.79 | 104,702,441.79 |
| Other non-current liabilities | III. (1) (iii) | 104,702,441.79 | (104,702,441.79) | – |

The Company

| | Note | Unit: RMB | | |
|-------------------------------------|-------------------|----------------------|------------------|---------------------|
| | | Before adjustment | Adjustment | After adjustment |
| Employee benefits payable | III. 32 (1) (iii) | 10,997,980.36 | (2,282,771.92) | 8,715,208.44 |
| Long-term employee benefits payable | III. 32 (1) (iii) | – | 2,282,771.92 | 2,282,771.92 |
| Deferred income | III. 32 (1) (iii) | – | 104,702,441.79 | 104,702,441.79 |
| Other non-current liabilities | III. 32 (1) (iii) | 104,702,441.79 | (104,702,441.79) | – |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

33. Correction of accounting errors in prior years

1. Description of accounting errors in prior years

(a) Accounting treatment of moulding flask as at 31 December 2012

Moulding flask is one of the ancillary materials being used in the Company's production, and according to the Company's accounting policy, the carrying amount of moulding flask should be fully charged to profit or loss upon usage. As at 31 December 2012, the Company recorded certain moulding flasks, which had been used in production and charged to profit or loss, within in work-in-progress at amount of RMB 34,860,213.24, with a corresponding reversal of cost of revenue at the same amount. This accounting treatment is not consistent with the Company's accounting policy.

As a result of this accounting error, cost of revenue was understated by RMB34,860,213.24, and income tax benefits was understated by RMB5,229,031.99 both in the Company's consolidated and company-level income statements for the year ended 31 December 2012. Moreover, inventory balance was overstated by RMB34,860,213.24 and deferred tax assets was understated by RMB5,229,031.99 both on the Company's consolidated and company-level balance sheet as at 31 December 2012. With respect to the statement of changes in equity for the year ended 31 December 2013, the accounting error resulted in an overstatement of RMB29,631,181.25 on the opening and closing balances of the Company's shareholders' equity both at consolidated and company level.

(b) Accounting treatment for the repair transaction of moulding flask in the year ended 31 December 2013

In 2013, the Company employed a third party to repair the above-mentioned moulding flasks. The Company entered into two separate agreements for this repair transaction, including an agreement to sell the moulding flasks to the party who was to carry out the repair work, and another agreement to re-purchase these moulding flasks back upon completion of the repair work. For accounting purpose, the Company recorded these two agreements as separate sales and purchase transactions. The Company recorded revenue and cost of revenue in respect of the sales agreement in 2013, and then recorded purchase of moulding flasks in inventories in respect of the purchase agreement in 2014. In 2014, pursuant to the requirement of the relevant accounting standards, and in order to reflect the commercial substance of the underlying transaction, the Company considered that these 2 agreements should be accounted for as a repair transaction, and the related repair & maintenance cost should be recorded in profit or loss in 2013.

As a result of this accounting error, revenue was overstated by RMB33,346,375.53, cost of revenue was overstated by RMB34,618,883.73, and income tax benefits was overstated by RMB190,876.22 both in the Company's consolidated and company-level income statements for the year ended 31 December 2013. Moreover, accounts receivable was overstated by RMB33,346,375.53, other payables was understated by RMB241,329.51, and deferred tax assets was overstated by RMB190,876.22 both on the Company's consolidated and company-level balance sheet as at 31 December 2013. With respect to the statement of changes in equity for the year ended 31 December 2013, the accounting error resulted in an understatement of RMB1,081,631.98 in both the Company's consolidated and company-level shareholders' equity at 31 December 2013.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

33. Correction of accounting errors in prior years *(Continued)*

(2) Impact of correction of accounting errors in prior years

The Company corrected the above-mentioned two accounting errors in 2014. The relevant comparative items have been retrospectively adjusted.

Effects of correction of the above accounting errors in prior years in the 2013 consolidated income statement and the Group's opening and closing balances of shareholders' equity for 2013 are summarised as follows:

The Group

| | Net profit increase ("()" for decrease) RMB | Closing balances of shareholders' equity increase ("()" for decrease) RMB | Opening balances of shareholders' equity increase ("()" for decrease) RMB |
|--|--|--|--|
| Net profit and shareholders' equity before adjustment | 9,325,291.11 | 1,372,915,706.66 | 1,363,590,415.55 |
| – Moulding flasks as at 31 December 2012 | – | (29,631,181.25) | (29,631,181.25) |
| – Repair transaction of moulding flasks in the year ended 31 December 2013 | 1,081,631.98 | 1,081,631.98 | – |
| Total | <u>1,081,631.98</u> | <u>(28,549,549.27)</u> | <u>(29,631,181.25)</u> |
| Net profit and shareholders' equity after adjustment | <u>10,406,923.09</u> | <u>1,344,366,157.39</u> | <u>1,333,959,234.30</u> |

The Company

| | Net profit increase ("()" for decrease) RMB | Closing balances of shareholders' equity increase ("()" for decrease) RMB | Opening balances of shareholders' equity increase ("()" for decrease) RMB |
|--|--|--|--|
| Net profit and shareholders' equity before adjustment | 5,690,167.34 | 1,302,088,138.35 | 1,296,397,971.01 |
| – Moulding flasks as at 31 December 2012 | – | (29,631,181.25) | (29,631,181.25) |
| – Repair transaction of moulding flasks in the year ended 31 December 2013 | 1,081,631.98 | 1,081,631.98 | – |
| Total | <u>1,081,631.98</u> | <u>(28,549,549.27)</u> | <u>(29,631,181.25)</u> |
| Net profit and shareholders' equity after adjustment | <u>6,771,799.32</u> | <u>1,273,538,589.08</u> | <u>1,266,766,789.76</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(III) SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES *(Continued)*

33. Correction of accounting errors in prior years *(Continued)*

(2) *Impact of correction of accounting errors in prior years (Continued)*

Affected assets and liabilities items in the consolidated balance sheet as at 31 December 2013:

The Group

| | Before adjustment RMB | Adjustment RMB | After adjustment RMB |
|---------------------|-----------------------------|-------------------|----------------------------|
| Accounts receivable | 421,649,692.09 | (33,346,375.53) | 388,303,316.56 |
| Deferred tax assets | 64,288,487.72 | 5,038,155.77 | 69,326,643.49 |
| Other payables | 121,768,252.44 | 241,329.51 | 122,009,581.95 |

The Company

| | Before adjustment RMB | Adjustment RMB | After adjustment RMB |
|---------------------|-----------------------------|-------------------|----------------------------|
| Accounts receivable | 331,925,136.42 | (33,346,375.53) | 298,578,760.89 |
| Deferred tax assets | 54,243,236.75 | 5,038,155.77 | 59,281,392.52 |
| Other payables | 123,094,286.24 | 241,329.51 | 123,335,615.75 |

Affected income and expenses items in the consolidated income statement for the year ended 31 December 2013:

The Group

| | Before adjustment RMB | Adjustment RMB | After adjustment RMB |
|-------------------------------|-----------------------------|-------------------|----------------------------|
| Operating income | 1,062,835,255.27 | (33,346,375.53) | 1,029,488,879.74 |
| Operating costs | 837,116,958.98 | (34,618,883.73) | 802,498,075.25 |
| Income tax (benefits)/expense | (660,370.34) | 190,876.22 | (469,494.12) |

The Company

| | Before adjustment RMB | Adjustment RMB | After adjustment RMB |
|-------------------------------|-----------------------------|-------------------|----------------------------|
| Operating income | 916,579,330.62 | (33,346,375.53) | 883,232,955.09 |
| Operating costs | 729,393,037.66 | (34,618,883.73) | 694,774,153.93 |
| Income tax (benefits)/expense | (457,422.71) | 190,876.22 | (266,546.49) |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

(IV) 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 2014 of the Company and the Company's subsidiaries Kunming TOS, Xi'an Ser, and Changsha Ser is 15% (2013: 15%) and the applicable rate of income tax of other subsidiaries for 2014 is 25% (2013: 25%).

2. Preferential tax policies and approvals

(1) Preferential tax policies of the Company

On 13 September 2012, the Company was recognised as a high and new technology enterprise ("HNTE") with a valid period of three years. In accordance with China's relevant laws and regulations in the PRC, the Company is entitled to the preferential tax rate for HNTE from 2012 to 2014. The Company is subject to 15% corporate income tax rate for the year 2014 (2013: 15%).

(2) Preferential tax policies of the subsidiaries

Kunming TOS was recognised as an HNTE with the high-tech enterprise certificate expiring on 27 August 2016. In accordance with relevant laws and regulations in the PRC, Kunming TOS is entitled to the preferential tax rate for HNTE from 2013 to 2015. Kunming TOS is subject to 15% corporate income tax rate for the year 2014 (2013:15%).

According to the Notice Issues on Tax Policies for the Implementation of the Strategy Further Exploration and Development of the Western Region, Kunming TOS qualifies as an enterprise engaging in encouraged industries as listed in the Encouraged Industries Catalog in the Western Region. Kunming TOS has submitted an application to Kunming State Taxation bureau for applying a preferential income tax rate of 15% for the year 2013, and such application was approved by Kunming State Taxation Bureau on 17 April 2014. Hence Kunming TOS was subject to 15% corporate income tax rate for 2013.

Kunming TOS satisfied the above the conditions in 2014 and would be subject to 15% corporate income tax rate. The Company has submitted an application to Kunming State Taxation bureau for applying a preferential income tax rate of 15% for the year 2014, and such application will be approved by Kunming State Taxation Bureau in April 2015.

The Company's subsidiaries, Xi'an Ser and Changsha Ser were recognised as HNTE with HNTE certificates respectively expiring on 9 October 2014 and 3 November 2014. In accordance with relevant laws and regulations in the PRC, the two companies are entitled to the preferential tax rate for HNTE from 2011 to 2013. Xi'an Ser and Changsha Ser were subject to 15% corporate tax rate for 2013.

Xi'an Ser was recognised as HNTE in 11 November 2014 with a valid period of three years. In accordance with China's relevant laws and regulations in the PRC, the Company is entitled to the preferential tax rate for HNTE from 2014 to 2016. The Company is subject to 15% corporate income tax rate for the year 2014.

According to the Notice of publicity of Hunan Province the second batch proposed recognised high-tech enterprises list in 2014 issued by the office of Hunan Province High-tech Enterprise Management Leading Group in 15 October 2015, Changsha Ser continued to be recognised as HNTE. Management anticipated that it will be able to renew the HNTE certificates for another three years, so that it will be able to continue to enjoy the preferential tax rate from 2014 to 2016. Therefore, Changsha Ser applies 15% corporate income tax rate for 2014.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

1. Cash at bank and on hand

The Group

| Item | 2014 | Unit: RMB |
|-------------------|-----------------------|-----------------------|
| | | 2013 |
| Cash on hand | 644,101.93 | 675,618.41 |
| Cash at bank | 123,565,945.78 | 138,716,035.84 |
| Security deposits | 38,817,949.91 | 42,414,015.75 |
| Total | <u>163,027,997.62</u> | <u>181,805,670.00</u> |

As at 31st December 2014, security deposits of RMB38,817,949.91 (at 31st December 2013: RMB42,414,015.75) were pledged for the Group's bank guarantees and bank acceptance notes.

The Company

| Item | 2014 | Unit: RMB |
|-------------------|-----------------------|-----------------------|
| | | 2013 |
| Cash on hand | 494,497.43 | 618,407.91 |
| Cash at bank | 91,118,844.90 | 131,043,528.83 |
| Security deposits | 30,017,171.63 | 35,398,295.80 |
| Total | <u>121,630,513.96</u> | <u>167,060,232.54</u> |

As at 31st December 2014, security deposits of RMB30,017,171.63 (at 31st December 2013: RMB35,398,295.80) were pledged for the Company's bank guarantees and bank acceptance notes.

2. Bills receivable

(1) Classification of bills receivable

The Group

| Type | 2014 | Unit: RMB |
|-----------------------------|----------------------|-----------------------|
| | | 2013 |
| Bank acceptance notes | 49,153,485.97 | 182,630,419.80 |
| Commercial acceptance notes | 16,081,174.00 | 10,987,100.67 |
| Total | <u>65,234,659.97</u> | <u>193,617,520.47</u> |

The Company

| Type | 2014 | Unit: RMB |
|-----------------------------|----------------------|-----------------------|
| | | 2013 |
| Bank acceptance notes | 20,267,064.87 | 159,837,525.50 |
| Commercial acceptance notes | 13,971,033.00 | 10,987,100.67 |
| Total | <u>34,238,097.87</u> | <u>170,824,626.17</u> |

The above bills receivable are due within one year.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

2. Bills receivable (Continued)

(2) Bills receivables pledged at the end of the year:

The Group

| Type | <i>Unit: RMB</i> Amount pledged at the end of the year |
|-----------------------|--|
| Bank acceptance bills | <u>2,000,000.00</u> |

As at 31 December 2014, the bank acceptance bills pledged by the Group were the collaterals used to secure bills payable of RMB2,000,000.00.

As at 31 December 2014, the Company had no pledged bills receivable.

(3) Bills receivable endorsed or discounted at the end of the year and undue at the balance sheet date:

The Group

| Type | Amount derecognized at the end of the year | <i>Unit: RMB</i> Amount not derecognized at the end of the year |
|-----------------------------|---|---|
| Bank acceptance bills | 210,205,004.87 | – |
| Commercial acceptance bills | <u>–</u> | <u>8,526,233.00</u> |
| Total | <u>210,205,004.87</u> | <u>8,526,233.00</u> |

The Company

| Type | Amount derecognized at the end of the year | <i>Unit: RMB</i> Amount not derecognized at the end of the year |
|-----------------------------|---|---|
| Bank acceptance bills | 175,583,623.17 | – |
| Commercial acceptance bills | <u>–</u> | <u>8,526,233.00</u> |
| Total | <u>175,583,623.17</u> | <u>8,526,233.00</u> |

(4) As at the end of the year, neither the Group nor the Company had bills receivable transferred to accounts receivable due to non-compliance of any bill drawer.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

3. Accounts receivable

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

The Group

| Type | 2014 | Unit: RMB |
|--|-----------------------|-----------------------|
| | | 2013 (restated) |
| Third party | 808,171,448.96 | 587,473,461.24 |
| Related party | 1,396,094.95 | 4,538,294.31 |
| Subtotal | 809,567,543.91 | 592,011,755.55 |
| Less: provision for bad and doubtful debts | 236,500,219.26 | 203,708,438.99 |
| Total | <u>573,067,324.65</u> | <u>388,303,316.56</u> |

The Company

| Type | 2014 | Unit: RMB |
|--|-----------------------|-----------------------|
| | | 2013 (restated) |
| Third party | 652,149,854.64 | 449,292,162.97 |
| Related party | 5,213,761.32 | 4,782,294.31 |
| Subtotal | 657,363,615.96 | 454,074,457.28 |
| Less: provision for bad and doubtful debts | 177,105,521.96 | 155,495,696.39 |
| Total | <u>480,258,094.00</u> | <u>298,578,760.89</u> |

(2) Ageing analysis of accounts receivable:

The Group

| Ageing | 2014 | Unit: RMB |
|--|-----------------------|-----------------------|
| | | 2013 (restated) |
| Within one year (including one year) | 382,709,235.37 | 283,594,139.93 |
| 1-2 years (including two years) | 165,949,537.84 | 83,892,146.48 |
| 2-3 years (including three years) | 68,439,039.19 | 68,811,561.56 |
| Over three years | 192,469,731.51 | 155,713,907.58 |
| Subtotal | 809,567,543.91 | 592,011,755.55 |
| Less: provision for bad and doubtful debts | 236,500,219.26 | 203,708,438.99 |
| Total | <u>573,067,324.65</u> | <u>388,303,316.56</u> |

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)

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

The Company

| Ageing | Unit: RMB | |
|--|-----------------------|-----------------------|
| | 2014 | 2013 (restated) |
| Within one year (including one year) | 352,535,610.85 | 251,805,273.41 |
| 1-2 years (including two years) | 134,364,955.50 | 55,994,242.51 |
| 2-3 years (including three years) | 45,050,171.61 | 34,123,038.26 |
| Over three years | 125,412,878.00 | 112,151,903.10 |
| Subtotal | 657,363,615.96 | 454,074,457.28 |
| Less: provision for bad and doubtful debts | 177,105,521.96 | 155,495,696.39 |
| Total | <u>480,258,094.00</u> | <u>298,578,760.89</u> |

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

(3) Analysis of accounts receivable by category

The Group

| Type | Note | Unit: RMB | | | | | | | | | |
|---|----------------|-----------------------|--------------------------------------|-----------------------|-----------------|--------------------------------------|-----------------------|---------------|-----------------------|----------|-----------------------|
| | | 2014 | | | 2013 (restated) | | | | | | |
| | | Carrying amount | Provision for bad and doubtful debts | Book value | Carrying amount | Provision for bad and doubtful debts | Book value | | | | |
| Amount | Proportion (%) | Amount | Proportion (%) | Amount | Proportion (%) | Amount | Proportion (%) | Amount | Proportion (%) | | |
| Individually significant accounts receivable with individual bad debt provision | (a) | 255,983,203.56 | 31.62 | 12,465,295.79 | 4.87 | 243,517,907.77 | 56,155,757.01 | 9.49 | 12,381,227.10 | 22.05 | 43,774,529.91 |
| Bad debt provision for accounts receivable by combination with credit risk characters | | | | | | | | | | | |
| Receivable due from the third party | (b) | 542,738,902.76 | 67.04 | 223,165,573.47 | 41.12 | 319,573,329.29 | 523,850,221.22 | 88.49 | 190,718,486.98 | 36.41 | 333,131,734.24 |
| Receivable due from the related party | (c) | 1,396,094.95 | 0.17 | - | - | 1,396,094.95 | 4,538,294.31 | 0.77 | - | - | 4,538,294.31 |
| Sub-total | | 544,134,997.71 | 67.21 | 223,165,573.47 | 41.01 | 320,969,424.24 | 528,388,515.53 | 89.26 | 190,718,486.98 | 36.09 | 337,670,028.55 |
| Individually not significant accounts receivable but with individual bad debt provision | | 9,449,342.64 | 1.17 | 869,350.00 | 9.20 | 8,579,992.64 | 7,467,483.01 | 1.25 | 608,724.91 | 8.15 | 6,858,758.10 |
| Total | | <u>809,567,543.91</u> | <u>100.00</u> | <u>236,500,219.26</u> | <u>-</u> | <u>573,067,324.65</u> | <u>592,011,755.55</u> | <u>100.00</u> | <u>203,708,438.99</u> | <u>-</u> | <u>388,303,316.56</u> |

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 (Continued)

The Company

Unit: RMB

| Type | Note | 2014 | | | 2013 (restated) | | | | | | |
|---|------|-----------------------|----------------|--------------------------------------|-----------------|-----------------------|-----------------------|--------------------------------------|-----------------------|----------|-----------------------|
| | | Carrying amount | | Provision for bad and doubtful debts | Book value | Carrying amount | | Provision for bad and doubtful debts | Book value | | |
| | | Amount | Proportion (%) | Amount | Proportion (%) | Amount | Proportion (%) | Amount | Proportion (%) | | |
| Individually significant accounts receivable with individual bad debt provision | (a) | 211,755,446.55 | 32.21 | 4,036,468.69 | 1.91 | 207,718,977.86 | - | - | - | - | |
| Bad debt provision for accounts receivable by combination with credit risk characters | | | | | | | | | | | |
| Receivable due from the third party | (b) | 437,381,253.09 | 66.54 | 173,069,053.27 | 39.57 | 264,312,199.82 | 446,767,162.97 | 98.39 | 155,495,696.39 | 34.80 | 291,271,466.58 |
| Receivable due from the related party | (c) | 5,213,761.32 | 0.79 | - | - | 5,213,761.32 | 4,782,294.31 | 1.05 | - | - | 4,782,294.31 |
| Sub-total | | 442,595,014.41 | 67.33 | 173,069,053.27 | 39.10 | 269,525,961.14 | 451,549,457.28 | 99.44 | 155,495,696.39 | 34.44 | 296,053,760.89 |
| Individually not significant accounts receivable but with individual bad debt provision | | 3,013,155.00 | 0.46 | - | - | 3,013,155.00 | 2,525,000.00 | 0.56 | - | - | 2,525,000.00 |
| Total | | <u>657,363,615.96</u> | <u>100.00</u> | <u>177,105,521.96</u> | <u>-</u> | <u>480,258,094.00</u> | <u>454,074,457.28</u> | <u>100.00</u> | <u>155,495,696.39</u> | <u>-</u> | <u>298,578,760.89</u> |

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

The Group

Unit: RMB

| Type | Carrying amount | Provision for bad and doubtful debts | Proportion | Reasons for making provision |
|---|-----------------------|--------------------------------------|-------------|--|
| Single accounts receivable over RMB7,000,000 in machine tools business | 211,755,446.55 | 4,036,468.69 | 1.91 | Impairment occurred under individual assessment method |
| Single accounts receivable over RMB7,000,000 in turbo machines business | 44,227,757.01 | 8,428,827.10 | 19.06 | Impairment occurred under individual assessment method |
| Total | <u>255,983,203.56</u> | <u>12,465,295.79</u> | <u>4.87</u> | - |

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 (Continued)

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

The Company

| Type | Carrying amount | Provision for bad and doubtful debts | Proportion | Unit: RMB Reasons for making provision |
|--|-----------------------|--------------------------------------|-------------|--|
| Single accounts receivable over RMB7,000,000 in machine tools business | <u>211,755,446.55</u> | <u>4,036,468.69</u> | <u>1.91</u> | Impairment occurred under individual assessment method |

- (b) Provisions for accounts receivable due from the third party in groups using ageing analysis method:

The Group

| Ageing | Carrying amount | Provision for bad and doubtful debts | Proportion | Unit: RMB |
|-----------------|-----------------------|--------------------------------------|------------|-----------|
| Within one year | 221,010,567.55 | 11,050,528.38 | 5% | |
| 1-2 years | 120,458,476.52 | 36,137,542.96 | 30% | |
| 2-3 years | 43,511,039.19 | 26,106,623.52 | 60% | |
| Over 3 years | <u>157,758,819.50</u> | <u>149,870,878.61</u> | <u>95%</u> | |
| Total | <u>542,738,902.76</u> | <u>223,165,573.47</u> | <u>-</u> | |

The Company

| Ageing | Carrying amount | Provision for bad and doubtful debts | Proportion | Unit: RMB |
|-----------------|-----------------------|--------------------------------------|------------|-----------|
| Within one year | 191,564,776.66 | 9,578,238.83 | 5% | |
| 1-2 years | 89,178,581.82 | 26,753,574.55 | 30% | |
| 2-3 years | 34,482,171.61 | 20,689,302.97 | 60% | |
| Over 3 years | <u>122,155,723.00</u> | <u>116,047,936.92</u> | <u>95%</u> | |
| Total | <u>437,381,253.09</u> | <u>173,069,053.27</u> | <u>-</u> | |

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 (Continued)

(c) Accounts receivable due from related parties

The Group

| Name | Note | Relationship with the Company | Amount | Unit: RMB |
|---|------|-------------------------------|---------------------|---|
| | | | | Percentage of total accounts receivable (%) |
| Shenyang Machine Tool Co., Ltd. t (Shenyang Machine Tool) | X.6 | Related party | 1,123,219.99 | 0.14 |
| Shiess GmbH, Germany ("Shiess") | X.6 | Related party | 272,874.96 | 0.03 |
| Total | | | <u>1,396,094.95</u> | <u>0.17</u> |

The Company

| Name | Note | Relationship with the Company | Amount | Unit: RMB |
|-----------------------|------|-------------------------------|---------------------|---|
| | | | | Percentage of total accounts receivable (%) |
| Kunming TOS | X.6 | Subsidiary | 3,573,666.37 | 0.54 |
| Shenyang Machine Tool | X.6 | Related party | 1,123,219.99 | 0.17 |
| Shiess | X.6 | Related party | 272,874.96 | 0.04 |
| Changsha Ser | X.6 | Subsidiary | 244,000.00 | 0.04 |
| Total | | | <u>5,213,761.32</u> | <u>0.79</u> |

As at 31st December 2014, the Group and the Company 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.

(4) The provision, recovery and reversal of bad debts during the year:

The Group

| | Note | 2014 | Unit: RMB 2013 |
|--|------|-----------------------|-----------------------|
| Opening balance | | 203,708,438.99 | 231,765,313.91 |
| Provision for the year | | 27,760,486.06 | 48,194,656.77 |
| Recovery or reversal during the year | (a) | (424,543.95) | (52,089,403.65) |
| Write-off during the year | (b) | (186,000.00) | (5,301,054.97) |
| Transferred out for the year | (c) | – | (18,861,073.07) |
| Increase in number of business combinations not under common control | | <u>5,641,838.16</u> | – |
| Closing balance | | <u>236,500,219.26</u> | <u>203,708,438.99</u> |

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) *The provision, recovery and reversal of bad debts during the year: (Continued)*

The Company

| | Note | 2014 | Unit: RMB 2013 |
|--------------------------------------|------|-----------------------|-----------------------|
| Opening balance | | 155,495,696.39 | 185,547,357.79 |
| Provision for the year | | 21,795,825.57 | 45,785,228.60 |
| Recovery or reversal during the year | (a) | – | (51,674,761.96) |
| Write-off during the year | (b) | (186,000.00) | (5,301,054.97) |
| Transferred out for the year | (c) | – | (18,861,073.07) |
| Closing balance | | <u>177,105,521.96</u> | <u>155,495,696.39</u> |

(a) Neither the Group nor the Company had any recovered or reversed provisions for bad debts of more than RMB7 million during the year.

(b) Neither the Group nor the Company had any written-off accounts payable of more than RMB7 million during the year.

(c) In order to expedite the recovery of funds to ease the cash flow pressure on the Company, the Company entered into accounts receivable transfer agreements with each of seven third parties in December 2013. Pursuant to these agreements, the Company transferred a few or single accounts receivable to the corresponding transferees. The agreed transfer price was equal to the original book value or 50%-85% of the original book value of these accounts receivable. None of the seven transferees is a related party of the Company or the Group, or holds more than 5% (including 5%) of the Company's shares carrying voting rights. The accumulated provision for bad debts of RMB18,861,073.07 before transfer was subsequently transferred out.

(5) *Top five accounts receivable by debtor as at the end of the year*

The Group's top five balances of accounts receivable as at the end of the year totalled RMB114,296,612.67, accounting for 14.12% of the Group's total balance of accounts receivable as at the end of the year, and the aggregate provision for bad debts made accordingly amounted to RMB8,190,799.27.

The Company's top five balances of accounts receivable at the end of the year totalled RMB100,416,933.54, accounting for 15.28% of the Group's total balance of accounts receivable as at the end of the year, and the aggregate provision for bad debts made accordingly amounted to RMB1,134,297.29.

(6) *Credit policy*

The account receivables of the Group were mainly in the form of payment for goods with granted credit period and 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. Prepayments

(1) Prepayments by category

The Group

| Item | Unit: RMB | |
|--------------------------|----------------------|----------------------|
| | 2014 | 2013 |
| Prepayment for materials | 31,744,907.32 | 44,447,262.87 |
| Others | 3,573,556.23 | 5,420,292.10 |
| Total | <u>35,318,463.55</u> | <u>49,867,554.97</u> |

The Company

| Item | Unit: RMB | |
|--------------------------|----------------------|----------------------|
| | 2014 | 2013 |
| Prepayment for materials | 24,077,246.84 | 27,676,086.31 |
| Others | 3,326,612.60 | 5,420,292.10 |
| Total | <u>27,403,859.44</u> | <u>33,096,378.41</u> |

(2) Ageing analysis of prepayments

The Group

| Ageing | 2014 | | 2013 | |
|---|----------------------|----------------|----------------------|----------------|
| | Amount | Proportion (%) | Amount | Proportion (%) |
| Within one year (including one year) | 14,030,835.51 | 39.73 | 48,419,364.91 | 97.10 |
| 1-2 years (including 2 years) | 19,143,210.60 | 54.20 | 1,232,334.73 | 2.47 |
| 2-3 years (including 3 years) | 1,402,086.27 | 3.97 | 29,376.00 | 0.06 |
| Over 3 years | 742,331.17 | 2.10 | 186,479.33 | 0.37 |
| Total | <u>35,318,463.55</u> | <u>100.00</u> | <u>49,867,554.97</u> | <u>100.00</u> |

The Company

| Ageing | 2014 | | 2013 | |
|---|----------------------|----------------|----------------------|----------------|
| | Amount | Proportion (%) | Amount | Proportion (%) |
| Within one year (including one year) | 9,713,049.07 | 35.44 | 32,596,940.77 | 98.49 |
| 1-2 years (including 2 years) | 17,257,944.90 | 62.98 | 368,297.64 | 1.11 |
| 2-3 years (including 3 years) | 301,749.03 | 1.10 | – | – |
| Over 3 years | 131,116.44 | 0.48 | 131,140.00 | 0.40 |
| Total | <u>27,403,859.44</u> | <u>100.00</u> | <u>33,096,378.41</u> | <u>100.00</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

4. Prepayments (Continued)

(2) Ageing analysis of prepayments (Continued)

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

As at the end of the year, the Group and the Company's prepayment with an ageing of over one year and an amount of more than RMB7 million was the prepayment to Shenyang Shenjiao Coals Sales Agency for purchase of coke. The prepayment was not settled due to the fact that the coke purchased had not been received. As of March 2015, such prepayment was refunded in full.

(3) Top five balances of prepayments by prepaid item as at the end of the year

The Group's top five balances of prepayments as at the end of the year totalled RMB21,428,662.52, accounting for 60.67% of the Group's total balance of prepayments as at the end of the year.

The Company's top five balances of prepayments as at the end of the year totalled RMB20,535,477.94, accounting for 74.94% of the Company's total balance of prepayments as at the end of the year.

5. Dividend receivables

(1) Dividend receivables by category

The Company

| Invested company | Unit: RMB | |
|------------------|----------------------|----------------------|
| | 2014 | 2013 |
| Xi'an Ser | <u>11,000,000.00</u> | <u>11,000,000.00</u> |

(2) Significant Dividend receivables ageing over one year

The Company

| Invested company | Closing balance | Ageing | Unrecovered reason | Unit: RMB |
|------------------|-----------------|-------------|---|--|
| | | | | Whether occurred impairment and the judgment basis |
| Xi'an Ser | 11,000,000.00 | Over 1 year | Xi'an Serb did not pay the cash dividend to the Company which declared but not paid | No impairment occurred under individual assessment |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

6. Other receivables

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

The Group

| Type of customers | 2014 | Unit: RMB |
|--|----------------------|----------------------|
| | | 2013 |
| Third party | 21,624,670.38 | 13,815,287.13 |
| Related party | 447.68 | 1,775,181.97 |
| Sub-total | 21,625,118.06 | 15,590,469.10 |
| Less: provision for bad and doubtful debts | 3,595,124.83 | 2,944,569.21 |
| Total | <u>18,029,993.23</u> | <u>12,645,899.89</u> |

The Company

| Type of customers | 2014 | Unit: RMB |
|--|----------------------|----------------------|
| | | 2013 |
| Third party | 17,586,601.35 | 8,649,446.10 |
| Related party | 9,690,754.44 | 9,435,488.73 |
| Sub-total | 27,277,355.79 | 18,084,934.83 |
| Less: provision for bad and doubtful debts | 3,033,922.07 | 2,394,670.06 |
| Total | <u>24,243,433.72</u> | <u>15,690,264.77</u> |

(2) Ageing analysis of other receivables:

The Group

| Ageing | 2014 | Unit: RMB |
|--|----------------------|----------------------|
| | | 2013 |
| Within one year (including one year) | 15,804,143.92 | 12,478,055.46 |
| 1-2 years (including 2 years) | 3,286,963.13 | 672,653.60 |
| 2-3 years (including 3 years) | 135,392.40 | 313,120.66 |
| Over 3 years | 2,398,618.61 | 2,126,639.38 |
| Sub-total | 21,625,118.06 | 15,590,469.10 |
| Less: provision for bad and doubtful debts | 3,595,124.83 | 2,944,569.21 |
| Total | <u>18,029,993.23</u> | <u>12,645,899.89</u> |

The Company

| Ageing | 2014 | Unit: RMB |
|--|----------------------|----------------------|
| | | 2013 |
| Within one year (including one year) | 16,804,475.44 | 8,326,463.10 |
| 1-2 years (including 2 years) | 1,484,311.85 | 1,220,328.75 |
| 2-3 years (including 3 years) | 786,641.97 | 2,470,899.83 |
| Over 3 years | 8,201,926.53 | 6,067,243.15 |
| Sub-total | 27,277,355.79 | 18,084,934.83 |
| Less: provision for bad and doubtful debts | 3,033,922.07 | 2,394,670.06 |
| Total | <u>24,243,433.72</u> | <u>15,690,264.77</u> |

The ageing of other receivables 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)

6. Other receivables

(3) Analysis of other receivables by category:

The Group

Unit: RMB

| | Note | 2014 | | 2013 | | 2014 | | 2013 | | Book Value | |
|---|------|----------------------|----------------|--------------------------------------|----------------|----------------------|----------------------|--------------------------------------|---------------------|------------|----------------------|
| | | 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 other receivables with individually dab debt provision | (a) | - | - | - | - | - | - | - | - | - | |
| Bad debt provision for other receivables by combination with credit risk characters | | | | | | | | | | | |
| Receivables due from third party | (b) | 19,259,221.72 | 89.06 | 3,595,124.83 | 18.67 | 15,664,096.89 | 13,815,287.13 | 88.61 | 2,944,569.21 | 21.31 | 10,870,717.92 |
| Receivables due from relate party | (c) | 447.68 | 0.00 | - | - | 447.68 | 1,775,181.97 | 11.39 | - | - | 1,775,181.97 |
| Sub-total | | 19,259,669.40 | 89.06 | 3,595,124.83 | 18.67 | 15,664,544.57 | 15,590,469.10 | 100.00 | 2,944,569.21 | 18.89 | 12,645,899.89 |
| Individually not significant other receivables but with individually dab debt provision | | 2,365,448.66 | 10.94 | - | - | 2,365,448.66 | - | - | - | - | - |
| Total | | <u>21,625,118.06</u> | <u>100.00</u> | <u>3,595,124.83</u> | <u>-</u> | <u>18,029,993.23</u> | <u>15,590,469.10</u> | <u>100.00</u> | <u>2,944,569.21</u> | <u>-</u> | <u>12,645,899.89</u> |

The Company

Unit: RMB

| | Note | 2014 | | 2013 | | 2014 | | 2013 | | Book Value | |
|---|------|----------------------|----------------|--------------------------------------|----------------|----------------------|----------------------|--------------------------------------|---------------------|------------|----------------------|
| | | 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 other receivables with individually dab debt provision | (a) | - | - | - | - | - | - | - | - | - | |
| Bad debt provision for other receivables by combination with credit risk characters | | | | | | | | | | | |
| Receivables due from third party | (b) | 17,586,601.35 | 64.47 | 3,033,922.07 | 17.25 | 14,552,679.28 | 8,649,446.10 | 47.83 | 2,394,670.06 | 27.69 | 6,254,776.04 |
| Receivables due from relate party | (c) | 9,690,754.44 | 35.53 | - | - | 9,690,754.44 | 9,435,488.73 | 52.17 | - | - | 9,435,488.73 |
| Sub-total | | 27,277,355.79 | 100.00 | 3,033,922.07 | 11.12 | 24,243,433.72 | 18,084,934.83 | 100.00 | 2,394,670.06 | 13.24 | 15,690,264.77 |
| Individually not significant other receivables but with individually dab debt provision | | - | - | - | - | - | - | - | - | - | - |
| Total | | <u>27,277,355.79</u> | <u>100.00</u> | <u>3,033,922.07</u> | <u>-</u> | <u>24,243,433.72</u> | <u>18,084,934.83</u> | <u>100.00</u> | <u>2,394,670.06</u> | <u>-</u> | <u>15,690,264.77</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

6. Other receivables (Continued)

(3) Analysis of other receivables by category: (Continued)

- (a) No other receivables was individually significant and assessed individually for bad and doubtful debts at the year end.
- (b) Other receivables due from the third party in groups with provision for bad and doubtful debts using ageing analysis method:

The Group

Unit: RMB

| Ageing | Carrying amount | Provision for bad and doubtful debts | Proportion (%) |
|-------------------------------|----------------------|--------------------------------------|----------------|
| Within one year | | | |
| (including one year) | 15,660,990.54 | 564,351.59 | 4% |
| 1-2 years (including 2 years) | 1,134,915.88 | 567,457.94 | 50% |
| 2-3 years (including 3 years) | 135,392.40 | 135,392.40 | 100% |
| Over 3 years | 2,327,922.90 | 2,327,922.90 | 100% |
| Total | <u>19,259,221.72</u> | <u>3,595,124.83</u> | — |

The Company

Unit: RMB

| Ageing | Carrying amount | Provision for bad and doubtful debts | Proportion (%) |
|-------------------------------|----------------------|--------------------------------------|----------------|
| Within one year | | | |
| (including one year) | 14,547,348.45 | 524,894.88 | 4% |
| 1-2 years (including 2 years) | 1,044,751.40 | 514,525.69 | 50% |
| 2-3 years (including 3 years) | 130,392.40 | 130,392.40 | 100% |
| Over 3 years | 1,864,109.10 | 1,864,109.10 | 100% |
| Total | <u>17,586,601.35</u> | <u>3,033,922.07</u> | — |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

6. Other receivables (Continued)

(3) Analysis of other receivables by category: (Continued)

(c) Other receivables due from the related party

The Group

| Name | Note | Relationship with the Company | Amount | Unit: RMB Percentage of total other receivables (%) |
|-----------------|------|-------------------------------|---------------|--|
| Kunji Group Co. | X. 6 | Related party | <u>447.68</u> | <u>0.00</u> |

The Company

| Name | Note | Relationship with the Company | Amount | Unit: RMB Percentage of total other receivables (%) |
|-----------------|------|-------------------------------|---------------------|--|
| Xi'an Ser | X. 6 | Subsidiary | 8,430,773.56 | 30.91 |
| Kunming TOS | X. 6 | Subsidiary | 1,259,533.20 | 4.62 |
| Kunji Group Co. | X. 6 | Related party | <u>447.68</u> | <u>0.00</u> |
| Total | - | | <u>9,690,754.44</u> | <u>35.53</u> |

As at 31st December 2014, the Group and 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.

(4) The provision, recovery and reversal of bad debts during the year:

The Group

| | Note | 2014 | Unit: RMB 2013 |
|--|------|---------------------|---------------------|
| Opening balance | | 2,944,569.21 | 4,798,674.36 |
| Provision for the year | | 639,252.01 | - |
| Recovery or reversal during the year | (a) | (43,891.10) | (1,143,381.44) |
| Write-off during the year | (b) | - | (710,723.71) |
| Increase in number of business combinations not under common control | | <u>55,194.71</u> | <u>-</u> |
| Closing balance | | <u>3,595,124.83</u> | <u>2,944,569.21</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

6. Other receivables (Continued)

(4) The provision, recovery and reversal of bad debts during the year: (Continued)

The Company

| | Note | 2014 | Unit: RMB 2013 |
|---------------------------------------|------|---------------------|---------------------|
| Opening balance | | 2,394,670.06 | 4,248,775.21 |
| Provision for the year | | 639,252.01 | – |
| Recovered or reversed during the year | (a) | – | (1,143,381.44) |
| Write-off during the year | (b) | – | (710,723.71) |
| Closing balance | | <u>3,033,922.07</u> | <u>2,394,670.06</u> |

(a) Neither the Group nor the Company had any significant recovered or reversed provisions for bad debts for other receivables during the year.

(b) Neither the Group nor the Company had any significant written-off other payables during the year.

(5) Other receivables by nature

The Group

| Nature | 2014 | Unit: RMB 2013 |
|-------------------------------|----------------------|----------------------|
| Deposit | 10,032,288.40 | 4,981,560.40 |
| Petty cash | 2,847,914.45 | 3,918,769.35 |
| Others | 8,744,915.21 | 6,690,139.35 |
| Sub-total | 21,625,118.06 | 15,590,469.10 |
| Less: provision for bad debts | <u>3,595,124.83</u> | <u>2,944,569.21</u> |
| Total | <u>18,029,993.23</u> | <u>12,645,899.89</u> |

The Company

| Nature | 2014 | Unit: RMB 2013 |
|---------------------------------|----------------------|----------------------|
| Deposit | 9,432,288.40 | 3,131,560.40 |
| Petty cash | 1,391,352.16 | 2,512,446.24 |
| Royalties receivable | 4,595,371.74 | 4,595,371.74 |
| Interest of dividend receivable | 3,835,401.82 | 3,256,301.82 |
| Others | 8,022,941.67 | 4,589,254.63 |
| Sub-total | 27,277,355.79 | 18,084,934.83 |
| Less: provision for bad debts | <u>3,033,922.07</u> | <u>2,394,670.06</u> |
| Total | <u>24,243,433.72</u> | <u>15,690,264.77</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

6. Other receivables (Continued)

(6) Top five other receivables by debtor as at the end of the year

The Group

Unit: RMB

| Name of company | Nature | Closing balance | Ageing: | Percentage of total balance of other receivables at the end of the year (%) | Balance of provision for bad debts at the end of the year |
|--|-------------|---------------------|-----------------|---|---|
| Far Eastern International Leasing Co., Ltd. | Third party | 3,888,888.00 | Within one year | 17.98 | 194,444.40 |
| Zhejiang Huijin Financial Leasing Co., Ltd. | Third party | 1,541,000.00 | Within one year | 7.13 | 77,050.00 |
| China Shipbuilding Industry Equipment and Material Co., Ltd. | Third party | 800,000.00 | Within one year | 3.70 | 40,000.00 |
| Lanzhou Pump Factory | Third party | 600,000.00 | Within one year | 2.77 | 30,000.00 |
| Baotou Iron & Steel Group Mechanical Equipment Manufacturing Co., Ltd. | Third party | 563,899.93 | Over one year | 2.61 | 28,195.00 |
| Total | | <u>7,393,787.93</u> | | <u>34.19</u> | <u>369,689.40</u> |

The Company

Unit: RMB

| Name of company | Nature | Closing balance | Ageing: | Percentage of total balance of other receivables at the end of the year (%) | Balance of provision for bad debts at the end of the year |
|---|-------------|----------------------|----------------------|---|---|
| Xi'an Ser | Subsidiary | 8,430,773.56 | Within/over one year | 30.91 | – |
| Far Eastern International Leasing Co., Ltd. | Third party | 3,888,888.00 | Within one year | 14.26 | 194,444.40 |
| Zhejiang Huijin Financial Leasing Co., Ltd. | Third party | 1,541,000.00 | Within one year | 5.65 | 77,050.00 |
| China Shipbuilding Industry Equipment and Material Co., Ltd | Third party | 800,000.00 | Within one year | 2.93 | 40,000.00 |
| Lanzhou Pump Factory | Third party | 600,000.00 | Within one year | 2.20 | 30,000.00 |
| Total | | <u>15,260,661.56</u> | | <u>55.95</u> | <u>341,494.40</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

7. Inventories

(1) Inventories by category

The Group

Unit: RMB

| Inventories by category | Carrying amount | 2014 | | 2013 | |
|-----------------------------------|-----------------------|--|-----------------------|--|-----------------------|
| | | Provision for diminution in value of inventories | Book value | Provision for diminution in value of inventories | Book value |
| Raw materials | 131,327,077.75 | 3,435,619.64 | 127,891,458.11 | 93,080,072.44 | 90,014,452.80 |
| Consumables | 4,599,897.80 | 82,781.00 | 4,517,116.80 | 4,573,076.86 | 4,490,295.86 |
| Work in progress | 648,085,763.42 | 16,848,131.97 | 631,237,631.45 | 610,932,340.09 | 600,572,743.73 |
| Finished goods | 140,689,133.17 | 8,274,992.42 | 132,414,140.75 | 149,297,954.65 | 142,174,055.73 |
| Commissioned processing materials | 615,414.73 | - | 615,414.73 | 951,286.47 | 951,286.47 |
| Total | 925,317,286.87 | 28,641,525.03 | 896,675,761.84 | 858,834,730.51 | 838,202,834.59 |

The Company

Unit: RMB

| Inventories by category | Carrying amount | 2014 | | 2013 | |
|-----------------------------------|-----------------------|--|-----------------------|--|-----------------------|
| | | Provision for diminution in value of inventories | Book value | Provision for diminution in value of inventories | Book value |
| Raw materials | 101,692,243.35 | 3,065,619.64 | 98,626,623.71 | 83,063,932.42 | 79,998,312.78 |
| Consumables | 660,759.34 | 82,781.00 | 577,978.34 | 590,897.33 | 508,116.33 |
| Work in progress | 464,809,343.04 | 2,521,277.84 | 462,288,065.20 | 407,545,019.17 | 407,435,238.64 |
| Finished goods | 140,689,133.17 | 8,274,992.42 | 132,414,140.75 | 149,297,954.65 | 142,174,055.73 |
| Commissioned processing materials | 615,414.73 | - | 615,414.73 | 951,286.47 | 951,286.47 |
| Total | 708,466,893.63 | 13,944,670.90 | 694,522,222.73 | 641,449,090.04 | 631,067,009.95 |

The Group and the Company's inventories' closing balance did not include borrowing costs capitalized amount.

As at the end of 2014, no inventory was pledged by the Group or the Company (2013: nil).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

7. Inventories *(Continued)*

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

The Group

Unit: RMB

| Inventories by category | Opening balance | Increase during the year | Decrease during the year | Closing balance |
|--|-----------------------|--------------------------|--------------------------|-----------------------|
| Raw materials | 93,080,072.44 | 452,467,105.85 | 414,220,100.54 | 131,327,077.75 |
| Consumables | 4,573,076.86 | 5,820,780.44 | 5,793,959.50 | 4,599,897.80 |
| Work in progress | 610,932,340.09 | 766,099,680.70 | 728,946,257.37 | 648,085,763.42 |
| Finished goods | 149,297,954.65 | 683,913,315.28 | 692,522,136.76 | 140,689,133.17 |
| Commissioned processing materials | 951,286.47 | 5,689,680.21 | 6,025,551.95 | 615,414.73 |
| Sub-total | 858,834,730.51 | 1,913,990,562.48 | 1,847,508,006.12 | 925,317,286.87 |
| Less: Provision for diminution in value of inventories | 20,631,895.92 | 9,918,876.97 | 1,909,247.86 | 28,641,525.03 |
| Total | <u>838,202,834.59</u> | <u>1,904,071,685.51</u> | <u>1,845,598,758.26</u> | <u>896,675,761.84</u> |

The Company

Unit: RMB

| Inventories by category | Opening balance | Increase during the year | Decrease during the year | Closing balance |
|--|-----------------------|--------------------------|--------------------------|-----------------------|
| Raw materials | 83,063,932.42 | 389,697,386.99 | 371,069,076.06 | 101,692,243.35 |
| Consumables | 590,897.33 | 4,851,451.31 | 4,781,589.30 | 660,759.34 |
| Work in progress | 407,545,019.17 | 646,348,718.30 | 589,084,394.43 | 464,809,343.04 |
| Finished goods | 149,297,954.65 | 554,389,311.42 | 562,998,132.90 | 140,689,133.17 |
| Commissioned processing materials | 951,286.47 | 5,689,680.21 | 6,025,551.95 | 615,414.73 |
| Sub-total | 641,449,090.04 | 1,600,976,548.23 | 1,533,958,744.64 | 708,466,893.63 |
| Less: Provision for diminution in value of inventories | 10,382,080.09 | 4,906,467.22 | 1,343,876.41 | 13,944,670.90 |
| Total | <u>631,067,009.95</u> | <u>1,596,070,081.01</u> | <u>1,532,614,868.23</u> | <u>694,522,222.73</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

7. Inventories (Continued)

(3) Provision for diminution in value of inventories

The Group

Unit: RMB

| Inventories by category | Opening balance | Provision made for the period | | Decrease during the period | | Closing balance |
|-------------------------|----------------------|-------------------------------|---|----------------------------|---------------------|----------------------|
| | | Charge for the period | Increase by business combination not under common control | Reversal | Write-off | |
| Raw materials | 3,065,619.64 | – | 935,371.45 | 565,371.45 | – | 3,435,619.64 |
| Consumables | 82,781.00 | – | – | – | – | 82,781.00 |
| Work in progress | 10,359,596.36 | 6,598,316.14 | – | – | 109,780.53 | 16,848,131.97 |
| Finished goods | 7,123,898.92 | 2,385,189.38 | – | – | 1,234,095.88 | 8,274,992.42 |
| Total | 20,631,895.92 | 8,983,505.52 | 935,371.45 | 565,371.45 | 1,343,876.41 | 28,641,525.03 |

The Company

Unit: RMB

| Inventories by category | Provision made for the period | | Decrease during the period | | Closing balance |
|-------------------------|-------------------------------|-----------------------|----------------------------|---------------------|----------------------|
| | Opening balance | Charge for the period | Reversal | Write-off | |
| Raw materials | 3,065,619.64 | – | – | – | 3,065,619.64 |
| Consumables | 82,781.00 | – | – | – | 82,781.00 |
| Work in progress | 109,780.53 | 2,521,277.84 | – | 109,780.53 | 2,521,277.84 |
| Finished goods | 7,123,898.92 | 2,385,189.38 | – | 1,234,095.88 | 8,274,992.42 |
| Total | 10,382,080.09 | 4,906,467.22 | – | 1,343,876.41 | 13,944,670.90 |

For the year ended 31 December 2014, the Group and the Company recognized the excess of inventory cost over its net realizable value as diminution of inventory cost. When making estimation of the net realizable value of work in progress, the Group and the Company used the market price of finished goods less the estimated costs to completion and the estimated selling expenses and related taxes. The estimated costs to completion were determined based on the previous operation costs. When making estimation of the net realizable value of finished goods, the Group and the Company used the market price of finished goods less the costs of finished goods and the estimated selling expenses and related taxes to be occurred.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

8. Other Current assets

The Group

| Item | Unit: RMB | |
|-------------------------|---------------------|------------------|
| | 2014 | 2013 |
| Prepaid value-added tax | <u>1,724,042.72</u> | <u>71,326.31</u> |
| Total | <u>1,724,042.72</u> | <u>71,326.31</u> |

9. Available-for-Sale Financial Assets

(1) Information of available-for-sale financial assets:

The Group

| Item | Carrying amount | 2014 | | Carrying amount | 2013 (restated) | |
|---|---------------------|--|---------------------|---------------------|--|---------------------|
| | | Provision for diminution in value of available-for-sale financial assets | Book value | | Provision for diminution in value of available-for-sale financial assets | Book value |
| Available-for-sale equity instrument – measured by cost | <u>3,145,000.00</u> | <u>2,000,000.00</u> | <u>1,145,000.00</u> | <u>3,145,000.00</u> | <u>2,000,000.00</u> | <u>1,145,000.00</u> |

The Company

| Item | Carrying amount | 2014 | | Carrying amount | 2013 (restated) | |
|---|---------------------|--|------------|---------------------|--|------------|
| | | Provision for diminution in value of available-for-sale financial assets | Book value | | Provision for diminution in value of available-for-sale financial assets | Book value |
| Available-for-sale equity instrument – measured by cost | <u>2,000,000.00</u> | <u>2,000,000.00</u> | <u>–</u> | <u>2,000,000.00</u> | <u>2,000,000.00</u> | <u>–</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

9. Available-for-Sale Financial Assets(Continued)

(2) Available-for-sale financial assets measured by cost at the end of the year:

The Group

Unit: RMB

| Invested company | Opening balance | Carrying amount | | Closing balance | Provision for diminution in value of available-for-sale financial assets | | | Closing balance | Proportion of shares held in the invested company (%) | Cash dividend for the year |
|--|---------------------|--------------------------|--------------------------|---------------------|--|--------------------------|----------|---------------------|---|----------------------------|
| | | Increase during the year | Decrease during the year | | Increase during the year | Decrease during the year | | | | |
| Yunnan Cheng Jiang Copper Products Plant | 2,000,000.00 | - | - | 2,000,000.00 | 2,000,000.00 | - | - | 2,000,000.00 | 40% | - |
| Hangzhou Ser Gas Engineering Co., Ltd ("Hangzhou Ser") | 1,145,000.00 | - | - | 1,145,000.00 | - | - | - | - | 11.45% | - |
| Total | 3,145,000.00 | - | - | 3,145,000.00 | 2,000,000.00 | - | - | 2,000,000.00 | | |

The Company

Unit: RMB

| Invested company | Opening balance | Carrying amount | | Closing balance | Provision for diminution in value of available-for-sale financial assets | | | Closing balance | Proportion of shares held in the invested company (%) | Cash dividend for the year |
|--|-----------------|--------------------------|--------------------------|-----------------|--|--------------------------|---|-----------------|---|----------------------------|
| | | Increase during the year | Decrease during the year | | Increase during the year | Decrease during the year | | | | |
| Yunnan Cheng Jiang Copper Products Plant | 2,000,000.00 | - | - | 2,000,000.00 | 2,000,000.00 | - | - | 2,000,000.00 | 40% | - |

(3) Impairment loss on available-for-sale financial assets

Full provision for impairment loss on available-for-sale financial assets of Yunnan Cheng Jiang Copper Products Plant was made in 1999 because the plant has lost the ability of sustainable operation. According to the resolution passed at the 7th meeting of the 6th board of directors of the Company held in 2009, the Company began to liquidate this investment project. As at 31 December 2014, the liquidation of Yunnan Chengjiang copper plant is still in progress.

(4) As at 31 December 2014 and 2013, neither the Group nor the Company had available-for-sale equity instruments which recorded a significant or prolonged decline in the fair value at the end of the period but no provision was made for impairment.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

10. Long-term equity investments

(1) Long-term equity investments by category:

The Group

| Item | Unit: RMB | |
|-------------------------------|----------------------|----------------------|
| | 2014 | 2013 (restated) |
| Investments in joint ventures | – | 44,449,919.40 |
| Investments in associates | 14,384,564.38 | 13,440,673.03 |
| Total | <u>14,384,564.38</u> | <u>57,890,592.43</u> |

The Company

| Item | Unit: RMB | |
|-------------------------------|----------------------|----------------------|
| | 2014 | 2013 (restated) |
| Investments in subsidiaries | 68,126,236.86 | 24,693,265.85 |
| Investments in joint ventures | – | 44,449,919.40 |
| Investments in associates | 14,384,564.38 | 13,440,673.03 |
| Total | <u>82,510,801.24</u> | <u>82,583,858.28</u> |

(2) Investments in subsidiaries

The Company

| Subsidiary | Unit: RMB | | | | | |
|---|----------------------|--------------------------|--------------------------|----------------------|---|---|
| | Opening balance | Increase during the year | Decrease during the year | Closing balance | Impairment provision made during the year | Closing balance of impairment provision |
| Kunming TOS | – | 43,432,971.01 | – | 43,432,971.01 | – | – |
| Xi'an Ser | 21,693,265.85 | – | – | 21,693,265.85 | – | – |
| Kunming Kunji General Machine Co., Ltd. (General Machine) | <u>3,000,000.00</u> | – | – | <u>3,000,000.00</u> | – | – |
| Total | <u>24,693,265.85</u> | <u>43,432,971.01</u> | <u>–</u> | <u>68,126,236.86</u> | <u>–</u> | <u>–</u> |

Please refer to the note VII for the information of the subsidiaries of the Company.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

10. Long-term equity investments (Continued)

(3) Investments in joint ventures and associates

The Group and the Company

Unit: RMB

| Investment company | Opening balance | Additional investment | Decrease investment | Changes in equity for the year | | | | | | Closing balance | Closing balance of impairment provision |
|--|----------------------|-----------------------|----------------------|--|----------------------------|--------------------------|------------------------------------|---|----------|----------------------|---|
| | | | | Investment income recognized under the equity method | Other comprehensive income | Movement of other equity | Declared cash dividends or profits | Impairment provision made during the year | others | | |
| Joint venture | | | | | | | | | | | |
| Kunming TOS | 44,449,919.40 | - | 43,432,971.01 | 983,051.61 | - | - | 2,000,000.00 | - | - | - | - |
| Associate | | | | | | | | | | | |
| Xi'an Ruite Laser Prototyping Manufacturing & Engineering Research Co., Ltd. ("Xi'an Ruite") | 13,440,673.03 | - | - | 943,891.35 | - | - | - | - | - | 14,384,564.38 | - |
| Total | 57,890,592.43 | - | 43,432,971.01 | 1,926,942.96 | - | - | 2,000,000.00 | - | - | 14,384,564.38 | - |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

11. Fixed assets

(1) Details of fixed assets

The Group

Unit: RMB

| Item | Building and structures | Machinery and equipment | Transportation equipment | Electronic equipment | Total |
|---|-------------------------|-------------------------|--------------------------|----------------------|------------------|
| Cost | | | | | |
| Opening balance | 336,702,165.29 | 537,515,268.51 | 31,940,286.74 | 15,421,770.15 | 921,579,490.69 |
| Addition during the year | | | | | |
| – Acquisition | 181,211.69 | 6,592,470.94 | 2,119,239.32 | 1,013,015.93 | 9,905,937.88 |
| – Transfer from construction in progress | 20,670,061.42 | 48,675,554.07 | – | – | 69,345,615.49 |
| – increase by business combination not under common control | 7,686,945.92 | 3,786,228.16 | 821,692.42 | 879,072.17 | 13,173,938.67 |
| Disposal or scrapped during the year | – | (2,196,879.16) | (2,846,325.58) | (26,904.27) | (5,070,109.01) |
| Closing balance | 365,240,384.32 | 594,372,642.52 | 32,034,892.90 | 17,286,953.98 | 1,008,934,873.72 |
| Accumulated depreciation | | | | | |
| Opening balance | 97,706,046.01 | 287,866,336.68 | 18,948,674.65 | 11,393,544.50 | 415,914,601.84 |
| Charge for the year | 10,186,457.02 | 30,284,170.09 | 2,507,039.98 | 1,437,057.90 | 44,414,724.99 |
| Disposal or scrapped during the year | – | (1,640,626.81) | (2,187,189.63) | (9,981.60) | (3,837,798.04) |
| Closing balance | 107,892,503.03 | 316,509,879.96 | 19,268,525.00 | 12,820,620.80 | 456,491,528.79 |
| Impairment provision | | | | | |
| Opening balance | – | 2,861,408.11 | – | 41,365.93 | 2,902,774.04 |
| Disposal or scrapped during the year | – | (74,215.60) | – | – | (74,215.60) |
| Closing balance | – | 2,787,192.51 | – | 41,365.93 | 2,828,558.44 |
| Carrying amounts | | | | | |
| At the end of the year | 257,347,881.29 | 275,075,570.05 | 12,766,367.90 | 4,424,967.25 | 549,614,786.49 |
| At the beginning of the year | 238,996,119.28 | 246,787,523.72 | 12,991,612.09 | 3,986,859.72 | 502,762,114.81 |

As at 31st December 2014, building and structures of the Group with net book value of RMB10,429,037.44 were pledged to banks for short-term loans (2013: RMB11,370,003.28).

As at 31st December 2014, machinery and equipment of the Group with net book value of RMB52,874,987.54 were used as mortgage collateral for long-term payables. (2013: Nil)(see note V.28(2)).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

11. Fixed assets (Continued)

(1) Details of fixed assets (Continued)

The Company

Unit: RMB

| Item | Building and structures | Machinery and equipment | Transportation equipment | Electronic equipment | Total |
|--|----------------------------|----------------------------|-----------------------------|-------------------------|----------------|
| Cost | | | | | |
| Opening balance | 298,805,566.43 | 486,127,087.45 | 29,485,106.61 | 11,569,092.53 | 825,986,853.02 |
| Addition during the year | | | | | |
| – Acquisition | 181,211.69 | 6,444,008.55 | 1,971,239.32 | 903,645.09 | 9,500,104.65 |
| – Transfer from construction in progress | 20,670,061.42 | 48,675,554.07 | – | – | 69,345,615.49 |
| Disposal or scrapped during the year | – | (1,269,913.81) | (2,312,226.58) | (4,169.23) | (3,586,309.62) |
| Closing balance | 319,656,839.54 | 539,976,736.26 | 29,144,119.35 | 12,468,568.39 | 901,246,263.54 |
| Accumulated depreciation | | | | | |
| Opening balance | 82,160,451.87 | 247,721,825.86 | 17,686,515.86 | 8,292,071.82 | 355,860,865.41 |
| Charge for the year | 7,978,776.30 | 26,254,374.14 | 2,102,337.85 | 1,129,366.49 | 37,464,854.78 |
| Disposal or scrapped during the year | – | (986,585.65) | (1,925,744.96) | (2,706.41) | (2,915,037.02) |
| Closing balance | 90,139,228.17 | 272,989,614.35 | 17,863,108.75 | 9,418,731.90 | 390,410,683.17 |
| Impairment provision | | | | | |
| Opening balance | – | 2,861,408.11 | – | 41,365.93 | 2,902,774.04 |
| Disposal or scrapped during the year | – | (74,215.60) | – | – | (74,215.60) |
| Closing balance | – | 2,787,192.51 | – | 41,365.93 | 2,828,558.44 |
| Carrying amounts | | | | | |
| At the end of the year | 229,517,611.37 | 264,199,929.40 | 11,281,010.60 | 3,008,470.56 | 508,007,021.93 |
| At the beginning of the year | 216,645,114.56 | 235,543,853.48 | 11,798,590.75 | 3,235,654.78 | 467,223,213.57 |

As at 31st December 2014, machinery and equipment of the Company with net book value of RMB52,874,987.54 were used as mortgage collateral for long-term payables. (2013: Nil)(see note V.28(2)).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

11. Fixed assets (Continued)

(2) Fixed assets acquired under financial leases

The Group and the Company

| Item | Cost | Accumulated depreciation | Impairment provision | Unit: RMB |
|---|---------------------|--------------------------|----------------------|-------------------|
| | | | | Carrying amount |
| As at 31 December 2014 and 31 December 2013 | | | | |
| Buildings and structures | <u>2,592,597.82</u> | <u>2,488,893.91</u> | <u>-</u> | <u>103,703.91</u> |

In 2014 and 2013, fixed assets acquired under financial leases were fully depreciated.

(3) As at 31 December 2014 and 31 December 2013, no fixed assets were leased by way of operating lease.

(4) Fixed assets with pending certificates of ownership

As at 31 December 2014 and 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. At 31 December 2014, the carrying amount of the above mentioned fixed assets was RMB39,931,706.86 (31 December 2013: RMB42,279,528.22).

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.

12. Construction in progress

(1) Information of construction in progress

The Group

| Item | Book value | 2014 | | Book value | 2013 | | Unit: RMB |
|---|-----------------------|----------------------|-----------------------|-----------------------|----------------------|-----------------------|-----------|
| | | Impairment provision | Carrying amount | | Impairment provision | Carrying amount | |
| Heavy casting base SCHIESS GmbH VMG6 machine tool | 196,835,870.09 | - | 196,835,870.09 | 220,445,960.71 | - | 220,445,960.71 | |
| Other items | <u>39,084,812.42</u> | <u>-</u> | <u>39,084,812.42</u> | <u>39,084,812.42</u> | <u>-</u> | <u>39,084,812.42</u> | |
| | <u>34,760,184.98</u> | <u>2,056,931.37</u> | <u>32,703,253.61</u> | <u>42,016,317.52</u> | <u>2,056,931.37</u> | <u>39,959,386.15</u> | |
| Total | <u>270,680,867.49</u> | <u>2,056,931.37</u> | <u>268,623,936.12</u> | <u>301,547,090.65</u> | <u>2,056,931.37</u> | <u>299,490,159.28</u> | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

12. Construction in progress (Continued)

(1) Information of construction in progress (Continued)

The Company

Unit: RMB

| Item | 2014 | | | 2013 | | |
|--------------------------------------|-----------------------|----------------------|-----------------------|-----------------------|----------------------|-----------------------|
| | Book value | Impairment provision | Carrying amount | Book value | Impairment provision | Carrying amount |
| Heavy casting base | 196,835,870.09 | - | 196,835,870.09 | 220,445,960.71 | - | 220,445,960.71 |
| SCHIESS GmbH VMG6 machine tool | 39,084,812.42 | - | 39,084,812.42 | 39,084,812.42 | - | 39,084,812.42 |
| Other items | 31,864,495.12 | 2,056,931.37 | 29,807,563.75 | 41,639,370.52 | 2,056,931.37 | 39,582,439.15 |
| Total | <u>267,785,177.63</u> | <u>2,056,931.37</u> | <u>265,728,246.26</u> | <u>301,170,143.65</u> | <u>2,056,931.37</u> | <u>299,113,212.28</u> |

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

The Group and the Company

Unit: RMB

| Item | Budget | Opening balance | Additions during the year | Transfer to fixed assets during the year | Transfer to intangible assets during the year | Closing balance | Investment percentage to total budget (%) | Project progress | Accumulated amount of interest capitalized | Of which, amount of interest capitalized during the year | Interest capitalization rate of the year | Source |
|---|----------------|-----------------|---------------------------|--|---|-----------------|---|------------------|--|--|--|---|
| | | | | | | | | | | | | of the fund |
| Heavy casting base | 729,560,000.00 | 220,445,960.71 | 40,229,531.68 | 57,602,879.57 | 6,236,742.73 | 196,835,870.09 | 35.73% | 42% | 28,134,715.35 | 12,279,543.91 | 7.00% | Self-financing and budgetary investment of central government |
| SCHIESS GmbH VMG6 machine tool (note X. 5(3) note 2) | 39,084,812.42 | 39,084,812.42 | - | - | - | 39,084,812.42 | to be installed | 0% | - | - | - | Self-financing |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

13. Intangible assets

(1) Information of intangible assets

The Group

Unit: RMB

| Item | Land use rights | Various softwares | Others | Total |
|---|-----------------|-------------------|---------------|----------------|
| Cost | | | | |
| Opening balance | 61,890,483.46 | 20,852,190.62 | 16,746,281.92 | 99,488,956.00 |
| Addition during the year | | | | |
| – Acquisition | 63,256,833.04 | – | – | 63,256,833.04 |
| – increase by business combination not under common control | – | 22,509.23 | 3,172,248.89 | 3,194,758.12 |
| Closing balance | 125,147,316.50 | 20,874,699.85 | 19,918,530.81 | 165,940,547.16 |
| Accumulated amortization | | | | |
| Opening balance | 5,897,303.63 | 12,379,139.79 | 1,351,010.71 | 19,627,454.13 |
| Charge for the year | 2,078,265.29 | 1,455,686.43 | 2,153,900.20 | 5,687,851.92 |
| Closing balance | 7,975,568.92 | 13,834,826.22 | 3,504,910.91 | 25,315,306.05 |
| Carrying amounts | | | | |
| At the end of the year | 117,171,747.58 | 7,039,873.63 | 16,413,619.90 | 140,625,241.11 |
| At the beginning of the year | 55,993,179.83 | 8,473,050.83 | 15,395,271.21 | 79,861,501.87 |

As at 31 December 2014, the Group's land use rights with the carrying amounts of RMB6,317,425.03 was pledged to banks for short-term loans (2013: RMB6,476,353.93).

The Company

Unit: RMB

| Item | Land use rights | Various softwares | Others | Total |
|------------------------------|-----------------|-------------------|---------------|----------------|
| Cost | | | | |
| Opening balance | 47,737,603.46 | 20,759,357.28 | 16,746,281.92 | 85,243,242.66 |
| Addition during the year | | | | |
| – Acquisition | 63,256,833.04 | – | – | 63,256,833.04 |
| Closing balance | 110,994,436.50 | 20,759,357.28 | 16,746,281.92 | 148,500,075.70 |
| Accumulated amortization | | | | |
| Opening balance | 3,261,421.11 | 12,321,506.45 | 1,351,010.71 | 16,933,938.27 |
| Charge for the year | 1,795,207.73 | 1,424,547.24 | 1,423,938.60 | 4,643,693.57 |
| Closing balance | 5,056,628.84 | 13,746,053.69 | 2,774,949.31 | 21,577,631.84 |
| Carrying amounts | | | | |
| At the end of the year | 105,937,807.66 | 7,013,303.59 | 13,971,332.61 | 126,922,443.86 |
| At the beginning of the year | 44,476,182.35 | 8,437,850.83 | 15,395,271.21 | 68,309,304.39 |

As at 31 December 2014 and 31 December 2013, no land use rights of the Company was pledged to banks.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

13. Intangible assets (Continued)

(2) Land use rights with pending certificates of ownership

As at 31 December 2014 and 31 December 2013, neither the Group nor the Company had land use rights without property certificates.

14. Goodwill

| | <i>Unit: RMB</i> | | | |
|------------------|------------------------|---------------------------------|---------------------------------|------------------------|
| Xi'an Ser | Opening balance | Increase during the year | Decrease during the year | Closing balance |
| Carrying amount | 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 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.

15. Long-term deferred expenses

The Group

| | <i>Unit: RMB</i> | | | |
|-------------|------------------------|---------------------------------|-------------------------------------|------------------------|
| Item | Opening balance | Increase during the year | Amortization during the year | Closing balance |
| Decoration | 1,307,187.73 | 75,000.00 | 466,491.19 | 915,696.54 |

The Company

| | <i>Unit: RMB</i> | | | |
|-------------|------------------------|---------------------------------|-------------------------------------|------------------------|
| Item | Opening balance | Increase during the year | Amortization during the year | Closing balance |
| Decoration | 1,165,250.73 | 75,000.00 | 356,215.19 | 884,035.54 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

16. Deferred tax assets

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

The Group

Unit: RMB

| Item | 2014 | | 2013 (restated) | |
|---|---|---|---|---|
| | Deductible or taxable temporary difference ("()" for taxable temporary difference) | Deferred tax assets ("()" for liabilities) | Deductible or taxable temporary difference ("()" for taxable temporary difference) | Deferred tax assets ("()" for liabilities) |
| Deferred tax assets: | | | | |
| Provision for bad and doubtful debts | 213,944,556.41 | 32,091,683.48 | 206,653,008.20 | 30,997,951.23 |
| Provision for diminution in value of inventories | 11,281,283.49 | 1,692,192.53 | 20,631,895.92 | 3,094,784.39 |
| Provision for impairment of fixed assets | – | – | 2,902,774.04 | 435,416.10 |
| Provision for impairment of construction in progress | – | – | 2,056,931.37 | 308,539.71 |
| Provision for impairment of long-term equity investments | – | – | 2,000,000.00 | 300,000.00 |
| Provisions | 3,082,619.70 | 462,392.95 | 7,172,981.31 | 1,075,947.19 |
| Depreciation of fixed assets | – | – | 5,193,975.02 | 779,096.25 |
| Accrued expenses | – | – | 22,604,448.33 | 3,390,667.25 |
| Unrealized internal profits | 1,493,932.60 | 224,089.89 | 5,035,382.07 | 755,307.31 |
| Discounted value of retirement benefits for internal staff under early retirement | – | – | 4,629,605.61 | 694,440.85 |
| Government grants | – | – | 103,265,338.88 | 15,489,800.82 |
| Payables overdue for two years | – | – | 1,276,914.33 | 191,537.15 |
| Deductible tax losses | 2,573,623.77 | 386,043.56 | 78,754,368.10 | 11,813,155.24 |
| Total | 232,376,015.97 | 34,856,402.41 | 462,177,623.18 | 69,326,643.49 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

16. Deferred tax assets (Continued)

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

The Company

Unit: RMB

| Item | 2014 | | 2013 (restated) | |
|---|--|--|--|--|
| | Deductible or taxable temporary difference ("()") for taxable temporary difference | Deferred tax assets ("()") for liabilities | Deductible or taxable temporary difference ("()") for taxable temporary difference | Deferred tax assets ("()") for liabilities |
| Deferred tax assets: | | | | |
| Provision for bad and doubtful debts | 157,704,366.45 | 23,655,654.95 | 157,890,366.45 | 23,683,554.95 |
| Provision for diminution in value of inventories | – | – | 10,382,080.09 | 1,557,312.01 |
| Provision for impairment of fixed assets | – | – | 2,902,774.04 | 435,416.10 |
| Provision for impairment of construction in progress | – | – | 2,056,931.37 | 308,539.71 |
| Provision for impairment of long-term equity investments | – | – | 2,000,000.00 | 300,000.00 |
| Provisions | – | – | 7,172,981.31 | 1,075,947.19 |
| Depreciation of fixed assets | – | – | 5,193,975.02 | 779,096.25 |
| Accrued expenses | – | – | 19,683,948.33 | 2,952,592.25 |
| Unrealized internal profits | – | – | – | – |
| Discounted value of retirement benefits for internal staff under early retirement | – | – | 4,629,605.61 | 694,440.85 |
| Government grants | – | – | 103,265,338.88 | 15,489,800.82 |
| Payables overdue for two years | – | – | 1,276,914.33 | 191,537.15 |
| Deductible tax losses | – | – | 78,754,368.11 | 11,813,155.24 |
| Total | <u>157,704,366.45</u> | <u>23,655,654.95</u> | <u>395,209,283.54</u> | <u>59,281,392.52</u> |

(2) Breakdown of unrecognized deferred tax assets

The Group

Unit: RMB

| Item | 2014 | 2013 |
|---------------------------------|-----------------------|---------------------|
| Deductible temporary difference | 212,834,451.30 | – |
| Deductible tax losses | <u>238,688,417.41</u> | <u>5,170,367.50</u> |
| Total | <u>451,522,868.71</u> | <u>5,170,367.50</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

16. Deferred tax assets (Continued)

(2) Breakdown of unrecognized deferred tax assets (Continued)

The Company

| Item | 2014 | Unit: RMB | |
|---------------------------------|-----------------------|-----------|----------|
| | | 2013 | |
| Deductible temporary difference | 204,882,023.97 | | – |
| Deductible tax losses | 224,736,965.19 | | – |
| Total | <u>429,618,989.16</u> | <u>–</u> | <u>–</u> |

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

The Group

| Year | 2014 | Unit: RMB | |
|-------|-----------------------|---------------------|----------|
| | | 2013 | |
| 2015 | 2,403,783.38 | 2,408,917.21 | |
| 2016 | 836,746.12 | 836,746.12 | |
| 2017 | 74,349,516.50 | 1,924,704.17 | |
| 2018 | 7,263,796.92 | | – |
| 2019 | 153,834,574.49 | | – |
| Total | <u>238,688,417.41</u> | <u>5,170,367.50</u> | <u>–</u> |

The Company

| Year | 2014 | Unit: RMB | |
|-------|-----------------------|-----------|----------|
| | | 2013 | |
| 2017 | 72,424,812.33 | | – |
| 2018 | 7,263,796.92 | | – |
| 2019 | 145,048,355.94 | | – |
| Total | <u>224,736,965.19</u> | <u>–</u> | <u>–</u> |

As the management anticipated that relevant taxpayers would not have sufficient taxable profit to deduct the aforesaid deductible tax losses before their expiration, the relevant deferred tax assets were not recognized.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

17. Other non-current assets

The Group and the Company

| Item | Unit: RMB | |
|--|----------------------|----------------------|
| | 2014 | 2013 |
| Project prepayments | 808,350.00 | 8,300,675.00 |
| Prepayments for land use rights | 4,116,091.08 | 33,410,785.60 |
| Prepayments for contracted technology licensing fee (Note X.5(3), note 1) | 39,656,925.20 | 39,656,925.20 |
| Total | <u>44,581,366.28</u> | <u>81,368,385.80</u> |

18. Short-term loans

(1) Types of short-term loans:

The Group

| Item | Unit: RMB | |
|--------------------------|-----------------------|-----------------------|
| | 2014 | 2013 |
| Pledged loans | – | 79,279,000.00 |
| Secured loans (note 1) | 21,000,000.00 | 15,000,000.00 |
| Guarantee loans (note 2) | 82,000,000.00 | – |
| Credit loans | 181,500,000.00 | 205,000,000.00 |
| Total | <u>284,500,000.00</u> | <u>299,279,000.00</u> |

The Company

| Item | Unit: RMB | |
|--------------------------|-----------------------|-----------------------|
| | 2014 | 2013 |
| Pledged loans | – | 79,279,000.00 |
| Guarantee loans (note 2) | 82,000,000.00 | – |
| Credit loans | 181,500,000.00 | 205,000,000.00 |
| Total | <u>263,500,000.00</u> | <u>284,279,000.00</u> |

Note:

- As at 31 December 2014, buildings and structures of the Group with net book value of RMB10,429,037.44 were pledged to banks for short-term loans (2013: RMB11,370,003.28).

As at 31 December 2014, land use rights of the Group with book value of RMB6,317,425.03 were secured to banks for short-term loans (2013: RMB6,476,353.93)
- Shenyang (Group) provided guarantee for the Company's financing facilities at a total amount of RMB300 million secured from the Export-Import Bank of China. As at 31 December 2014, the amount of financing facilities used by the Company was RMB282 million, of which, balance of short-term loan was RMB82 million.

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 (Continued)

(2) As at 31st December 2014, the Group and the Company had no short-term loans due but outstanding.

19. Bills payable

The Group

| Type | 2014 | Unit: RMB 2013 |
|-----------------------|----------------------|----------------------|
| Bank acceptance bills | <u>75,048,188.00</u> | <u>67,742,506.00</u> |

The Company

| Type | 2014 | Unit: RMB 2013 |
|-----------------------|----------------------|----------------------|
| Bank acceptance bills | <u>63,000,000.00</u> | <u>47,230,000.00</u> |

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

At the end of the year, the Group and the Company had no bills payable due but outstanding.

20. Accounts payable

(1) Types of accounts payable are as follows:

The Group

| Item | 2014 | Unit: RMB 2013 |
|-------------------------------------|-----------------------|-----------------------|
| Accounts payable to related company | 2,100,388.42 | 18,238,531.66 |
| Accounts payable to suppliers | <u>501,604,077.73</u> | <u>485,101,074.38</u> |
| Total | <u>503,704,466.15</u> | <u>503,339,606.04</u> |

The Company

| Item | 2014 | Unit: RMB 2013 |
|-------------------------------------|-----------------------|-----------------------|
| Accounts payable to related company | 14,676,824.32 | 18,238,531.66 |
| Accounts payable to suppliers | <u>372,874,259.63</u> | <u>337,205,721.07</u> |
| Total | <u>387,551,083.95</u> | <u>355,444,252.73</u> |

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)

(2) Ageing analysis of accounts payable:

The Group

| Ageing | 2014 | Unit: RMB | |
|--------------------------------------|-----------------------|-----------------------|--|
| | | 2013 | |
| Within one year (including one year) | 355,949,961.33 | 377,970,807.66 | |
| 1-2 years (including 2 years) | 85,184,799.92 | 95,953,035.13 | |
| 2-3 years (including 3 years) | 31,251,884.12 | 24,141,854.80 | |
| Over 3 years | 31,317,820.78 | 5,273,908.45 | |
| Total | <u>503,704,466.15</u> | <u>503,339,606.04</u> | |

The Company

| Type | 2014 | Unit: RMB | |
|--------------------------------------|-----------------------|-----------------------|--|
| | | 2013 | |
| Within one year (including one year) | 314,483,972.68 | 275,000,345.73 | |
| 1-2 years (including 2 years) | 44,512,951.60 | 71,424,921.74 | |
| 2-3 years (including 3 years) | 18,471,052.28 | 4,468,613.08 | |
| Over 3 years | 10,083,107.39 | 4,550,372.18 | |
| Total | <u>387,551,083.95</u> | <u>355,444,252.73</u> | |

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

(3) As at 31 December 2014, the Group's accounts payable with an ageing of over one year were mainly for material procurement. Breakdown of accounts payable with an ageing over one year and an amount to single supplier of more than RMB7 million are as follows:

The Group

| Item | Closing balance | Unit: RMB | |
|-------------------------------|-----------------|------------------------------|--|
| | | Unpaid reason | |
| Accounts payable for material | 35,861,124.69 | Not be collected temporarily | |

As at 31 December 2014, the Company had no accounts payable with an ageing over one year and an amount more than RMB7 million.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

21. Advances from customers

(1) Information of advances from customers

The Group

| Item | 2014 | Unit: RMB |
|-------------------------------|-----------------------|-----------------------|
| | | 2013 |
| Advances from related party | 9,640.00 | 5,000.00 |
| Advances from the third party | 229,745,906.36 | 256,360,206.37 |
| Total | <u>229,755,546.36</u> | <u>256,365,206.37</u> |

The Company

| Item | 2014 | Unit: RMB |
|-------------------------------|-----------------------|-----------------------|
| | | 2013 |
| Advances from related party | 18,760.67 | 14,120.67 |
| Advances from the third party | 124,324,147.50 | 134,322,834.77 |
| Total | <u>124,342,908.17</u> | <u>134,336,955.44</u> |

(2) As at 31 December 2014, breakdown of the advances from customers of the Group and the Company with an ageing over one year and an amount from single customer more than RMB7 million are as follows:

The Group

| Item | Closing balance | Unit: RMB |
|-----------------------|-----------------|-------------------------|
| | | Reason for not settled |
| Advance sales payment | 59,323,100.00 | No delivery temporarily |

The Company

| Item | Closing balance | Unit: RMB |
|-----------------------|-----------------|-------------------------|
| | | Reason for not settled |
| Advance sales payment | 14,012,000.00 | No delivery temporarily |

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

(1) Employee benefits payable are as follows:

The Group

| | Note | Balance at 1 January 2014 (restated) | Accrued during the year | Paid during the year | Unit: RMB Balance at 31 December 2014 |
|-------------------------------------|------|--|-------------------------------|------------------------------|--|
| Short-term employee benefits | | 8,158,280.81 | 265,003,289.36 | 262,701,881.76 | 10,459,688.41 |
| Termination benefits | | | | | |
| – Defined contribution plan | | – | 28,231,619.71 | 28,222,130.35 | 9,489.36 |
| Long-term employee benefits payable | | | | | |
| – payment within one year | V.29 | <u>2,346,833.68</u> | <u>2,240,546.39</u> | <u>2,346,833.68</u> | <u>2,240,546.39</u> |
| Total | | <u>10,505,114.49</u> | <u>295,475,455.46</u> | <u>293,270,845.79</u> | <u>12,709,724.16</u> |

The Company

| | Note | Balance at 1 January 2014 (restated) | Accrued during the year | Paid during the year | Unit: RMB Balance at 31 December 2014 |
|-------------------------------------|------|--|-------------------------------|------------------------------|--|
| Short-term employee benefits | | 6,368,374.76 | 235,122,929.07 | 234,437,358.64 | 7,053,945.19 |
| Termination benefits | | | | | |
| – Defined contribution plan | | – | 22,865,487.16 | 22,865,487.16 | – |
| Long-term employee benefits payable | | | | | |
| – payment within one year | V.29 | <u>2,346,833.68</u> | <u>2,240,546.39</u> | <u>2,346,833.68</u> | <u>2,240,546.39</u> |
| Total | | <u>8,715,208.44</u> | <u>260,228,962.62</u> | <u>259,649,679.48</u> | <u>9,294,491.58</u> |

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 (Continued)

(2) Short-term employee benefits

The Group

| Item | Unit: RMB | | | |
|--|--|-------------------------------|----------------------------|-----------------------------------|
| | Balance at 1 January 2014 (restated) | Accrued during the year | Paid during the year | Balance at 31 December 2014 |
| Salary, bonus, subsidy and grants | 586,517.85 | 218,366,258.36 | 217,767,177.38 | 1,185,598.83 |
| Staff welfare | – | 9,522,998.39 | 9,522,998.39 | – |
| Social insurance | – | 14,384,524.22 | 14,382,503.42 | 2,020.80 |
| Medical insurance | – | 12,013,624.66 | 12,011,603.86 | 2,020.80 |
| Work injury | – | 882,266.92 | 882,266.92 | – |
| Maternity insurance | – | 1,488,632.64 | 1,488,632.64 | – |
| Housing fund | 1,874,823.32 | 16,460,088.05 | 16,579,198.05 | 1,755,713.32 |
| Union expenses and employees education expenses | 5,696,939.64 | 6,269,420.34 | 4,450,004.52 | 7,516,355.46 |
| Total | 8,158,280.81 | 265,003,289.36 | 262,701,881.76 | 10,459,688.41 |

The Company

| Item | Unit: RMB | | | |
|--|--|-------------------------------|----------------------------|-----------------------------------|
| | Balance at 1 January 2014 (restated) | Accrued during the year | Paid during the year | Balance at 31 December 2014 |
| Salary, bonus, subsidy and grants | 586,517.85 | 196,419,130.77 | 196,689,832.97 | 315,815.65 |
| Staff welfare | – | 7,283,614.05 | 7,283,614.05 | – |
| Social insurance | – | 11,902,630.45 | 11,902,630.45 | – |
| Medical insurance | – | 10,168,450.55 | 10,168,450.55 | – |
| Work injury | – | 650,822.16 | 650,822.16 | – |
| Maternity insurance | – | 1,083,357.74 | 1,083,357.74 | – |
| Housing fund | 1,874,823.32 | 14,376,653.53 | 14,511,963.53 | 1,739,513.32 |
| Union expenses and employees education expenses | 3,907,033.59 | 5,140,900.27 | 4,049,317.64 | 4,998,616.22 |
| Total | 6,368,374.76 | 235,122,929.07 | 234,437,358.64 | 7,053,945.19 |

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 (Continued)

(3) Termination benefits – Defined contribution plan

The Group

| Item | Unit: RMB | | | |
|-------------------------------------|---------------------------------|-------------------------------|----------------------------|-----------------------------------|
| | Balance at 1 January 2014 | Accrued during the year | Paid during the year | Balance at 31 December 2014 |
| Basic retirement insurance premiums | – | 25,451,300.87 | 25,441,963.91 | 9,336.96 |
| Unemployment insurance | – | 2,780,318.84 | 2,780,166.44 | 152.40 |
| Total | – | <u>28,231,619.71</u> | <u>28,222,130.35</u> | <u>9,489.36</u> |

The Company

| Item | Unit: RMB | | | |
|-------------------------------------|---------------------------------|-------------------------------|----------------------------|-----------------------------------|
| | Balance at 1 January 2014 | Accrued during the year | Paid during the year | Balance at 31 December 2014 |
| Basic retirement insurance premiums | – | 20,614,478.04 | 20,614,478.04 | – |
| Unemployment insurance | – | 2,251,009.12 | 2,251,009.12 | – |
| Total | – | <u>22,865,487.16</u> | <u>22,865,487.16</u> | <u>–</u> |

23. Taxes payable

The Group

| Item | Unit: RMB | |
|----------------------|---------------------|----------------------|
| | 2014 | 2013 |
| Value added tax | 5,222,899.91 | 21,007,424.40 |
| Business tax | 29,205.00 | 29,724.51 |
| Corporate income tax | 153,959.15 | 127,273.69 |
| Others | 1,471,150.03 | 3,037,784.66 |
| Total | <u>6,877,214.09</u> | <u>24,202,207.26</u> |

The Company

| Item | Unit: RMB | |
|-----------------|---------------------|----------------------|
| | 2014 | 2013 |
| Value added tax | 2,244,414.11 | 19,617,783.60 |
| Business tax | 29,205.00 | 29,724.51 |
| Others | 1,040,517.87 | 2,818,053.54 |
| Total | <u>3,314,136.98</u> | <u>22,465,561.65</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

The Group

| Item | Unit: RMB | |
|-----------------------|------------|------------|
| | 2014 | 2013 |
| Common share dividend | 135,898.49 | 135,898.49 |

25. Other payables

(1) Other payables by nature of payments are as follows:

The Group

| Item | Unit: RMB | |
|---|----------------|-----------------|
| | 2014 | 2013 (restated) |
| Payable for projects | 100,127,398.62 | 68,596,110.21 |
| Secured deposits for projects | 1,292,600.00 | 2,320,800.00 |
| Leasing expenses | 5,516,413.56 | 6,327,333.96 |
| Auditor's fee | 2,940,283.02 | 3,238,679.25 |
| Commissions and business promotion fees | 9,994,000.00 | 10,433,743.69 |
| Others | 24,357,717.33 | 31,092,914.84 |
| Total | 144,228,412.53 | 122,009,581.95 |

The Company

| Item | Unit: RMB | |
|---|----------------|-----------------|
| | 2014 | 2013 (restated) |
| Payable for projects | 99,624,696.77 | 67,812,976.56 |
| Secured deposits for projects | 1,292,600.00 | 2,320,800.00 |
| Leasing expenses | 5,516,413.56 | 6,327,333.96 |
| Auditor's fee | 2,940,283.02 | 3,238,679.25 |
| Commissions and business promotion fees | 9,994,000.00 | 10,433,743.69 |
| Others | 25,566,494.74 | 33,202,082.29 |
| Total | 144,934,488.09 | 123,335,615.75 |

(2) As at 31 December 2014, the Group and the Company had no single other payables with an ageing over one year and amount more than RMB3.5 million.

26. Non-current liabilities due within one year

The Group and the Company

| Item | Note | Unit: RMB | |
|--|-------|---------------|------------|
| | | 2014 | 2013 |
| Obligation under finance lease due within one year | V. 28 | 213,209.00 | 213,209.00 |
| Sale and leaseback due within one year | V. 32 | 205,300.00 | 205,300.00 |
| Secured loans due within one years | V. 28 | 19,328,596.78 | - |
| Total | | 19,747,105.78 | 418,509.00 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

27. Long-term borrowings

(1) *Classification of Long-term borrowings*

The Group and the Company

| Item | 2014 | <i>Unit: RMB</i> 2013 |
|-----------------|-----------------------|---------------------------------|
| Guarantee loans | <u>200,000,000.00</u> | <u>–</u> |

Shenyang Machine Tool provided guarantee for the Company's financing facilities at a total amount of RMB300 million secured from the Export-Import Bank of China. As at 31 December 2014, the amount of financing facilities used by the Company was RMB282 million, of which, balance of long-term borrowings was RMB200 million.

(2) *As at 31 December 2014, long-term borrowings are as follows:*

The Group and the Company

| Loan bank | Date of beginning | Date of termination | Currency | Interest rate (%) | <i>Unit: RMB</i> Amount in RMB in 2014 |
|--------------------------------|--------------------------|----------------------------|-----------------|--------------------------|--|
| Export-Import Bank of China | 28 April 2014 | 28 April 2016 | RMB | 6.77% | 39,000,000.00 |
| Export-Import Bank of China | 28 April 2014 | 28 April 2016 | RMB | 6.77% | 21,000,000.00 |
| Export-Import Bank of China | 30 May 2014 | 30 May 2016 | RMB | 6.77% | 50,000,000.00 |
| Export-Import Bank of China | 26 June 2014 | 26 June 2016 | RMB | 6.77% | <u>90,000,000.00</u> |
| Total | | | | | <u>200,000,000.00</u> |

(3) As at 31 December 2014, neither the Group nor the Company had long-term loans due but outstanding.

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

The Group and the Company

| Item | Note | Unit: RMB | |
|--|------|----------------------|---------------------|
| | | 2014 | 2013 |
| Obligation under finance lease | (1) | 1,492,463.90 | 1,705,672.90 |
| Secured loan payables | (2) | 29,494,440.35 | – |
| Sub-total | | 30,986,904.25 | 1,705,672.90 |
| Less: long-term payables due within one year | | | |
| Of which, secured loan payables due within one year | | 19,328,596.78 | – |
| Of which, obligation under finance lease due within one year | | 213,209.00 | 213,209.00 |
| Sub-total | | 19,541,805.78 | 213,209.00 |
| Total | | <u>11,445,098.47</u> | <u>1,492,463.90</u> |

(1) Breakdown of Obligation under finance lease under long-term payables

The minimum finance lease payment of the Group and the Company payable after 31 December 2014 is as follows:

| Minimum lease payments | Unit: RMB | |
|--------------------------------------|---------------------|---------------------|
| | 2014 | 2013 |
| 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 | 1,368,676.62 | 1,710,845.50 |
| Sub-total | 2,395,183.26 | 2,737,352.14 |
| Less: unrecognised finance charges | 902,719.36 | 1,031,679.24 |
| Total | <u>1,492,463.90</u> | <u>1,705,672.90</u> |

Obligation under finance lease reflected the present value of minimum lease payments caused by the Company'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 31 December 2014, the balance of unrecognised finance expenses of the Company was RMB902,719.36 (31 December 2013: RMB1,031,679.24).

The above amount of finance lease payment due within one year after deducting unrecognised finance charges was disclosed in Note V. 26.

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)

(2) Breakdown of secured loans repayable included in long-term payables

| Secured loans repayable | 2014 | Unit: RMB | |
|---|----------------------|-----------|----------|
| | | 2013 | |
| Within one year (including one year) | 19,328,596.78 | | – |
| 1-2 years (including two years) | 10,165,843.57 | | – |
| Sub-total | 29,494,440.35 | | – |
| Less: secured loans due within one year | 19,328,596.78 | | – |
| | | | |
| Carrying amount | <u>10,165,843.57</u> | <u>–</u> | <u>–</u> |

In 2014, the Company disposed certain machinery and equipment to a leasing company and leased back the same. The transaction was treated as a pledged loan as its economic essence was to secure a borrowing with pledged assets. As at 31 December 2014, the balance of such borrowing was RMB29,494,440.35, of which the principal repayable within one year of RMB19,328,596.78 was disclosed as non-current liabilities due within one year in Note V. 26, and the principal repayable over one year of RMB10,165,843.57 was disclosed as long-term payables.

29. Long-term employee benefits payable

The Group and the Company

| | 2014 | Unit: RMB | |
|--|---------------------|---------------------|--------------|
| | | 2013 (restated) | |
| Termination benefits (including early retirement expenses) | 7,351,320.45 | | 4,629,605.60 |
| Less: benefits due within one year (Note V.22) | 2,240,546.39 | | 2,346,833.68 |
| | | | |
| Total | <u>5,110,774.06</u> | <u>2,282,771.92</u> | |

Some employees of the Company retired from employment prior to their statutory retirement age. According to the requirements of the early retirement plan of the Company, 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 Company represented the interest rate of national bonds having the same credit term with early retirement plan of the Company.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

30. Special payables

The Group and the Company

Unit: RMB

| Item | Opening balance | Increase during the period | Decrease during the period | Closing balance | Causes |
|--|----------------------|----------------------------|----------------------------|----------------------|--------|
| Tax refund for import tariff and import VAT for key parts of machine tools | <u>20,947,539.29</u> | <u>-</u> | <u>-</u> | <u>20,947,539.29</u> | note |

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. 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.

31. Provisions

The Group

Unit: RMB

| Item | Opening balance | Increase during the period | Decrease during the period | Increase by business combination not under common control | Closing balance |
|----------|---------------------|----------------------------|----------------------------|---|---------------------|
| Warranty | <u>7,172,981.31</u> | <u>9,423,535.35</u> | <u>11,287,828.39</u> | <u>3,502,331.85</u> | <u>8,811,020.12</u> |

The Company

Unit: RMB

| Item | Opening balance | Increase during the period | Decrease during the period | Closing balance |
|----------|---------------------|----------------------------|----------------------------|---------------------|
| Warranty | <u>7,172,981.31</u> | <u>8,576,270.98</u> | <u>10,020,851.87</u> | <u>5,728,400.42</u> |

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

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

32. Deferred income

The Group

Unit: RMB

| Item | Opening balance (restated) | Increase during the year | Decrease during the year | Closing balance | Causes |
|--|----------------------------|--------------------------|--------------------------|-----------------------|--------|
| Deferred income | | | | | |
| – sale and leaseback causing operating lease | 1,437,102.91 | – | 205,300.00 | 1,231,802.91 | Note 1 |
| – government grants | <u>103,265,338.88</u> | <u>19,253,166.84</u> | <u>2,447,300.00</u> | <u>120,071,205.72</u> | Note 2 |
| Total | <u>104,702,441.79</u> | <u>19,253,166.84</u> | <u>2,652,600.00</u> | <u>121,303,008.63</u> | |

The Company

Unit: RMB

| Item | Opening balance (restated) | Increase during the year | Decrease during the year | Closing balance | Causes |
|--|----------------------------|--------------------------|--------------------------|-----------------------|--------|
| Deferred income | | | | | |
| – sale and leaseback causing operating lease | 1,437,102.91 | – | 205,300.00 | 1,231,802.91 | Note 1 |
| – government grants | <u>103,265,338.88</u> | <u>19,013,166.84</u> | <u>2,447,300.00</u> | <u>119,831,205.72</u> | Note 2 |
| Total | <u>104,702,441.79</u> | <u>19,013,166.84</u> | <u>2,652,600.00</u> | <u>121,063,008.63</u> | |

Note 1: Deferred income-sale and leaseback were caused by the Group and the Company'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 2014, the Group and the Company 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. 26).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

32. Deferred income (Continued)

Note 2: Government grants

The Group

Unit: RMB

| Item | Opening balance | Addition grant during the period | Amount recognized as non-operating income | Closing balance | Related to assets/income |
|---|-----------------------|----------------------------------|---|-----------------------|--------------------------|
| Phase one of the CNC heavy and precision machine tool manufacturing project | 16,000,000.00 | – | – | 16,000,000.00 | Related to income |
| Land use rights of Yanglin Base | 13,603,334.00 | – | (280,000.00) | 13,323,334.00 | Related to asset |
| R&D grants for high precision CNC horizontal jig boring machine tools | 7,835,000.00 | – | – | 7,835,000.00 | Related to income |
| R&D grants for precision horizontal and vertical products machine center | 21,334,204.00 | 5,198,062.00 | – | 26,532,266.00 | Related to income |
| R&D grants for intelligent manufacturing machine project | 14,000,000.00 | – | – | 14,000,000.00 | Related to income |
| R&D grants for KHC100/2 Double location precision horizontal machining center | 4,890,900.88 | 8,226,824.64 | – | 13,117,725.52 | Related to income |
| Other government grants | 25,601,900.00 | 5,828,280.20 | (2,167,300.00) | 29,262,880.20 | Related to income |
| Total | 103,265,338.88 | 19,253,166.84 | (2,447,300.00) | 120,071,205.72 | |

The Company

Unit: RMB

| Item | Opening balance | Addition grant during the period | Amount recognized as non-operating income | Closing balance | Related to assets/income |
|---|-----------------------|----------------------------------|---|-----------------------|--------------------------|
| Phase one of the CNC heavy and precision machine tool manufacturing project | 16,000,000.00 | – | – | 16,000,000.00 | Related to income |
| Land use rights of Yanglin Base | 13,603,334.00 | – | (280,000.00) | 13,323,334.00 | Related to asset |
| R&D grants for high precision CNC horizontal jig boring machine tools | 7,835,000.00 | – | – | 7,835,000.00 | Related to income |
| R&D grants for precision horizontal and vertical products machine center | 21,334,204.00 | 5,198,062.00 | – | 26,532,266.00 | Related to income |
| R&D grants for intelligent manufacturing machine project | 14,000,000.00 | – | – | 14,000,000.00 | Related to income |
| R&D grants for KHC100/2 Double location precision horizontal machining center | 4,890,900.88 | 8,226,824.64 | – | 13,117,725.52 | Related to income |
| Other government grants | 25,601,900.00 | 5,588,280.20 | (2,167,300.00) | 29,022,880.20 | Related to income |
| Total | 103,265,338.88 | 19,013,166.84 | (2,447,300.00) | 119,831,205.72 | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

33. Share capital

The Group and the Company

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

34. Capital reserve

The Group

| | <i>Unit: RMB</i> | | | |
|------------------------|------------------------|---------------------------------|---------------------------------|------------------------|
| Item | Opening balance | Increase during the year | Decrease during the year | Closing balance |
| Share premium | 19,206,777.12 | – | – | 19,206,777.12 |
| Other capital reserves | 8,096,544.60 | – | 7,538,290.55 | 558,254.05 |
| Total | <u>27,303,321.72</u> | <u>–</u> | <u>7,538,290.55</u> | <u>19,765,031.17</u> |

Note 1: Other capital reserves decreased during the period was due to the comprehensive income of Kunming TOS transferred from capital reserve to investment income (see Note VI. 1(1)).

The Company

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

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

35. Surplus reserve

The Group and the Company

| Item | <i>Unit: RMB</i> Opening and closing balance |
|---------------------------|---|
| Statutory surplus reserve | <u>117,077,019.33</u> |

36. Retained earnings

The Group

| Item | Note | 2014 | <i>Unit: RMB</i> 2013 (restated) |
|---|-----------|-----------------------|-------------------------------------|
| Retained earnings at the end of last year | | 650,275,276.12 | 643,404,128.51 |
| Add: correction of accounting errors in prior years | III.33(1) | (28,549,549.27) | (29,631,181.25) |
| Retained earnings at the beginning of the year | | 621,725,726.85 | 613,772,947.26 |
| Add: comprehensive income attributable to shareholders of the Company | | (204,091,306.53) | 8,521,796.32 |
| Less: Appropriation for statutory surplus reserve | | <u>–</u> | <u>569,016.73</u> |
| Retained earnings at the end of the year | (1) | <u>417,634,420.32</u> | <u>621,725,726.85</u> |

The Company

| Item | Note | 2014 | <i>Unit: RMB</i> 2013 (restated) |
|---|-----------|-----------------------|-------------------------------------|
| Retained earnings at the end of last year | | 626,626,694.30 | 621,505,543.69 |
| Add: correction of accounting errors in prior years | III.33(1) | (28,549,549.27) | (29,631,181.25) |
| Retained earnings at the beginning of the year | | 598,077,145.03 | 591,874,362.44 |
| Add: comprehensive income of the year | | (207,931,832.72) | 6,771,799.32 |
| Less: Appropriation for statutory surplus reserve | | <u>–</u> | <u>569,016.73</u> |
| Retained earnings at the end of the year | | <u>390,145,312.31</u> | <u>598,077,145.03</u> |

(1) Retained earnings at the end of the period

As at 31 December 2014, the Group's retained earnings attributed to the Company included RMB7,241,937.75 of surplus reserve drawn by subsidiaries of the Company (31 December 2013: RMB7,241,937.75). As at 31 December 2014, retained earnings available for distribution to shareholders was RMB410,392,482.57 (31 December 2013: RMB614,483,789.10).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

37. Operating income and operating costs

The Group

| Item | 2014 | | 2013 (restated) | |
|--|-----------------------|-----------------------|-------------------------|-----------------------|
| | Income | Cost | Income | Cost |
| Operating income from principal activities | 865,169,570.13 | 701,444,792.15 | 1,017,909,559.42 | 798,013,992.29 |
| Other operating income | <u>2,719,735.51</u> | <u>1,418,180.01</u> | <u>11,579,320.32</u> | <u>4,484,082.96</u> |
| Total of operating income | <u>867,889,305.64</u> | <u>702,862,972.16</u> | <u>1,029,488,879.74</u> | <u>802,498,075.25</u> |

Unit: RMB

The Company

| Item | 2014 | | 2013 (restated) | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | Income | Cost | Income | Cost |
| Operating income from principal activities | 703,835,918.17 | 594,445,132.17 | 871,069,534.77 | 690,290,070.97 |
| Other operating income | <u>4,098,175.13</u> | <u>1,418,180.01</u> | <u>12,163,420.32</u> | <u>4,484,082.96</u> |
| Total of operating income | <u>707,934,093.30</u> | <u>595,863,312.18</u> | <u>883,232,955.09</u> | <u>694,774,153.93</u> |

Unit: RMB

Breakdown of operating income:

The Group

| | 2014 | | 2013 (restated) | |
|--|------|-----------------------|-----------------|-------------------------|
| | | | | |
| Operating income from principal activities | | | | |
| – income from sales of goods | | 827,612,780.01 | | 999,127,712.28 |
| – income from services | | 37,556,790.12 | | 18,781,847.14 |
| Sub-total | | 865,169,570.13 | | 1,017,909,559.42 |
| Other operating income | | <u>2,719,735.51</u> | | <u>11,579,320.32</u> |
| Total | | <u>867,889,305.64</u> | | <u>1,029,488,879.74</u> |

Unit: RMB

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

37. Operating income and operating costs (Continued)

The Company

| | 2014 | Unit: RMB 2013 (restated) |
|--|-----------------------|------------------------------|
| Operating income from principal activities | | |
| – income from sales of goods | 666,446,289.47 | 852,287,687.63 |
| – income from services | 37,389,628.70 | 18,781,847.14 |
| Sub-total | 703,835,918.17 | 871,069,534.77 |
| Other operating income | 4,098,175.13 | 12,163,420.32 |
| Total | <u>707,934,093.30</u> | <u>883,232,955.09</u> |

Information regarding operating income from principal activities, expenses and profit included Note XIV. 2.

38. Business taxes and surcharges

The Group

| Item | 2014 | Unit: RMB 2013 |
|--|---------------------|---------------------|
| Business tax | 2,782.18 | 199,502.00 |
| Urban maintenance and construction tax | 3,849,233.56 | 4,212,900.37 |
| Education surcharges | 1,928,402.95 | 1,844,082.16 |
| Local education surcharges | 1,285,601.97 | 1,029,679.94 |
| Total | <u>7,066,020.66</u> | <u>7,286,164.47</u> |

The Company

| Item | 2014 | Unit: RMB 2013 |
|--|---------------------|---------------------|
| Business tax | – | 199,502.00 |
| Urban maintenance and construction tax | 2,912,559.39 | 3,787,171.56 |
| Education surcharges | 1,333,740.60 | 1,623,073.51 |
| Local education surcharges | 1,088,662.41 | 882,547.02 |
| Total | <u>5,334,962.40</u> | <u>6,492,294.09</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

39. Selling and distribution expenses

The Group

| Item | 2014 | Unit: RMB |
|--|-----------------------|----------------------|
| | | 2013 |
| Staff cost | 36,053,755.33 | 25,872,954.54 |
| Sales commission and business promotion expenses | 8,604,500.32 | 6,418,234.76 |
| Others | 71,360,528.94 | 49,373,389.00 |
| Total | <u>116,018,784.59</u> | <u>81,664,578.30</u> |

The Company

| Item | 2014 | Unit: RMB |
|--|-----------------------|----------------------|
| | | 2013 |
| Staff cost | 33,831,835.64 | 24,243,478.54 |
| Sales commission and business promotion expenses | 8,604,500.32 | 6,418,234.76 |
| Others | 62,597,310.53 | 44,032,274.50 |
| Total | <u>105,033,646.49</u> | <u>74,693,987.80</u> |

40. General and administrative expenses

The Group

| Item | 2014 | Unit: RMB |
|-----------------------|-----------------------|-----------------------|
| | | 2013 |
| Staff cost | 76,295,531.29 | 62,914,599.88 |
| Depreciation expenses | 8,151,449.74 | 8,912,084.83 |
| Others | 100,761,933.42 | 90,844,025.14 |
| Total | <u>185,208,914.45</u> | <u>162,670,709.85</u> |

The Company

| Item | 2014 | Unit: RMB |
|-----------------------|-----------------------|-----------------------|
| | | 2013 |
| Staff cost | 63,984,023.96 | 54,513,876.94 |
| Depreciation expenses | 6,940,215.85 | 7,685,218.40 |
| Others | 75,654,880.45 | 76,960,358.12 |
| Total | <u>146,579,120.26</u> | <u>139,159,453.46</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

41. Finance expenses

The Group

| Item | Unit: RMB | |
|---|----------------------|---------------------|
| | 2014 | 2013 |
| Interest expenses on loans and accounts payable | 28,988,788.22 | 15,390,927.26 |
| Less: interest expenses capitalized | 12,279,543.91 | 9,239,816.13 |
| Interest expenses on deposit ("()") for interest income | (841,927.69) | (469,431.82) |
| Net exchange loss | 259,741.24 | 173,674.69 |
| Other financial expenses | 1,464,381.78 | 1,262,711.55 |
| Total | <u>17,591,439.64</u> | <u>7,118,065.55</u> |

The Company

| Item | Unit: RMB | |
|---|----------------------|---------------------|
| | 2014 | 2013 |
| Interest expenses on loans and accounts payable | 27,092,661.17 | 13,565,469.21 |
| Less: interest expenses capitalized | 12,279,543.91 | 9,239,816.13 |
| Interest expenses on deposit ("()") for interest income | (605,549.37) | (299,404.34) |
| Net exchange loss | 674,414.70 | 173,674.69 |
| Other financial expenses | 1,422,204.16 | 1,262,156.31 |
| Total | <u>16,304,186.75</u> | <u>5,462,079.74</u> |

The interest rate per annum, at which the borrowing cost were capitalized for the current year by the Group and the Company was 7.00% (2013: 6.57%).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

42. Asset impairment losses (“()” for reversal)

The Group

| Item | 2014 | Unit: RMB | |
|---------------------|----------------------|-----------------------|--|
| | | 2013 | |
| Accounts receivable | 27,335,942.11 | (3,894,746.88) | |
| Other receivables | 595,360.91 | (1,143,381.44) | |
| Inventories | 8,418,134.07 | 2,684,786.15 | |
| Total | <u>36,349,437.09</u> | <u>(2,353,342.17)</u> | |

The Company

| Item | 2014 | Unit: RMB | |
|---------------------|----------------------|-----------------------|--|
| | | 2013 | |
| Accounts receivable | 21,795,825.57 | (5,889,533.36) | |
| Other receivables | 639,252.01 | (1,143,381.44) | |
| Inventories | 4,906,467.22 | 1,661,036.10 | |
| Total | <u>27,341,544.80</u> | <u>(5,371,878.70)</u> | |

43. Investment income

The Group

| Item | Note | 2014 | Unit: RMB | |
|--|------|---------------------|-------------------|--|
| | | | 2013 | |
| Income from long-term equity investments accounted for using the equity method | V.10 | 1,926,942.96 | 589,379.17 | |
| Income from disposal of long-term equity investments | (1) | 7,538,290.55 | – | |
| Total | | <u>9,465,233.51</u> | <u>589,379.17</u> | |

(1) Investment income of disposal of long-term equity investment

Investment income of disposal of long-term equity investment was transferred from capital reserve during the period which was related to the comprehensive income of Kunming TOS (see Note VI. 1(1)).

The Company

| Item | 2014 | Unit: RMB | |
|---|---------------------|-------------------|--|
| | | 2013 | |
| Income from long-term equity investments accounted for using the equity method (“()” for loss) | <u>1,926,942.96</u> | <u>589,379.17</u> | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

44. Non-operating income

(1) Non-operating income by item is as follows:

The Group

| Item | 2014 | 2013 | <i>Unit: RMB</i> |
|---|----------------------|----------------------|---|
| | | | Amount included in extraordinary gains or losses for the year 2014 |
| Gain on disposal of non-current assets | 196,298.44 | 1,270,162.87 | 196,298.44 |
| Of which: gain on fixed assets disposal | 196,298.44 | 1,270,162.87 | 196,298.44 |
| Government grants | 7,315,597.49 | 4,222,272.70 | 7,315,597.49 |
| Gain on transfer of accounts receivable | – | 14,555,496.15 | – |
| Gain on debt restructuring of accounts payable | 7,657,445.80 | 21,472,524.42 | 7,657,445.80 |
| Others | 465,210.98 | 225,827.84 | 465,210.98 |
| Total | 15,634,552.71 | 41,746,283.98 | 15,634,552.71 |

The Company

| Item | 2014 | 2013 | <i>Unit: RMB</i> |
|---|----------------------|----------------------|---|
| | | | Amount included in extraordinary gains or losses for the year 2014 |
| Gain on disposal of non-current assets | 196,298.44 | 506,407.63 | 196,298.44 |
| Of which: gain on fixed assets disposal | 196,298.44 | 506,407.63 | 196,298.44 |
| Government grants | 6,252,946.00 | 3,929,272.70 | 6,252,946.00 |
| Gain on transfer of accounts receivable | – | 14,555,496.15 | – |
| Gain on debt restructuring of accounts payable | 7,657,445.80 | 21,472,524.42 | 7,657,445.80 |
| Others | 392,451.98 | 225,827.84 | 392,451.98 |
| Total | 14,499,142.22 | 40,689,528.74 | 14,499,142.22 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

44. Non-operating income (Continued)

(2) Breakdown of government grants:

The Group

| Item | Unit: RMB | | Related to assets/income |
|---|---------------------|---------------------|--------------------------|
| | 2014 | 2013 | |
| High-end CNC machine tool design, technology research and Development of digital tools | 1,939,600.00 | – | Related to income |
| Kunming City Panlong District Finance Bureau working capital for supporting production | 2,997,800.00 | – | Related to income |
| R&D projects grants from Yunnan provincial precision machine tool engineering research center | – | 1,200,000.00 | Related to income |
| Others | 2,378,197.49 | 3,022,272.70 | Related to assets/income |
| Total | 7,315,597.49 | 4,222,272.70 | |

The Company

| Item | Unit: RMB | | Related to assets/income |
|---|---------------------|---------------------|--------------------------|
| | 2014 | 2013 | |
| High-end CNC machine tool design, technology research and Development of digital tools | 1,939,600.00 | – | Related to income |
| Kunming City Panlong District Finance Bureau working capital for supporting production | 2,997,800.00 | – | Related to income |
| R&D projects grants from Yunnan provincial precision machine tool engineering research center | – | 1,200,000.00 | Related to income |
| Others | 1,315,546.00 | 2,729,272.70 | Related to assets/income |
| Total | 6,252,946.00 | 3,929,272.70 | |

(3) Debt adjustment of accounts payable

In the year ended 31 December 2014, the Company entered into debt restructuring agreements with 41 suppliers, which agreed to accept certain reductions on the accounts payable owed by the Company to the suppliers. Pursuant to the provisions of these agreements, the suppliers committed to giving up ownership of the reduced amounts and will no longer claim the rights to the reduced amounts. None of these suppliers was a related party of the Company or the Group, or holding more than 5% (inclusive) of the Company's voting shares. As a result, the Company reduced the recorded accounts payable by RMB 7,657,445.80 and recognized the amount in the non-operating income accordingly.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

45. Non-operating expenses

The Group

| Item | 2014 | 2013 | <i>Unit: RMB</i> |
|--|-------------------|---------------------|--|
| | | | Amount included in extraordinary gains or losses for the year 2014 |
| Losses on disposal of non-current assets | 313,420.84 | 146,556.46 | 313,420.84 |
| Of which: losses on disposal of fixed assets | 313,420.84 | 146,556.46 | 313,420.84 |
| Others | 70,504.61 | 2,856,306.21 | 70,504.61 |
| Total | <u>383,925.45</u> | <u>3,002,862.67</u> | <u>383,925.45</u> |

The Company

| Item | 2014 | 2013 | <i>Unit: RMB</i> |
|--|-------------------|---------------------|--|
| | | | Amount included in extraordinary gains or losses for the year 2014 |
| Losses on disposal of non-current assets | 139,661.71 | 115,863.64 | 139,661.71 |
| Of which: losses on disposal of fixed assets | 139,661.71 | 115,863.64 | 139,661.71 |
| Others | 69,839.04 | 2,680,656.21 | 69,839.04 |
| Total | <u>209,500.75</u> | <u>2,796,519.85</u> | <u>209,500.75</u> |

46. Income tax expenses

The Group

| Item | Note | 2014 | <i>Unit: RMB</i> |
|--|------|----------------------|---------------------|
| | | | 2013 (restated) |
| Current tax expenses for the year based on tax law and related regulations | | 117,325.22 | 560,655.36 |
| Difference adjustment for making final settlement | | (114.21) | 198,186.71 |
| Changes in deferred tax assets | (1) | 36,853,706.87 | (1,228,336.19) |
| Total | | <u>36,970,917.88</u> | <u>(469,494.12)</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

46. Income tax expenses (Continued)

The Company

| Item | Note | 2014 | 2013 (restated) |
|---|------|-----------------------------|----------------------------|
| Difference adjustment for making final settlement | | – | 513,458.09 |
| Changes in deferred tax assets | (1) | <u>35,625,737.57</u> | <u>(780,004.58)</u> |
| Total | | <u><u>35,625,737.57</u></u> | <u><u>(266,546.49)</u></u> |

(1) The analysis of changes in deferred tax is set out below:

The Group

| Item | 2014 | 2013 (restated) |
|---|-----------------------------|------------------------------|
| Origination and reversal of the temporary differences (“()” for generation) | 569,264.18 | (197,032.10) |
| Reversal of deferred tax assets recognised in prior years | 36,303,557.12 | 369,932.08 |
| Using deductible losses unrecognised in prior years | <u>(19,114.43)</u> | <u>(1,401,236.17)</u> |
| Total | <u><u>36,853,706.87</u></u> | <u><u>(1,228,336.19)</u></u> |

The Company

| Item | 2014 | 2013 (restated) |
|---|-----------------------------|----------------------------|
| Origination and reversal of the temporary differences (“()” for generation) | 36,992.97 | (1,149,936.66) |
| Reversal of deferred tax assets recognised in prior years | <u>35,588,744.60</u> | <u>369,932.08</u> |
| Total | <u><u>35,625,737.57</u></u> | <u><u>(780,004.58)</u></u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

46. Income tax expenses (Continued)

(2) The relationship between income tax expenses and accounting profit:

The Group

| Item | Unit: RMB | |
|--|----------------------|---------------------|
| | 2014 | 2013 (restated) |
| Profit before tax ("") for loss | (172,492,402.18) | 9,937,428.97 |
| Expected income tax calculated at the rate of 25% | (43,123,100.54) | 2,484,357.24 |
| Add: non-deductible costs, expenses and losses | 1,292,221.32 | 1,188,725.92 |
| Non-taxable income | (1,812,022.19) | (147,344.79) |
| Effects of deductible temporary differences or losses of unrecognized deferred income tax assets in the year | 51,039,846.60 | – |
| Effects of reversal of deductible losses or temporary differences of deferred tax assets recognised in prior years | 36,303,557.12 | 369,932.08 |
| Using unrecognised deferred tax assets in prior years | (19,114.43) | (1,401,236.17) |
| Effects of different tax rates | (954,523.09) | 1,065,512.22 |
| Effects of items eligible for additional deduction | (5,677,615.89) | (3,853,933.23) |
| Effects on preferential income tax | (78,216.81) | (373,694.10) |
| Difference adjustment for making final settlement | (114.21) | 198,186.71 |
| | <u>36,970,917.88</u> | <u>(469,494.12)</u> |
| Income tax expenses for the year ("") for income tax income) | | |

The Company

| Item | Unit: RMB | |
|--|----------------------|---------------------|
| | 2014 | 2013 (restated) |
| Profit before tax ("") for loss | (172,306,095.15) | 6,505,252.83 |
| Expected income tax calculated at the rate of 25% | (43,076,523.79) | 1,626,313.21 |
| Add: non-deductible costs, expenses and losses | 834,124.14 | 458,403.71 |
| Non-taxable income | (481,735.74) | (147,344.79) |
| Effects of deductible temporary differences or losses of unrecognized deferred income tax assets in the year | 47,505,488.63 | – |
| Effects of reversal of deductible losses or temporary differences of deferred tax assets recognised in prior years | 35,588,744.60 | 369,932.08 |
| Effects of different tax rates | (24,661.98) | 766,624.44 |
| Effects of items eligible for additional deduction | (4,719,698.29) | (3,853,933.23) |
| Difference adjustment for making final settlement | – | 513,458.09 |
| | <u>35,625,737.57</u> | <u>(266,546.49)</u> |
| Income tax expenses for the year ("") for income tax income) | | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

47. 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:

| | 2014 | 2013 (restated) |
|---|------------------|------------------------|
| Consolidated net profit attributable to ordinary shareholders of the Company (“”) for loss) (RMB) | (204,091,306.53) | 8,521,796.32 |
| 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) | (0.38) | 0.02 |

In 2014 and 2013, 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 2014.

(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.

48. Income statement supplementary information

Classification of expenses in the income statement by nature:

The Group

| Item | 2014 | 2013 (restated) |
|---|-------------------------|------------------------|
| | | <i>Unit: RMB</i> |
| Operating income | 867,889,305.64 | 1,029,488,879.74 |
| Less: Changes in inventories of finished goods and work-in-progress | (28,544,601.85) | 125,829,126.37 |
| Raw materials used | 397,311,282.91 | 456,986,824.75 |
| Employee benefits expenses | 300,863,484.27 | 255,548,108.70 |
| Depreciation and amortization | 50,102,576.91 | 48,622,790.20 |
| Provision/(reversal) of impairment losses | 36,349,437.09 | (2,353,342.17) |
| Rental expenses | 8,728,482.94 | 7,234,341.70 |
| Financial expenses | 17,591,439.64 | 7,118,065.55 |
| Annual audit fee | 3,400,000.00 | 3,400,000.00 |
| Other expenses | 269,830,233.17 | 155,908,956.98 |
| Operating loss | <u>(187,743,029.44)</u> | <u>(28,805,992.34)</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

48. Income statement supplementary information (Continued)

The Company

| Item | 2014 | Unit: RMB | |
|---|-------------------------|------------------------|--|
| | | 2013 (restated) | |
| Operating income | 707,934,093.30 | 883,232,955.09 | |
| Less: Changes in inventories of finished goods and work-in-progress | (48,655,502.39) | 166,300,097.17 | |
| Raw materials used | 365,216,463.55 | 277,762,657.96 | |
| Employee benefits expenses | 265,616,991.43 | 229,233,562.42 | |
| Depreciation and amortization | 42,108,548.35 | 41,851,535.66 | |
| Provision/(reversal) of impairment losses | 27,341,544.80 | (5,371,878.70) | |
| Rental expenses | 6,796,298.27 | 7,230,147.70 | |
| Financial expenses | 16,304,186.75 | 5,462,079.74 | |
| Annual audit fee | 3,400,000.00 | 3,400,000.00 | |
| Other expenses | 216,401,299.16 | 188,752,509.20 | |
| Operating loss | <u>(186,595,736.62)</u> | <u>(31,387,756.06)</u> | |

49. Items of cash flow statement

(1) Cash received relating to other operating activities

The Group

| Item | 2014 | Unit: RMB | |
|----------------------------|----------------------|----------------------|--|
| | | 2013 | |
| Received government grants | 24,121,464.33 | 40,597,648.58 | |
| others | <u>1,329,644.41</u> | <u>653,616.52</u> | |
| Total | <u>25,451,108.74</u> | <u>41,251,265.10</u> | |

The Company

| Item | 2014 | Unit: RMB | |
|----------------------------|----------------------|----------------------|--|
| | | 2013 | |
| Received government grants | 22,818,812.84 | 40,597,648.58 | |
| Others | <u>792,701.35</u> | <u>233,011.32</u> | |
| Total | <u>23,611,514.19</u> | <u>40,830,659.90</u> | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

49. Items of cash flow statement (Continued)

(2) Cash paid relating to other operating activities

The Group

| Item | 2014 | Unit: RMB |
|-----------------|----------------------|----------------------|
| | | 2013 |
| R & D expenses | 11,561,307.43 | 8,702,690.51 |
| Warranty | 11,287,828.39 | 8,292,509.25 |
| Office expenses | 7,813,389.12 | 6,520,148.12 |
| Maintenance | 6,298,405.11 | 5,006,247.94 |
| Others | 9,886,728.42 | 11,834,242.22 |
| Total | <u>46,847,658.47</u> | <u>40,355,838.04</u> |

The Company

| Item | 2014 | Unit: RMB |
|-----------------|----------------------|----------------------|
| | | 2013 |
| R & D expenses | 6,511,838.06 | 3,726,463.06 |
| Warranty | 10,020,851.87 | 8,292,509.25 |
| Office expenses | 7,138,270.50 | 5,844,898.91 |
| Maintenance | 6,002,525.94 | 4,834,277.85 |
| Others | 2,828,624.84 | 1,354,617.93 |
| Total | <u>32,502,111.21</u> | <u>24,052,767.00</u> |

(3) Cash received relating to other financing activities

The Group and the Company

| Item | 2014 | Unit: RMB |
|--|----------|----------------------|
| | | 2013 |
| Cash received from notes payable financing | <u>—</u> | <u>47,230,000.00</u> |

(4) Cash paid relating to other financing activities

The Group and the Company

| Item | 2014 | Unit: RMB |
|---------------------------------------|----------------------|-----------|
| | | 2013 |
| Cash paid for notes payable financing | <u>47,230,000.00</u> | <u>—</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

50. Related information of cash flow statement

(1) Supplementary information on cash flow statement

a. Reconciliation of net profit (“()” for net loss) to cash flows from operating activities

The Group

| Supplementary information | 2014 | <i>Unit: RMB</i> 2013 (restated) |
|--|-------------------------|--|
| Net profit (“()” for net loss) | (209,463,320.06) | 10,406,923.09 |
| Add: Provision for impairment of assets “()” for reversal) | 36,349,437.09 | (2,353,342.17) |
| Depreciation of fixed assets | 44,414,724.99 | 45,286,164.86 |
| Amortization of intangible assets | 5,687,851.92 | 3,336,625.34 |
| Amortization of long-term deferred expenses | 466,491.19 | 935,635.62 |
| Amortization of deferred income | (2,652,600.00) | (1,935,300.00) |
| Loss on disposal of fixed assets “()” for profit) | 117,122.40 | (1,123,606.41) |
| Finance expense | 17,480,937.80 | 6,583,401.89 |
| Investment income | (9,465,233.51) | (589,379.17) |
| Gain on transfer of accounts receivable | – | (14,555,496.15) |
| Gain on adjustment of financial liabilities | (10,767,445.80) | (21,472,524.42) |
| Decrease in deferred tax assets “()” for increase) | 36,853,706.87 | (1,228,336.19) |
| Decrease in inventories (“()” for increase) | (33,762,492.01) | 141,906,206.94 |
| Increase in operating receivable | (35,412,058.64) | (258,072,391.12) |
| Increase in operating payable | 27,896,861.23 | 15,286,965.85 |
| Net cash flows from operating activities | <u>(132,256,016.53)</u> | <u>(77,588,452.04)</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

50. Related information of cash flow statement (Continued)

(1) Supplementary information on cash flow statement (Continued)

- a. Reconciliation of net profit (“”) for net loss) to cash flows from operating activities: (Continued)

The Company

| Supplementary information | 2014 | Unit: RMB |
|--|-------------------------|------------------------|
| | | 2013 (restated) |
| Net profit (“”) for net loss) | (207,931,832.72) | 6,771,799.32 |
| Add: Provision for impairment of assets (“”) for reversal) | 27,341,544.80 | (5,371,878.70) |
| Depreciation of fixed assets | 37,464,854.78 | 38,815,567.88 |
| Amortization of intangible assets | 4,643,693.57 | 3,035,967.78 |
| Amortization of long-term deferred expenses | 356,215.19 | 818,964.62 |
| Amortization of deferred income | (2,652,600.00) | (1,935,300.00) |
| Loss on disposal of fixed assets (“”) for profit) | (56,636.73) | (390,543.99) |
| Finance expense | 15,985,652.53 | 4,295,000.71 |
| Investment income | (1,926,942.96) | (589,379.17) |
| Gain on transfer of accounts receivable | – | (14,555,496.15) |
| Gain on adjustment of financial liabilities | (10,767,445.80) | (21,472,524.42) |
| Decrease in deferred tax assets (“”) for increase) | 35,625,737.57 | (780,004.58) |
| Decrease in inventories (“”) for increase) | (67,017,803.59) | 181,736,791.14 |
| Increase in operating receivable | (88,170,244.13) | (244,243,286.97) |
| Increase in operating payable (“”) for decrease) | 121,483,625.95 | (11,900,894.13) |
| Net cash flows from operating activities | <u>(135,622,181.54)</u> | <u>(65,765,216.66)</u> |

- b. Net change in cash and cash equivalents:

The Group

| Item | 2014 | Unit: RMB |
|--|------------------------|----------------------|
| | | 2013 |
| Cash balance at the end of the year | 124,210,047.71 | 139,391,654.25 |
| Less: cash balance at the beginning of the year | 139,391,654.25 | 89,677,792.83 |
| Net increase in cash and cash equivalents (“”) for decrease) | <u>(15,181,606.54)</u> | <u>49,713,861.42</u> |

The Company

| Item | 2014 | Unit: RMB |
|--|------------------------|----------------------|
| | | 2013 |
| Cash balance at the end of the year | 91,613,342.33 | 131,661,936.74 |
| Less: cash balance at the beginning of the year | 131,661,936.74 | 71,927,250.50 |
| Net increase in cash and cash equivalents (“”) for decrease) | <u>(40,048,594.41)</u> | <u>59,734,686.24</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

50. Related information of cash flow statement (Continued)

(2) Related information of acquisition of subsidiary during the year

Related information of acquisition of subsidiary:

| | 2014 | 2013 |
|--|----------------------|----------|
| Price of acquired subsidiary | – | – |
| Cash and cash equivalents paid for acquisition of subsidiary | – | – |
| Less: cash and cash equivalents held by subsidiary | 22,569,575.21 | – |
| Net cash from acquisition of subsidiary | <u>22,569,575.21</u> | <u>–</u> |

For information of non-cash assets and liabilities of acquired subsidiary and other operation business, please refer to Note VII.1(2).

(3) Composition of cash and cash equivalents

The Group

| Item | 2014 | Unit: RMB |
|-------------------------------------|-----------------------|-----------------------|
| | | 2013 |
| Cash | | |
| Including: cash on hand | 644,101.93 | 675,618.41 |
| Bank deposits available on demand | 123,565,945.78 | 138,716,035.84 |
| Cash balance at the end of the year | <u>124,210,047.71</u> | <u>139,391,654.25</u> |

The Company

| Item | 2014 | Unit: RMB |
|-------------------------------------|----------------------|-----------------------|
| | | 2013 |
| Cash | | |
| Including: cash on hand | 494,497.43 | 618,407.91 |
| Bank deposits available on demand | 91,118,844.90 | 131,043,528.83 |
| Cash balance at the end of the year | <u>91,613,342.33</u> | <u>131,661,936.74</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

51. Assets with ownership or use right restrictions

The Group

Unit: RMB

| Items | Opening balance | Increase during the year | Decrease during the year | Closing balance | Reason of restriction |
|--|-----------------------|--------------------------|--------------------------|-----------------------|------------------------|
| – Cash at bank and on hand | 42,414,015.75 | 111,625,711.18 | 115,221,777.02 | 38,817,949.91 | Pledged |
| – Bills receivable | | | | | |
| – Pledged bank acceptance bills | 64,684,500.00 | 2,000,000.00 | 64,684,500.00 | 2,000,000.00 | Pledged |
| – Endorsed or discounted commercial acceptance bills | – | 8,526,233.00 | – | 8,526,233.00 | Endorsed or discounted |
| – Fixed assets | 11,370,003.28 | 54,886,546.64 | 2,952,524.94 | 63,304,024.98 | Pledged |
| – Intangible assets | 6,476,353.93 | – | 158,928.90 | 6,317,425.03 | |
| Total | <u>124,944,872.96</u> | <u>177,038,490.82</u> | <u>183,017,730.86</u> | <u>118,965,632.92</u> | |

The Company

Unit: RMB

| Items | Opening balance | Increase during the year | Decrease during the year | Closing balance | Reason of restriction |
|--|----------------------|--------------------------|--------------------------|----------------------|------------------------|
| – Cash at bank and on hand | 35,398,295.80 | 87,040,674.95 | 92,421,799.12 | 30,017,171.63 | Pledged |
| – Bills receivable | | | | | |
| – Pledged bank acceptance bills | 56,741,500.00 | – | 56,741,500.00 | – | Pledged |
| – Endorsed or discounted commercial acceptance bills | – | 8,526,233.00 | – | 8,526,233.00 | Endorsed or discounted |
| – Fixed assets | – | 54,886,546.64 | 2,011,559.10 | 52,874,987.54 | pledged |
| Total | <u>92,139,795.80</u> | <u>150,453,454.59</u> | <u>151,174,858.22</u> | <u>91,418,392.17</u> | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

52. Director's remuneration

Details of director's remuneration for the year ended 31st December 2014:

Unit: RMB'000

| | Director's fee | Salaries, allowance and benefits in kind | Retirement scheme contribution | Discretionary bonus (vii) | Total |
|--|----------------|---|--------------------------------------|------------------------------|--------------|
| Executive directors: | | | | | |
| Wang Xing (<i>Chairman</i>) | 96 | 304 | 79 | – | 479 |
| Zhang Xiaoyi | 80 | 289 | 56 | – | 425 |
| Zhang Zeshun (<i>iii</i>) | 51 | 220 | 47 | – | 318 |
| Chang Baoqiang (<i>iv</i>) | 11 | 313 | 79 | – | 403 |
| Ye Nong (<i>v</i>) | 53 | 255 | 79 | – | 387 |
| Li Shunzhen (<i>ii</i>) | 5 | 20 | 5 | – | 30 |
| Non-executive directors: | | | | | |
| Guan Xin | 48 | – | – | – | 48 |
| Gao Minghui | 64 | 303 | 79 | – | 446 |
| Liu Haijie (<i>iv</i>) | 10 | – | – | – | 10 |
| Zhou Donghong(<i>iii</i>)及(<i>v</i>) | 17 | – | – | – | 17 |
| Zhang Tao (<i>i</i>) | – | – | – | – | – |
| Liu Yan(<i>i</i>)及(<i>iv</i>) | – | – | – | – | – |
| Li Zhenxiong (<i>i</i>) | – | – | – | – | – |
| Independent directors: | | | | | |
| Chen Fusheng | 200 | – | – | – | 200 |
| Liu Qiang (<i>iv</i>) | 97 | – | – | – | 97 |
| Yang Xiongsheng | 143 | – | – | – | 143 |
| Tang Chunsheng (<i>iii</i>) | 113 | – | – | – | 113 |
| Xiao Jianming (<i>vi</i>) | 12 | – | – | – | 12 |
| Total | <u>1,000</u> | <u>1,704</u> | <u>424</u> | <u>–</u> | <u>3,128</u> |

Note:

- (i) The director had elected to waive any remuneration to him from the Group.
- (ii) On 27 January 2014, Ms. Li Shunzhen resigned her directorship of the Company.
- (iii) The Company held a 1st EMG on 18 March 2014 to consider and approve Mr. Zhang Zeshun and Mr. Zhou Donghong as director of the Company with effective from 18 March 2014, and to consider and approve Mr. Tang Chunsheng as independent non-executive director of the Company with effective from 18 March 2014.
- (iv) On 31 October 2014, the 3rd EGM was held to consider and approve Mr. Chang Baoqiang as director of the Company with effective from 31 October 2014; to consider and approve Mr. Liu Yan and Ms. Liu Haijie as non-executive directors of the Company with effective from 31 October 2014; to consider and approve Mr. Liu Qiang as independent non-executive director of the Company with effective from 31 October 2014.
- (v) On 31 October 2014, Mr. Ye Nong and Mr. Zhou Donghong resigned their directorship of the Company due to the tenure of appointment expired.
- (vi) On 29 January 2014, Mr. Xiao Jianming resigned his independent non-executive director position of the Company.
- (vii) Discretionary bonuses represent the bonuses paid in 2014 and related to the performance of 2013. The Board confirmed that no discretionary bonuses would be paid for the year 2014.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

52. Director's remuneration (Continued)

Details of director's remuneration for the year ended 31st December 2013:

Unit: RMB'000

| | Director's fee | Salaries, allowance and benefits in kind | Retirement scheme contribution | Discretionary bonus (v) | Total |
|-------------------------------|----------------|---|--------------------------------------|----------------------------|--------------|
| Executive directors: | | | | | |
| Wang Xing (<i>Chairman</i>) | 99 | 402 | 75 | 250 | 826 |
| Zhang Xiaoyi | 80 | 388 | 56 | 280 | 804 |
| Ye Nong | 64 | 346 | 75 | 215 | 700 |
| Li Shunzhen | 64 | 327 | 64 | 30 | 485 |
| Non-executive directors: | | | | | |
| Guan Xin | 57 | – | – | – | 57 |
| Gao Minghui | 64 | 401 | 32 | 50 | 547 |
| Zhang Tao (<i>i</i>) | – | – | – | – | – |
| Li Zhenxiong (<i>i</i>) | – | – | – | – | – |
| Independent directors: | | | | | |
| Li Dongru (<i>ii</i>) | 119 | – | – | – | 119 |
| Chen Fusheng | 200 | – | – | – | 200 |
| Xiao Jianming | 143 | – | – | – | 143 |
| Yu Chengting (<i>iii</i>) | 30 | – | – | – | 30 |
| Liu Minghui (<i>iv</i>) | 36 | – | – | – | 36 |
| Yang Xiongsheng (<i>iv</i>) | 113 | – | – | – | 113 |
| Total | <u>1,069</u> | <u>1,864</u> | <u>302</u> | <u>825</u> | <u>4,060</u> |

Note:

- (i) The director had elected to waive any remuneration to him from the Group.
- (ii) On 29 June 2013, Ms. Li Dongru resigned due to the tenure of appointment expired.
- (iii) The Company held a 2nd EMG on 26 August 2013 to review and approve Mr. Yu Chengting as independent non-executive director of the Company. On 12 December 2013, Mr. Yu submitted the resignation due to personal health reason.
- (iv) On 22 March 2013, Mr. Liu Minghui resigned due to the tenure of appointment expired and Mr. Yang Xiongsheng replace his position as an independent non-executive director of the Company.
- (v) Discretionary bonuses represent the bonuses paid in 2013 and related to the performance of 2012.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

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

53. Individuals With Highest Emoluments

Of the five individuals with the highest emoluments, four (2013: three) are directors whose emolument are disclosed in note V. 52. The aggregate of the emoluments in respect of the remaining individuals are as follows:

| Item | 2014 | Unit: RMB'000 | |
|---------------------------------|------|---------------|--|
| | | 2013 | |
| Salaries and other emoluments | 349 | 698 | |
| Discretionary bonuses | – | 375 | |
| Retirement scheme contributions | 56 | 112 | |
| Total | 405 | 1,185 | |

Except for directors, the emoluments of one individual (2013: two) with the highest emoluments is within the following band:

| Item | 2014 | 2013 |
|-------------------------|------|------|
| HKD Nil – HKD 1,000,000 | 1 | 2 |

VI. CHANGE IN THE SCOPE OF CONSOLIDATION

1. Business combination not under common control

(1) Business combination not under common control during the year

| | Date of transfer | Consideration of acquisition | Proportion of equity acquired (%) | Equity acquisition method | Date of acquisition | Basis for determining date of acquisition | Unit: RMB | | |
|-------------|------------------|------------------------------|-----------------------------------|---|---------------------|--|--|--------------|-----------------|
| | | | | | | | From date of acquisition to 31 December 2014 | | Net cash inflow |
| | | | | | | | Revenue | Net profit | |
| TOS Kunming | 15 May 2014 | 43,432,971.01 | 50% | Business combination not under common control | 15 May 2014 | The date on which the rights of TOS Kunming were obtained and influence on its variable returns could be exercised | 66,494,451.62 | 5,394,403.52 | 796,676.98 |

TOS Kunming Machine Tool Co., Ltd. ("TOS Kunming") was founded in Kunming, Yunnan province, on 27 January 2005. It is headquartered in Kunming and mainly engaged in the production and sale of machine tool products. The Company and another investor, TOS Varnsdorf, a.s. (Czech TOS) from Czech Republic, each holds 50% of equity interests in TOS Kunming. In accordance with the Sino-foreign Joint Venture Agreement entered into by the two parties on 27 January 2005, the board of TOS Kunming is comprised of 6 directors, the Company and Czech TOS each appointed three directors. Accordingly, TOS Kunming was jointly controlled by the Company and Czech TOS, and was a joint venture of the Company. The difference of RMB7,538,290.55 between the carrying amount of the fixed assets invested as capital contribution and the amount of investments recognized was originally stated as capital reserve – equity investment reserve by the Company. The Company has adopted the new Accounting Standards for Business Enterprises since 1 January 2007, and the equity investment reserve was transferred into capital reserve arising from long-term equity investments (other capital reserve) under the new standards, which was accounted for using the equity method.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VI. CHANGE IN THE SCOPE OF CONSOLIDATION (Continued)

1. Business combination not under common control (Continued)

(1) Business combination not under common control during the year (Continued)

In accordance with the Amendment to the Joint Venture Agreement (2013) signed on 25 December 2013 ("Amendment (2013)"), the number of directors on the board of directors of Kunming TOS was increased from six to seven, with four directors to be appointed by the Company. Accordingly, the Company will have a majority of the board of directors of Kunming TOS. Amendment (2013) was considered and approved by the Annual General Meeting of the Company on 15 May 2014. As the Company had obtained more than half of the voting rights since then, Kunming TOS was incorporated into the scope of the consolidated financial statements of the Group by the Company with effect from 15 May 2014. The operating results of Kunming TOS for the period from the date of acquisition to 31 December 2014 have been incorporated into the consolidated income statement of the Group for the current period.

The acquisition cost incurred by the Group for the business combination was the carrying amount of the equity investment in Kunming TOS held by the Group at the acquisition date (RMB43,432,971.01). The Group acquired 50% equity interest of Kunming TOS in the business combination. The fair value of the identifiable net assets of Kunming TOS (net of non-controlling interests) at the acquisition date was RMB43,432,971.01. Meanwhile, other comprehensive income (i.e. the above equity investment reserve originally included in other capital reserve) of RMB7,538,290.55 related to the investment in Kunming TOS held by the Group prior to the acquisition date was carried over as investment income during the period (Note V.43).

(2) Identifiable assets and liabilities of the acquiree as at the acquisition date

Unit: RMB

| | Kunming TOS | |
|---|----------------------|----------------------|
| | Fair value | Carrying amount |
| Assets | | |
| Cash at bank and on hand | 22,569,575.21 | 22,569,575.21 |
| Bills receivable | 11,966,832.84 | 11,966,832.84 |
| Accounts receivable and other receivables | 42,914,532.45 | 42,914,532.45 |
| Prepayments | 4,978,614.91 | 4,978,614.91 |
| Inventories | 31,784,692.90 | 31,784,692.90 |
| Fixed assets | 13,173,938.67 | 13,173,938.67 |
| Intangible assets | 3,194,758.12 | 3,194,758.12 |
| Deferred tax assets | 2,383,465.79 | 2,383,465.79 |
| Liabilities | | |
| Accounts payable | 20,760,619.07 | 20,760,619.07 |
| Advances from customers | 10,519,348.25 | 10,519,348.25 |
| Employee benefits payable | 2,051,535.07 | 2,051,535.07 |
| Taxes payable | 1,479,852.39 | 1,479,852.39 |
| Dividend payable | 4,000,000.00 | 4,000,000.00 |
| Other payables | 7,289,114.10 | 7,289,114.10 |
| Net assets | 86,865,942.01 | 86,865,942.01 |
| Less: non-controlling interest | 43,432,971.00 | 43,432,971.00 |
| Net assets acquired | <u>43,432,971.01</u> | <u>43,432,971.01</u> |

As there is no active market for the above identifiable assets and no active market for the same type of assets or similar assets, valuation technique is used to determine the fair value. The fair value of the above identifiable liabilities is based on the amount payable or the present value of the amount payable.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VII. INTERESTS IN OTHER ENTITIES

1. Interests in subsidiaries

(1) The constitution of the Group

| Name of subsidiary | Principal place of business | Place of registration | Nature of business | Registered capital | Percentage of shareholding (%) (or percentage of similar interests) | | Percentage of voting rights (%) | Method of acquisition |
|--------------------|-----------------------------|-----------------------|---|--------------------|---|------------|---------------------------------|---|
| | | | | | Directly | Indirectly | | |
| Xi'an Ser (note) | Xi'an | Xi'an | Development, design, production and sales of compressor series products and accessories | RMB50,000,000 | 45% | | 60.00% | Business combination not under common control |
| Changsha Ser | Changsha | Changsha | Development, design, production and sales of compressor series products and accessories | RMB10,000,000 | 100% | | 100% | Business combination not under common control |
| Kunming TOS (note) | Kunming | Kunming | Development, design, production and sales of machine tool series products and accessories | RMB49,457,000 | 50% | | 57.14% | Business combination not under common control |
| General Machine | Kunming | Kunming | Development, design, production and sales of machine tool series products and accessories | RMB3,000,000 | 100% | | 100% | Established through investments |

Note: The percentage of voting rights of the Company in Xi'an Ser and Kunming TOS is determined based on the percentage of voting rights of the Company in the board of directors of the investee companies. The Group has control over the financial and operational decision-making of the investee companies, and is able to exercise its power over Xi'an Ser and Kunming TOS to influence the amount of its attributable variable returns. Therefore, the Company has treated the investee companies as its subsidiaries and adopted the cost method for accounting.

(2) Major non wholly-owned subsidiaries

| Name of subsidiary | Percentage of shareholding of non-controlling shareholders | Profit | Dividend | Balance of |
|--------------------|--|---|--|--|
| | | attributable to non-controlling shareholders for the year ("(") for losses) | declared to non-controlling shareholders during the year | non-controlling interests at the end of the year |
| Xi'an Ser | 55% | (7,335,813.46) | – | 3,579,780.23 |
| Changsha Ser | 55% | (583,021.52) | – | 33,213,912.83 |
| Kunming TOS | 50% | 2,752,839.49 | – | 46,185,810.49 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VII. INTERESTS IN OTHER ENTITIES (Continued)

1. Interests in subsidiaries (Continued)

(3) Principal financial information on major non wholly-owned subsidiaries

The following table sets forth the principal financial information on the aforesaid subsidiaries, which represented the amounts before elimination of intra-group transactions but after adjustments made based on relevant fair value as at the date of consolidation and the unified accounting policies:

| | Xi'an Ser | | Changsha Ser | | Kunming TOS | |
|--------------------------------------|-----------------|----------------|----------------|----------------|----------------|----------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Current assets | 152,508,054.82 | 173,515,583.09 | 202,596,884.75 | 246,020,146.72 | 116,581,899.44 | 123,851,562.40 |
| Non-current assets | 21,038,863.56 | 195,852,825.62 | 43,678,086.17 | 46,070,421.61 | 16,328,531.66 | 19,630,137.71 |
| Total assets | 173,546,918.38 | 369,368,408.71 | 246,274,970.92 | 292,090,568.33 | 132,910,431.10 | 143,481,700.11 |
| Current liabilities | 165,351,851.21 | 172,128,950.75 | 172,466,275.74 | 216,986,269.77 | 37,456,190.43 | 49,168,126.25 |
| Non-current liabilities | 240,000.00 | - | - | - | 3,082,619.70 | 3,225,080.98 |
| Total liabilities | 165,591,851.21 | 172,128,950.75 | 172,466,275.74 | 216,986,269.77 | 40,538,810.13 | 52,393,207.23 |
| Operating income | 93,335,777.70 | 111,576,286.17 | 121,601,413.11 | 125,668,452.03 | 86,969,967.23 | 81,167,874.91 |
| Net profit ("()" for net losses) | (16,301,807.69) | 721,812.51 | (1,295,603.38) | 2,618,539.49 | 5,283,128.09 | 2,994,473.60 |
| Total comprehensive income | (16,301,807.69) | 721,812.51 | (1,295,603.38) | 2,618,539.49 | 5,283,128.09 | 2,994,473.60 |
| Cash flows from operating activities | 195,281.62 | (9,938,966.09) | (1,258,260.68) | (6,108,740.84) | 7,488,137.71 | 18,583,679.87 |

2. Interests in joint ventures and associated companies

| Items | 2014 | 2013 |
|--------------------------------|----------------------|----------------------|
| Joint ventures | | |
| – Major joint ventures | - | 44,449,919.40 |
| Associated companies | | |
| – Major associated company | 14,384,564.38 | 13,440,673.03 |
| Sub-total | 14,384,564.38 | 57,890,592.43 |
| Less: provision for impairment | - | - |
| Total | <u>14,384,564.38</u> | <u>57,890,592.43</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VII. INTERESTS IN OTHER ENTITIES *(Continued)*

2. Interests in joint ventures and associated companies *(Continued)*

(1) *Major joint ventures and associated company:*

| Name of enterprise | Principal place of business | Place of registration | Nature of business | Percentage of shareholdings | | Accounting method for investments in joint ventures or associated company | Registered capital | Strategic significance to the Group's activities |
|------------------------------|-----------------------------|-----------------------|---|-----------------------------|------------|---|--------------------|--|
| | | | | Directly | Indirectly | | | |
| Joint ventures | | | | | | | | |
| Kunming TOS <i>(note)</i> | PRC | PRC | Production and sales of machine tools | 50% | - | Equity method | EUR5,000,000 | Yes |
| Associated company | | | | | | | | |
| Xi'an Ruite | PRC | PRC | Production and sales of laser prototyping machine | 23.34% | - | Equity method | RMB60,000,000 | Yes |

Note: Kunming TOS was previously a joint venture of the Company. The Group acquired the control over Kunming TOS on 15 May 2014, and Kunming TOS thus became a subsidiary of the Company (refer to Note VI).

(2) *Principal financial information on the major associated company*

The following table sets forth the principal financial information on the major associated company, which represented the amounts after adjustments made based on relevant fair value upon investment and the unified accounting policies. In addition, the following table also sets forth reconciliation of such financial information to the carrying amount of the investment in the associated company of the Group using equity method:

| | Xi'an Ruite | |
|--|----------------|----------------|
| | 2014 | 2013 |
| Current assets | 68,029,211.23 | 65,376,341.02 |
| Non-current assets | 66,334,649.95 | 75,673,103.42 |
| Total assets | 134,363,861.18 | 141,049,444.44 |
| Current liabilities | 26,315,859.77 | 25,164,369.02 |
| Non-current liabilities | 40,231,000.00 | 52,099,900.00 |
| Total liabilities | 66,546,859.77 | 77,264,269.02 |
| Net assets | 67,817,001.41 | 63,785,175.42 |
| Non-controlling interests | 8,435,718.74 | 8,449,141.34 |
| Equity attributable to shareholders of the Company | 59,381,282.67 | 55,336,034.08 |
| Share of net assets calculated based on percentage of shareholding | 15,828,488.13 | 14,887,459.94 |
| Carrying amount of investment in associates | 14,384,564.38 | 13,440,673.03 |
| Operating income | 53,599,327.14 | 34,207,644.51 |
| Net profit ("(" for losses) | 4,045,248.59 | (3,889,707.09) |
| Total comprehensive income | 4,045,248.59 | (3,889,707.09) |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VIII. RISK RELATED TO 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.

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 2014 and 31st December 2013 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. As at the date of balance sheet, 14.94% (2013: 21.34%) of the total accounts receivable and other receivables was due from the Group's top five buyers. Moreover, The Group's neither overdue nor impaired accounts receivable mainly related to those customers without default records recently.

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.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VIII. RISK RELATED TO FINANCIAL INSTRUMENTS (Continued)

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). On the other hand, the Company also considers to negotiate with the suppliers by requiring them to adjust some amount of the debts, or using the measure of sale long ageing accounts receivable to obtain money in advance to reduce the pressure of cash flow of the Company. 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.

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

| Item | 2014 Undiscounted contractual cash flow | | | | Total | Carrying amount on balance sheet |
|-------------------------------------|---|-----------------------|---------------------|-------------------|-------------------------|----------------------------------|
| | Within one year or on demand | 1-2 years | 2-5 years | Over 5 years | | |
| Short term loans | 292,986,496.39 | - | - | - | 292,986,496.39 | 284,500,000.00 |
| Bills payable | 75,048,188.00 | - | - | - | 75,048,188.00 | 75,048,188.00 |
| Accounts payable and other payables | 647,932,878.68 | - | - | - | 647,932,878.68 | 647,932,878.68 |
| Long-term borrowings | 14,186,333.33 | 205,613,666.67 | - | - | 219,800,000.00 | 200,000,000.00 |
| Long-term payable | 21,078,052.72 | 10,710,110.80 | 1,026,506.64 | 684,337.76 | 33,499,007.92 | 30,986,904.25 |
| Total | 1,051,231,949.12 | 216,323,777.47 | 1,026,506.64 | 684,337.76 | 1,269,266,570.99 | 1,238,467,970.93 |

Unit: RMB

| Item | 2013 Undiscounted contractual cash flow (restated) | | | | Total | Carrying amount on balance sheet |
|-------------------------------------|--|------------|--------------|--------------|------------------|----------------------------------|
| | Within one year or on demand | 1-2 years | 2-5 years | Over 5 years | | |
| Short term loans | 310,861,512.05 | - | - | - | 310,861,512.05 | 299,279,000.00 |
| Bills payable | 67,742,506.00 | - | - | - | 67,742,506.00 | 67,742,506.00 |
| Accounts payable and other payables | 625,349,187.99 | - | - | - | 625,349,187.99 | 625,349,187.99 |
| Long-term borrowings | 342,168.88 | 342,168.88 | 1,026,506.64 | 1,026,507.74 | 2,737,352.14 | 1,705,672.90 |
| Long-term payable | 1,004,295,374.92 | 342,168.88 | 1,026,506.64 | 1,026,507.74 | 1,006,690,558.18 | 994,076,366.89 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VIII. RISK RELATED TO 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:*

Fixed interest rate financial instruments:

| Item | 2014 | | 2013 | |
|-------------------------|--------------------|-------------------------|--------------------|-------------------------|
| | Real interest rate | Amount | Real interest rate | Amount |
| Financial liabilities | | | | |
| – short-term borrowings | 5.51% – 7.5% | (284,500,000.00) | 6.3% – 6.6% | (213,575,500.00) |
| Total | | <u>(284,500,000.00)</u> | | <u>(213,575,500.00)</u> |

Unit: RMB

Floating interest rate financial instruments:

| Item | 2014 | | 2013 | |
|---|--------------------|------------------------|--------------------|----------------------|
| | Real interest rate | Amount | Real interest rate | Amount |
| Financial assets | | | | |
| – monetary fund | 0.35% | 162,383,895.69 | 0.35% | 181,130,051.59 |
| Financial liabilities | | | | |
| – short-term borrowings | – | – | 6.6% – 8.7% | (85,703,500.00) |
| – long-term borrowings | 6.77% | (200,000,000.00) | – | – |
| – secured loans payable due within one year | 6.93% | (19,328,596.78) | – | – |
| – long-term payables | | | | |
| – secured loans payables | 6.93% | (10,165,843.57) | – | – |
| Total | | <u>(67,110,544.66)</u> | | <u>95,426,551.59</u> |

Unit: RMB

(b) *Sensitivity Analysis*

As at 31st December 2014, if the interest rates had been 25 basis point higher/lower and all other variables held constant, the net profit and shareholder equity of the Group would decrease/increase RMB142,609.91.

As at 31st December 2013, if the interest rates had been 25 basis point higher/lower and all other variables held constant, the net profit and shareholder equity of the Group would increase/decrease RMB202,781.42.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VIII. RISK RELATED TO FINANCIAL INSTRUMENTS (Continued)

3. Interest Rate Risk (Continued)

(b) Sensitivity Analysis (Continued)

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.

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

| | 2014 | | 2013 | |
|------------------------------|-----------------------------|----------------------------------|-----------------------------|----------------------------------|
| | Foreign currency balance | The conversion of RMB balance | Foreign currency balance | The conversion of RMB balance |
| Cash at bank and on hand | | | | |
| – EUR | 20,853.92 | 155,478.48 | 2,313.56 | 19,477.80 |
| – USD | 48,887.85 | 299,144.75 | 1,551,125.33 | 9,457,056.02 |
| – JPY | – | – | – | – |
| – HKD | 8,979,524.54 | 7,083,677.52 | 9,010,594.96 | 7,084,400.08 |
| Accounts receivable | | | | |
| – EUR | – | – | – | – |
| – USD | 102,236.70 | 625,586.37 | 403,195.00 | 2,458,239.58 |
| – JPY | – | – | – | – |
| – HKD | – | – | – | – |
| Other receivables | | | | |
| – EUR | – | – | – | – |
| – USD | – | – | – | – |
| – JPY | – | – | – | – |
| – HKD | 2,000.00 | 1,592.74 | 2,025.87 | 1,592.74 |
| Accounts payable | | | | |
| – EUR | (852,872.38) | (6,358,675.33) | (550,163.11) | (4,631,768.21) |
| – USD | (646,515.58) | (3,956,028.81) | (15,024.22) | (91,601.17) |
| – JPY | (85,380,933.47) | (4,386,113.42) | (3,344,063.25) | (193,189.88) |
| – HKD | – | – | – | – |
| Total balance sheet exposure | | | | |
| – EUR | (832,018.46) | (6,203,196.85) | (547,849.55) | (4,612,290.41) |
| – USD | (495,391.03) | (3,031,297.69) | 1,939,296.11 | 11,823,694.43 |
| – JPY | (85,380,933.47) | (4,386,113.42) | (3,344,063.25) | (193,189.88) |
| – HKD | 8,981,524.54 | 7,085,270.26 | 9,012,620.83 | 7,085,992.82 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

VIII. RISK RELATED TO FINANCIAL INSTRUMENTS (Continued)

4. Foreign Exchange Risk (Continued)

(b) The exchange rates of RMB to foreign currency applicable by the Group are as follows:

| Item | Average rate | | Reporting date mid-spot rate | |
|------|--------------|--------|------------------------------|--------|
| | 2014 | 2013 | 2014 | 2013 |
| USD | 6.1080 | 6.1912 | 6.1190 | 6.0969 |
| JPY | 0.0546 | 0.0654 | 0.0514 | 0.0578 |
| HKD | 0.7875 | 0.7985 | 0.7889 | 0.7862 |
| EUR | 7.9373 | 8.3683 | 7.4556 | 8.4189 |

Unit: RMB

(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.

| Item | Unit: RMB | |
|--------------------------|---------------------|---------------------|
| | Equity | Net profit |
| As at 31st December 2014 | | |
| USD | 25,766.03 | 25,766.03 |
| JPY | 37,281.96 | 37,281.96 |
| HKD | (60,224.80) | (60,224.80) |
| EUR | 52,727.17 | 52,727.17 |
| Total | <u>55,550.36</u> | <u>55,550.36</u> |
| As at 31st December 2013 | | |
| USD | (100,501.40) | (100,501.40) |
| JPY | 1,642.11 | 1,642.11 |
| HKD | (60,230.94) | (60,230.94) |
| EUR | 39,204.47 | 39,204.47 |
| Total | <u>(119,885.76)</u> | <u>(119,885.76)</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)

IX. DISCLOSURE OF FAIR VALUE

The following table presents the fair value information and the fair value hierarchy, at the end of the current reporting period, of the Group's assets and liabilities which are measured at fair value at each balance sheet date on a recurring or non-recurring basis. The level in which fair value measurement is categorised is determined by the level of the fair value hierarchy of the lowest level input that is significant to the entire fair value measurement. The levels are defined as follows:

Level 1 inputs: unadjusted quoted prices in active markets that are observable at the measurement date for identical assets or liabilities;

Level 2 inputs: inputs other than Level 1 inputs that are either directly or indirectly observable for underlying

Level 3 inputs: inputs that are unobservable for underlying assets or liabilities.

The Group did not have financial assets or financial liabilities measured at fair value.

Financial assets and financial liabilities not measured at fair value

The Group's financial assets and financial liabilities mainly include: cash at bank and on hand, receivables, payables and available-for-sale financial assets. Given the above financial assets and liabilities (other than equity investments which are classified as available-for-sale financial assets) are expected to be realized in a short term, the differences between their carrying amounts and their fair values are insignificant. As the fair value of equity investments which are classified as available-for-sale financial assets cannot be obtained, the Group and the Company measure such financial assets at costs.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS

1. Information on the largest shareholder of the Company

| Name of the largest shareholder | Place of registration | Business nature | Registered capital | Percentage of shareholding (%) | Percentage of voting rights (%) | Ultimate controlling shareholder of the Company |
|---------------------------------|-----------------------|---------------------------------------|--------------------|--------------------------------|---------------------------------|---|
| Shenji Group | China | Production and sales of machine tools | RMB1,556,480,000 | 25.08 | 25.08 | Shenyang State-owned Assets Supervision and Administration Commission |

2. Subsidiaries of the Company

Please see Note VII.1 for information of subsidiaries of the Company.

3. Joint ventures and associated companies of the Company

Please see Note VII.2 for information of joint ventures and associated companies of the Company.

4. Information on other related parties

| Name of other related parties | Related relationship |
|---|---|
| Yunnan Industrial Investment Holding Group Co Ltd. | The second largest shareholder of the Company |
| Yunnan Yun Ji Group Import and Export Co., Ltd. ("Yun Ji I & E Co.") | Subsidiary of the largest shareholder of the Company |
| Yunnan CY Group Co., Ltd. | Subsidiary of the largest shareholder of the Company |
| Kunming Kunji Group Co., Ltd. ("Kunji Group Co.") | Subsidiary of the second largest shareholder of the Company |
| Yunnan State-owned Assets Property Management Co., Ltd. ("Yunnan State-owned Assets Property") | Subsidiary of the second largest shareholder of the Company |
| Yunnan CY (Group) Company Jinhui Spraying Factory ("Jinhui Spraying Factory") | Subsidiary of the largest shareholder of the Company |
| Yunnan CY Group Co., Ltd., Mechanical and Electrical Products Trading Centre ("Trading Centre") | Subsidiary of the largest shareholder of the Company |
| Shenyang Zhongjie Machine Tool Co., Ltd. ("Zhongjie machine tool") | Subsidiary of the largest shareholder of the Company |
| Shenyang Machine Tool Company Limited ("Shenyang Machine Tool") | Subsidiary of the largest shareholder of the Company |
| Shenyang Machine Tool YinFeng Foundry Co., Ltd. ("YinFeng Foundry") | Subsidiary of the largest shareholder of the Company |
| Shiess GmbH, Germany ("Shiess") | Subsidiary of the largest shareholder of the Company |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS *(Continued)*

5. Related party transactions

(1) *Purchase of goods/receiving services (not included salaries for key management staff)*

The Group

Unit: RMB

| Related party | Nature of connected transaction | 2014 | 2013 |
|------------------------------------|--|--------------|---------------|
| Kunming TOS | Purchase of goods | – | 22,442,545.11 |
| Jinhui Spraying Factory | Purchase of goods | 4,015,164.00 | 3,323,458.74 |
| Shenyang Machine Tool | Purchase of goods | 364,735.04 | – |
| Yunnan State-owned Assets Property | Receiving services | 450,975.64 | 683,518.62 |

The Company

Unit: RMB

| Related party | Nature of connected transaction | 2014 | 2013 |
|------------------------------------|--|--------------|---------------|
| Kunming TOS | Purchase of goods | 6,478,708.42 | 22,442,545.11 |
| Jinhui Spraying Factory | Purchase of goods | 4,015,164.00 | 3,323,458.74 |
| Shenyang Machine Tool | Purchase of goods | 364,735.04 | – |
| Kunming TOS | Receiving services | 6,696.00 | – |
| Yunnan State-owned Assets Property | Receiving services | 449,157.11 | 683,518.62 |

Related party transactions applicable Listing Rules

The transactions between the Company and Kunming TOS, as a joint venture, did not constitute connected transactions or continuing connected transactions under chapter 14 of Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules"); however, transactions between the Company and other parties above constitute connected transactions or continuing connected transactions under chapter 14 of the Listing Rules.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS (Continued)

5. Related party transactions (Continued)

(2) Sales of goods/providing services

The Group

Unit: RMB

| Related party | Nature of connected transaction | 2014 | 2013 |
|---------------------------|---------------------------------|--------------|--------------|
| Kunming TOS | Sales of goods | 1,285,002.14 | 9,204,228.36 |
| Yunji I & E Co. | Sales of goods | 8,213.68 | 358,974.36 |
| Yunnan CY Group Co., Ltd. | Sales of goods | 1,273,504.27 | – |
| YinFeng Foundry | Sales of goods | – | 2,918,158.97 |
| Schiess | Sales of goods | 1,119,761.60 | – |
| Yunnan CY Group Co., Ltd | Providing services | 146,290.59 | 7,798.28 |
| Shenyang Machine Tool | Providing services | 1,760,017.10 | – |

Related party transactions applicable Listing Rules

The transactions between the Company and Kunming TOS, as a joint venture, did not constitute connected transactions or continuing connected transactions under chapter 14 of Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (“Listing Rules”); however, transactions between the Company and other parties above constitute connected transactions or continuing connected transactions under chapter 14 of the Listing Rules.

The Company

Unit: RMB

| Related party | Nature of connected transaction | 2014 | 2013 |
|---------------------------|---------------------------------|--------------|--------------|
| Yunji I & E Co. | Sales of goods | 8,213.68 | 358,974.36 |
| Yunnan CY Group Co., Ltd. | Sales of goods | 1,273,504.27 | – |
| Kunming TOS | Sales of goods | 6,534,016.87 | 9,204,228.36 |
| YinFeng Foundry | Sales of goods | – | 2,918,158.97 |
| Schiess | Sales of goods | 1,119,761.60 | – |
| Kunming TOS | Providing services | 794,339.62 | – |
| Yunnan CY Group Co., Ltd. | Providing services | 146,290.59 | 7,798.28 |
| Shenyang Machine Tool | Providing services | 1,760,017.10 | – |
| Kunming TOS | Dividend income | 2,000,000.00 | – |
| Xi’an Ser | Interest income | 584,100.00 | 584,100.00 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS *(Continued)*

5. Related party transactions *(Continued)*

- (3) *Payment of contracted technology license fees, Staff technical training fee and purchase of prototype machine tool*

The Group and the Company

| Related party | Nature of connected transaction | 2014 | Unit: RMB |
|-------------------------|---|--------------|---------------|
| | | | 2013 |
| Schiess <i>(note 1)</i> | Payment of contracted technology license fees | – | 10,834,962.80 |
| Schiess <i>(note 1)</i> | Staff technical training fee | 1,571,860.00 | 2,462,037.00 |
| Schiess <i>(note 2)</i> | Purchase of prototype machine tool | – | 17,984,737.21 |

Note 1: 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;

Payment of contract technology license fees

As at 31 December 2014 and 31 December 2013, according to the terms of the contract, the Company has accumulately paid 70% of contract technology license fee to Schiess, e.g. EUR4,620,000 (equivalent of RMB39,656,925.20). The Company has received some parts of technology documents for the first prototype machine (including design drawings, technical solutions and directory). The above stated amounts were included in the balance sheet as other non-current assets (see Note V. 17).

Staff technical training fee

In November 2011 and June 2013, the Company paid EUR400,000 (equivalent of RMB3,483,152.00) and EUR300,000 (equivalent of RMB2,462,037.00) separately for staff technical training fee to Schiess respectively.

Prototype machines providing technical service fees

In November 2014, the Company paid EUR200,000 (equivalent of RMB1,571,860.00) for technical service fees for prototype machines.

Note 2: 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 paid EUR2,240,654.50 (equivalent to RMB18,844,219.15) to Schiess for VMG6 prototype machine. In September 2013, under the terms of the contract, the Company paid the remaining amount of EUR2,227,024.50 (equivalent to RMB17,984,737.21) to Schiess for VMG6 prototype machine. As at 31 December 2014, the Company has received the VMG6 prototype machine, however, the installation of the machine has not been completed. The payments of the machine was included in the balance sheet as construction in progress (refer to Note V. 12).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS *(Continued)*

5. Related party transactions *(Continued)*

(4) Leases

The Group and the Company

| Name of leaser | Type of lease assets | Lease fee recognised in 2014 | <i>Unit: RMB</i> |
|---|-------------------------|------------------------------|------------------------------|
| | | | Lease fee recognised in 2013 |
| Yunnan State-owned Assets Property <i>(note 1)</i> | Land and premises | 537,219.60 | 1,196,871.00 |
| Kunji Group Co. <i>(note 2)</i> | Land and Plant building | 5,250,000.00 | 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.

On 1 January 2014, the Company entered into the rental adjustment agreement with Yunnan State-owned Assets Property to adjust the annual rental to RMB537,219.60. The agreement was effective from 1 January 2014 to 31 December 2015.

Note 2: The transactions were about rental fees for premises and land use rights paid to Kunji Group Co

Kunji Group Co. who 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. According to the previous rental agreement, 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. On 28 August 2014, the Company renewed the aforesaid land use right and premise rental agreement. Relevant amount of the rent remains unchanged and the agreements were effective from 12 November 2013 to 11 November 2016.

According to the renewed agreements, the Company continued to rent land and premises from Kunming Kunji Group Co., in the period of 1 January to 31 December 2014, the rental fees amounted to RMB5,250,000.00.

(5) Emoluments of key management staff

The Group and the Company

| Item | 2014 | <i>Unit: RMB</i> |
|------------------------------------|--------------|------------------|
| | | 2013 |
| Emoluments of key management staff | 5,345,395.40 | 7,547,345.15 |

This amount has included the emoluments to the Company's directors (see Note V.52) and several staff with the highest emoluments (see Note V.53).

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS (Continued)

5. Related party transactions (Continued)

(6) Guarantee to related parties

The Group and the Company

| Guarantor | The secured party | Currency | Amount | Commencement | Expiration | Unit: RMB Whether the guarantee completed |
|-------------------------------|-------------------|----------|---------------|--------------|------------|--|
| Shenyang Machine Tool (Group) | The Company | RMB | 39,000,000.00 | 28/04/2014 | 28/04/2016 | No |
| Shenyang Machine Tool (Group) | The Company | RMB | 21,000,000.00 | 28/04/2014 | 28/04/2016 | No |
| Shenyang Machine Tool (Group) | The Company | RMB | 50,000,000.00 | 30/05/2014 | 30/05/2016 | No |
| Shenyang Machine Tool (Group) | The Company | RMB | 90,000,000.00 | 26/06/2014 | 26/06/2016 | No |
| Shenyang Machine Tool (Group) | The Company | RMB | 32,000,000.00 | 26/11/2014 | 25/05/2015 | No |
| Shenyang Machine Tool (Group) | The Company | RMB | 50,000,000.00 | 11/12/2014 | 11/03/2015 | No |

Shenyang Machine Tool (Group) provided guarantee for the Company's financing facilities secured from the Export-Import Bank of China (Note V.18).

(7) Provision of funds/Receipt of funds

The Group

| Related party | Nature of connected transaction | 2014 | 2013 | Unit: RMB |
|-----------------------|--|--------------|---------------|-----------|
| Zhongjie machine tool | Receipt of funds – other expenses on behalf of related parties | 79,687.01 | – | |
| Kunming TOS | Receipt of funds-funding transactions | 300,000.00 | 23,940,000.00 | |
| Kunming TOS | Provision of funds – other expenses on behalf of related parties | 1,791,954.22 | 4,371,333.75 | |
| Kunji Group Co. | Provision of funds – other expenses on behalf of related parties | 2,456,425.55 | – | |

The Company

| Related party | Nature of connected transaction | 2014 | 2013 | Unit: RMB |
|-----------------|--|----------------|----------------|-----------|
| General Machine | Receipt of funds – funding transactions | 265,000,000.00 | 105,000,000.00 | |
| Kunming TOS | Receipt of funds – funding transactions | 300,000.00 | 23,940,000.00 | |
| Kunming TOS | Provision of funds – other expenses on behalf of related parties | 4,246,382.50 | 4,371,333.75 | |
| Xi'an Ser | Provision of funds – other expenses on behalf of related parties | 770,466.80 | 105,212.17 | |
| Kunji Group Co. | Provision of funds – other expenses on behalf of related parties | 2,456,425.55 | – | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS *(Continued)*

6. Receivables and payables from/to related parties

Receivables from related parties

The Group

| Name | Related parties | 2014 | <i>Unit: RMB</i> |
|--------------------------|-----------------------|---------------|------------------|
| | | | 2013 |
| Accounts receivable | Kunming TOS | – | 4,538,294.31 |
| Accounts receivable | Shenyang Machine Tool | 1,123,219.99 | – |
| Accounts receivable | Schiess | 272,874.96 | – |
| Other receivables | Kunming TOS | – | 1,775,181.97 |
| Other non-current assets | Schiess | 39,656,925.20 | 39,656,925.20 |

The Company

| Name | Related parties | 2014 | <i>Unit: RMB</i> |
|--------------------------|-----------------------|---------------|------------------|
| | | | 2013 |
| Accounts receivable | Kunming TOS | 3,573,666.37 | 4,538,294.31 |
| Accounts receivable | Shenyang Machine Tool | 1,123,219.99 | – |
| Accounts receivable | Schiess | 272,874.96 | – |
| Accounts receivable | Changsha Ser | 244,000.00 | 244,000.00 |
| Other receivables | Kunming TOS | 1,259,533.20 | 1,775,181.97 |
| Other receivables | Xi'an Ser | 8,430,773.56 | 7,660,306.76 |
| Other non-current assets | Schiess | 39,656,925.20 | 39,656,925.20 |
| Dividends receivable | Xi'an Ser | 11,000,000.00 | 11,000,000.00 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

X. RELATED PARTIES AND TRANSACTIONS *(Continued)*

6. Receivables and payables from/to related parties *(Continued)*

Payables to related parties

The Group

| Name | Related parties | 2014 | <i>Unit: RMB</i> |
|-------------------------|------------------------------------|--------------|------------------|
| | | | 2013 |
| Accounts payable | Kunming TOS | – | 14,906,079.25 |
| Accounts payable | Jinhui Spraying Factory | 1,678,617.65 | 3,332,452.41 |
| Accounts payable | Shenyang Machine Tool | 421,770.77 | – |
| Advances from customers | Yunnan CY Group Co., Ltd. | 4,640.00 | – |
| Advances from customers | Trading Centre | 5,000.00 | 5,000.00 |
| Other payables | Kunji Group Co. | 5,253,903.52 | 5,250,000.00 |
| Other payables | Yunnan State-owned Assets Property | 13,195.96 | 777,824.00 |
| Bills payables | Jinhui Spraying Factory | 1,530,000.00 | – |
| Bills payables | Kunming TOS | – | 23,940,000.00 |

The Company

| Name | Related parties | 2014 | <i>Unit: RMB</i> |
|-------------------------|------------------------------------|---------------|------------------|
| | | | 2013 |
| Accounts payable | Kunming TOS | 12,576,435.90 | 14,906,079.25 |
| Accounts payable | Jinhui Spraying Factory | 1,678,617.65 | 3,332,452.41 |
| Accounts payable | Shenyang Machine Tool | 421,770.77 | – |
| Advances from customers | Yunnan CY Group Co., Ltd. | 4,640.00 | – |
| Advances from customers | Trading Centre | 5,000.00 | 5,000.00 |
| Advances from customers | Changsha Ser | 9,120.67 | 9,120.67 |
| Other payables | Kunji Group Co. | 5,249,552.32 | 5,250,000.00 |
| Other payables | Yunnan State-owned Assets Property | 10,376.71 | 777,824.00 |
| Other payables | General machine | 3,000,000.00 | 3,000,000.00 |
| Bills payables | Jinhui Spraying Factory | 1,530,000.00 | – |
| Bills payables | Kunming TOS | – | 23,940,000.00 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XI. CAPITAL MANAGEMENT

The Group's primary objective in managing capital is to safeguard its ability to continue as a going concern and profitability by pricing its products with the level of risks it faced and by securing access to finance at a reasonable cost, so as to maintain sustainable development of the Group and provide return to the shareholders.

The Group manages the amount of capital in proportion to risk and manages its debt portfolio in conjunction with projected financing requirements. In accordance with industry practice, the Group monitors capital structure on the basis of the debt to equity ratio (calculated as total debt divided by total assets).

There was no change in the Group's approach to capital management for 2014 as compared with prior years, i.e. maintaining the debt to equity ratio at a reasonable range. To maintain or adjust this ratio, the Group may adjust the dividend payment to shareholders, implement debt finance and dispose of assets to reduce debts. The Group's debt to equity ratio was 58% as at 31 December 2014 (31 December 2013: 51%).

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

XII. COMMITMENTS AND CONTINGENCIES

1. Significant commitments

(1) Capital commitments

The Group and the Company

| Item | 2014 | Unit: RMB | |
|---|-----------------------|-----------------------|------|
| | | 2014 | 2013 |
| Construction contract signed but not implemented or not fully implemented | 84,215,440.80 | 113,015,982.80 | |
| Construction contract authorized but not signed or not implemented or not fully implemented | 250,337,149.62 | 257,729,722.41 | |
| Proprietary technology and patent licensing contract signed and implementing or proposed to implement | 42,241,312.67 | 43,925,092.67 | |
| Total | <u>376,793,903.09</u> | <u>414,670,797.88</u> | |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XII. COMMITMENTS AND CONTINGENCIES (Continued)

1. Significant commitments (Continued)

(2) Operating Lease commitments

According to the irrevocable lease agreement of premises, the minimum lease payments after the date of the reporting period that the Group should pay are as follows:

The Group

| Item | 2014 | Unit: RMB |
|----------------------------------|----------------------|----------------------|
| | | 2013 |
| Within 1 year (including 1 year) | 6,363,517.60 | 5,844,746.33 |
| 1-2 years (including 2 years) | 5,271,750.00 | 5,352,600.00 |
| 2-3 years (including 3 years) | 5,250,000.00 | 5,264,500.00 |
| Over 3 years | <u>22,750,000.00</u> | <u>25,375,000.00</u> |
| Total | <u>39,635,267.60</u> | <u>41,836,846.33</u> |

The Company

| Item | 2014 | Unit: RMB |
|----------------------------------|----------------------|----------------------|
| | | 2013 |
| Within 1 year (including 1 year) | 5,976,069.60 | 5,501,118.33 |
| 1-2 years (including 2 years) | 5,271,750.00 | 5,352,600.00 |
| 2-3 years (including 3 years) | 5,250,000.00 | 5,264,500.00 |
| Over 3 years | <u>22,750,000.00</u> | <u>25,375,000.00</u> |
| Total | <u>39,247,819.60</u> | <u>41,493,218.33</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XII. COMMITMENTS AND CONTINGENCIES *(Continued)*

2. Contingencies

The Company and its distributor Beijing Hanhai Hongzheng Machinery Co., Ltd. (Beijing Hanhai") signed a Machine Tool Sales Contract in August 2011, and the Company signed a Manufacturer Authorization Letter authorizing Beijing Hanhai to participate in a tender exercise conducted by Jilin Haoyu Electrical Co., Ltd. ("Jilin Haoyu") using the tool machine, and the Company undertook to assume responsibility for quality assurance of the tool machine. Subsequent to being awarded the tender, Beijing Hanhai signed a Machine Tool Sales Contract with the end-user, Jilin Haoyu. Jilin Haoyu instituted legal proceedings in November 2013 whereby Beijing Hanhai and the Company was named the 1st and 2nd defendants, respectively. Jilin Haoyu considered that Beijing Hanhai and the Company were unable to resolve product quality issues effectively within the product warranty period, and requested that the product be returned and the amount of RMB11.7325 million paid to Beijing Hanhai be refunded, and liquidated damages of RMB1.235 million be paid; and at the same time requested that the Company assume joint and several liabilities for payment. The Company pointed out in its defence at the trial of first instance that the Company had performed its quality assurance obligations, and that in accordance with the confirmed Service Invoice and Work Completion Invoice for the maintenance service of the Company, it could basically be confirmed that the tool machine under dispute had been functioning normally. Therefore, the Company did not commit any act in breach of the contract and should not assume joint and several liabilities. On 24 July 2014, as requested by the plaintiff, the court commissioned the identification organization to identify the machine. On 18 December 2014, identification organization issued a report that the main entrusted identified issues of the machine did not have the identification conditions.

As at the date of this financial report, the trial of first instance of the above litigation was still in progress. Having sought legal advice, the management considered that it was unlikely for the litigation to be ruled in favour of Jilin Haoyu. Therefore, the above controversy resulted in significant economic benefits outflow from the Group is unlikely. The Group did not make provision in respect of the above lawsuit in the financial statements.

XIII. SUBSEQUENT EVENT TO THE BALANCE SHEET DATE

Profit subsequent to the balance sheet date

Pursuant to the sixth meeting held by the Eighth Board of Directors of the Company on 30 March 2015, the directors proposed nil final profit distribution.

XIV. OTHER SIGNIFICANT EVENTS

1. Correction of accounting errors in prior years

See Note III.33.

2. Segment reporting

The Group has two reportable segments, which are boring machines segment and turbo machines segment, determined based on the structure of its internal organisation, management requirements and internal reporting system. Each reportable segment is a separate business unit which offers different products and services, and is managed separately because they require different technology and marketing strategies. The financial information of the different segments is regularly reviewed by the Group's management to make decisions about resources to be allocated to each segment and assess its performance.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XIV. OTHER SIGNIFICANT EVENTS (Continued)

2. Segment reporting (Continued)

(1) Profit or loss, assets and liabilities of reporting segments

For the purposes of assessing segment performance and allocating resources between segments, the Group's management regularly reviews the assets, liabilities, revenue, expenses and results of operations, attributable to each reportable segment on the following bases:

Segment assets include all tangible assets, intangible assets and current assets, such as receivables, prepayments and inventories, with the exception of deferred tax assets arising from the unrealized profit of internal transactions between group companies, long-term equity investments and other unallocated corporate assets. Segment liabilities include payables, advances, bank borrowings and provisions attributable to the individual segments.

Financial performance is operating income (including operating income from external customers and inter-segment operating income) after deducting expenses, depreciation, amortisation and impairment losses attributable to the individual segments, and interest income and expense from cash balances and borrowings managed directly by the segments. Inter-segment sales are determined with reference to prices charged to external parties for similar orders. Investment income and directors' remunerations are not allocated to individual segments.

Information regarding the Group's reportable segments set out below is the measure of segment profit ("") for loss) and segment assets and liabilities reviewed by the chief operating decision maker or is otherwise regularly provided to the chief operating decision maker, even if not included in the measure of segment profit or loss and segment assets and liabilities:

| Item | Unit: RMB | | | | | | | | | |
|--|------------------|------------------|-----------------|----------------|----------------------------|-----------------|-------------------|---------------|------------------|------------------|
| | Boring machines | | Turbo machines | | Elimination among segments | | Unallocated items | | Total | |
| | 2014 | 2013 (Restated) | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 (Restated) |
| Operating income from external customers | 760,037,380.01 | 882,648,855.09 | 107,851,925.63 | 146,840,024.65 | - | - | - | - | 867,889,305.64 | 1,029,488,879.74 |
| Inter segment operating income | 584,100.00 | 584,100.00 | - | - | (584,100.00) | (584,100.00) | - | - | - | - |
| Income from investment in associates and joint ventures | - | - | - | - | - | - | 1,926,942.96 | 589,379.17 | 1,926,942.96 | 589,379.17 |
| Impairment losses | 28,981,232.77 | (5,371,878.70) | 7,368,204.32 | 3,018,536.53 | - | - | - | - | 36,349,437.09 | (2,353,342.17) |
| Depreciation and amortization | 43,672,325.03 | 41,586,502.78 | 6,430,251.88 | 7,036,287.42 | - | - | - | - | 50,102,576.91 | 48,622,790.20 |
| Interest income | 681,305.43 | 306,075.22 | 160,622.26 | 163,356.60 | - | - | - | - | 841,927.69 | 469,431.82 |
| Interest expense | 14,813,117.26 | 4,325,653.08 | 1,896,127.05 | 1,825,458.05 | - | - | - | - | 16,709,244.31 | 6,151,111.13 |
| Income/(Losses) before income tax | (158,547,116.91) | 4,460,597.35 | (13,754,077.61) | 3,184,686.42 | - | - | (191,207.66) | 2,292,145.20 | (172,492,402.18) | 9,937,428.97 |
| Income tax expense/(benefits) | 35,449,999.18 | (570,499.10) | 1,018,382.43 | (242,816.80) | - | - | 502,536.27 | 343,821.78 | 36,970,917.88 | (469,494.12) |
| Net income/(losses) | (193,997,116.09) | 5,031,096.45 | (14,772,460.04) | 3,427,503.22 | - | - | (693,743.93) | 1,948,323.42 | (209,463,320.06) | 10,406,923.09 |
| Total assets | 2,475,134,188.20 | 2,311,618,697.65 | 346,917,565.67 | 415,465,815.24 | (22,683,894.23) | (21,913,427.43) | 15,753,654.27 | 59,790,899.74 | 2,815,121,513.91 | 2,764,961,985.20 |
| Total liabilities | 1,391,097,840.08 | 1,112,823,415.43 | 275,910,050.28 | 329,685,839.81 | (22,683,894.23) | (21,913,427.43) | - | - | 1,644,323,996.13 | 1,420,595,827.81 |
| Other items: | | | | | | | | | | |
| - Operating income | 757,317,644.50 | 871,069,534.77 | 107,851,925.63 | 146,840,024.65 | - | - | - | - | 865,169,570.13 | 1,017,909,559.42 |
| - Operating cost | 623,252,536.17 | 690,290,070.97 | 78,410,233.46 | 107,988,954.20 | (217,977.48) | (265,032.88) | - | - | 701,444,792.15 | 798,013,992.29 |
| - Other non-cash expenses other than depreciation and amortization | 45,772,972.44 | 7,514,206.62 | - | - | - | - | - | - | 45,772,972.44 | 7,514,206.62 |
| - Long-term investment in associates and financial assets available for sale | - | - | - | - | - | - | 15,529,564.38 | 59,035,592.43 | 15,529,564.38 | 59,035,592.43 |
| - The amounts of additions/ (decrease) to non-current assets other than long-term equity investments | 83,763,891.81 | 128,510,822.29 | 2,682,817.18 | (3,203,681.32) | (217,977.48) | (265,032.88) | - | - | 86,228,731.51 | 125,042,108.09 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XIV. OTHER SIGNIFICANT EVENTS *(Continued)*

2. Segment reporting *(Continued)*

(2) Geographic Information

The Group according to different regions presented information which related to the revenue from external customers and non-current assets (not including financial assets, separate account, deferred tax assets, the same below) in the table below. Revenue from external customers is divided according to the customer's location of accepting service or purchase products. Whereas non-current assets is divided according to physical location of assets (for fixed assets) or location of assigned relevant business (for intangible assets and goodwill) or location of joint control enterprises and associate companies.

| Country or region | Revenue from external customers | |
|-------------------|---------------------------------|-------------------------|
| | 2014 | 2013 (Restated) |
| Mainland China | 836,894,252.79 | 999,190,548.49 |
| Overseas | 30,995,052.85 | 30,298,331.25 |
| Total | <u>867,889,305.64</u> | <u>1,029,488,879.74</u> |

The Group's non-current assets are located in Mainland 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 2014 and 2013.

XV. SUPPLEMENTAL INFORMATION ON CHANGE IN ACCOUNTING POLICIES AND CORRECTIONS OF ACCOUNTING ERRORS OF PRIOR PERIODS

The Group revised its accounting policies and retrospectively restated its comparative financial statements in accordance with the requirements of CAS No.2 (2014), CAS No.9 (2014), CAS No.37 (2014), CAS No.41 and relevant application guidance issued/revised by Ministry of Finance in 2014 as well as Cai Kuai [2014] No. 13.

In addition, the Group also made corrections of accounting errors of prior periods (Note III. 33), and retrospectively restated relevant items of its comparative financial statements for 2013 using the retrospective restatement method.

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XV. SUPPLEMENTAL INFORMATION ON CHANGE IN ACCOUNTING POLICIES AND CORRECTIONS OF ACCOUNTING ERRORS OF PRIOR PERIODS *(Continued)*

The restated consolidated balance sheet is as follows:

The Group

| Item | <i>Unit: RMB</i> | | |
|---|-------------------------|--------------------------------|------------------------------|
| | 31 December 2014 | 31 December 2013 (restated) | 1 January 2013 (restated) |
| CURRENT ASSETS: | | | |
| Cash at bank or on hand | 163,027,997.62 | 181,805,670.00 | 98,887,040.73 |
| Bills receivable | 65,234,659.97 | 193,617,520.47 | 74,194,825.88 |
| Accounts receivable | 573,067,324.65 | 388,303,316.56 | 296,885,249.95 |
| Prepayments | 35,318,463.55 | 49,867,554.97 | 38,170,658.92 |
| Other receivables | 18,029,993.23 | 12,645,899.89 | 13,678,852.21 |
| Inventories | 896,675,761.84 | 838,202,834.59 | 977,067,557.16 |
| Other current assets | 1,724,042.72 | 71,326.31 | 1,495,385.23 |
| TOTAL CURRENT ASSETS | 1,753,078,243.58 | 1,664,514,122.79 | 1,500,379,570.08 |
| NON-CURRENT ASSETS: | | | |
| Available-for-sale financial assets | 1,145,000.00 | 1,145,000.00 | 1,145,000.00 |
| Long-term equity investments | 14,384,564.38 | 57,890,592.43 | 57,979,901.68 |
| Fixed assets | 549,614,786.49 | 502,762,114.81 | 539,598,993.33 |
| Construction in progress | 268,623,936.12 | 299,490,159.28 | 182,359,702.75 |
| Intangible assets | 140,625,241.11 | 79,861,501.87 | 69,000,264.01 |
| Goodwill | 7,296,277.00 | 7,296,277.00 | 7,296,277.00 |
| Long-term deferred expenses | 915,696.54 | 1,307,187.73 | 1,926,385.55 |
| Deferred tax assets | 34,856,402.41 | 69,326,643.49 | 68,098,307.30 |
| Other non-current assets | 44,581,366.28 | 81,368,385.80 | 91,336,642.15 |
| TOTAL NON-CURRENT ASSETS | 1,062,043,270.33 | 1,100,447,862.41 | 1,018,741,473.77 |
| TOTAL ASSETS | 2,815,121,513.91 | 2,764,961,985.20 | 2,519,121,043.85 |
| CURRENT LIABILITIES: | | | |
| Short-term loans | 284,500,000.00 | 299,279,000.00 | 105,000,000.00 |
| Bills payable | 75,048,188.00 | 67,742,506.00 | 28,693,005.00 |
| Accounts payable | 503,704,466.15 | 503,339,606.04 | 506,762,578.19 |
| Advances from customers | 229,755,546.36 | 256,365,206.37 | 339,341,062.27 |
| Employee benefits payable | 12,709,724.16 | 10,505,114.49 | 19,681,286.44 |
| Taxes payable | 6,877,214.09 | 24,202,207.26 | 12,322,840.16 |
| Dividends payable | 135,898.49 | 135,898.49 | 135,898.49 |
| Other payables | 144,228,412.53 | 122,009,581.95 | 73,419,209.14 |
| Non-current liabilities due within one year | 19,747,105.78 | 418,509.00 | 418,509.00 |
| TOTAL CURRENT LIABILITIES | 1,276,706,555.56 | 1,283,997,629.60 | 1,085,774,388.69 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XV. SUPPLEMENTAL INFORMATION ON CHANGE IN ACCOUNTING POLICIES AND CORRECTIONS OF ACCOUNTING ERRORS OF PRIOR PERIODS *(Continued)*

The Group *(Continued)*

| Item | <i>Unit: RMB</i> | | |
|--|-------------------------|--------------------------------|------------------------------|
| | 31 December 2014 | 31 December 2013 (restated) | 1 January 2013 (restated) |
| NON-CURRENT LIABILITIES: | | | |
| Long-term borrowings | 200,000,000.00 | – | – |
| Long-term payables | 11,445,098.47 | 1,492,463.90 | 1,705,672.90 |
| Special payables | 20,947,539.29 | 20,947,539.29 | 15,167,565.87 |
| Long-term employee benefits payable | 5,110,774.06 | 2,282,771.92 | 5,819,115.24 |
| Provisions | 8,811,020.12 | 7,172,981.31 | 9,921,145.94 |
| Deferred income | 121,303,008.63 | 104,702,441.79 | 66,773,920.91 |
| TOTAL NON-CURRENT LIABILITIES | <u>367,617,440.57</u> | <u>136,598,198.21</u> | <u>99,387,420.86</u> |
| TOTAL LIABILITIES | <u>1,644,323,996.13</u> | <u>1,420,595,827.81</u> | <u>1,185,161,809.55</u> |
| Shareholders' equity: | | | |
| Share capital | 531,081,103.00 | 531,081,103.00 | 531,081,103.00 |
| Capital reserve | 19,765,031.17 | 27,303,321.72 | 27,303,321.72 |
| Surplus reserve | 117,077,019.33 | 117,077,019.33 | 116,508,002.60 |
| Retained earnings | 417,634,420.32 | 621,725,726.85 | 613,772,947.26 |
| Total equity attributable to shareholders of the Company | 1,085,557,573.82 | 1,297,187,170.90 | 1,288,665,374.58 |
| Non-controlling interests | 85,239,943.96 | 47,178,986.49 | 45,293,859.72 |
| TOTAL SHAREHOLDERS' EQUITY | <u>1,170,797,517.78</u> | <u>1,344,366,157.39</u> | <u>1,333,959,234.30</u> |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | <u>2,815,121,513.91</u> | <u>2,764,961,985.20</u> | <u>2,519,121,043.85</u> |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XV. SUPPLEMENTAL INFORMATION ON CHANGE IN ACCOUNTING POLICIES AND CORRECTIONS OF ACCOUNTING ERRORS OF PRIOR PERIODS *(Continued)*

The Company

| Item | <i>Unit: RMB</i> | | |
|---|-------------------------|--------------------------------|------------------------------|
| | 31 December 2014 | 31 December 2013 (restated) | 1 January 2013 (restated) |
| CURRENT ASSETS: | | | |
| Cash at bank or on hand | 121,630,513.96 | 167,060,232.54 | 71,927,250.50 |
| Bills receivable | 34,238,097.87 | 170,824,626.17 | 51,132,033.52 |
| Accounts receivable | 480,258,094.00 | 298,578,760.89 | 212,997,106.53 |
| Prepayments | 27,403,859.44 | 33,096,378.41 | 11,023,576.86 |
| Dividends receivable | 11,000,000.00 | 11,000,000.00 | 11,000,000.00 |
| Other receivables | 24,243,433.72 | 15,690,264.77 | 18,962,601.80 |
| Inventories | 694,522,222.73 | 631,067,009.95 | 808,984,761.89 |
| Other current assets | — | — | 1,495,385.23 |
| TOTAL CURRENT ASSETS | 1,393,296,221.72 | 1,327,317,272.73 | 1,187,522,716.33 |
| NON-CURRENT ASSETS: | | | |
| Available-for-sale financial assets | — | — | — |
| Long-term equity investments | 82,510,801.24 | 82,583,858.28 | 82,673,167.53 |
| Fixed assets | 508,007,021.93 | 467,223,213.57 | 496,634,816.84 |
| Construction in progress | 265,728,246.26 | 299,113,212.28 | 182,094,281.75 |
| Intangible assets | 126,922,443.86 | 68,309,304.39 | 57,147,408.97 |
| Long-term deferred expenses | 884,035.54 | 1,165,250.73 | 1,727,777.55 |
| Deferred tax assets | 23,655,654.95 | 59,281,392.52 | 58,501,387.94 |
| Other non-current assets | 44,581,366.28 | 81,368,385.80 | 91,336,642.15 |
| TOTAL NON-CURRENT ASSETS | 1,052,289,570.06 | 1,059,044,617.57 | 970,115,482.73 |
| TOTAL ASSETS | 2,445,585,791.78 | 2,386,361,890.30 | 2,157,638,199.06 |
| CURRENT LIABILITIES: | | | |
| Short-term loans | 263,500,000.00 | 284,279,000.00 | 90,000,000.00 |
| Bills payable | 63,000,000.00 | 47,230,000.00 | — |
| Accounts payable | 387,551,083.95 | 355,444,252.73 | 394,827,490.92 |
| Advances from customers | 124,342,908.17 | 134,336,955.44 | 205,275,982.82 |
| Employee benefits payable | 9,294,491.58 | 8,715,208.44 | 18,118,569.61 |
| Taxes payable | 3,314,136.98 | 22,465,561.65 | 11,755,291.00 |
| Other payables | 144,934,488.09 | 123,335,615.75 | 71,088,145.09 |
| Non-current liabilities due within one year | 19,747,105.78 | 418,509.00 | 418,509.00 |
| TOTAL CURRENT LIABILITIES | 1,015,684,214.55 | 976,225,103.01 | 791,483,988.44 |
| NON-CURRENT LIABILITIES: | | | |
| Long-term borrowings | 200,000,000.00 | — | — |
| Long-term payables | 11,445,098.47 | 1,492,463.90 | 1,705,672.90 |
| Special payables | 20,947,539.29 | 20,947,539.29 | 15,167,565.87 |
| Long-term employee benefits payable | 5,110,774.06 | 2,282,771.92 | 5,819,115.24 |
| Provisions | 5,728,400.42 | 7,172,981.31 | 9,921,145.94 |
| Deferred income | 121,063,008.63 | 104,702,441.79 | 66,773,920.91 |
| TOTAL NON-CURRENT LIABILITIES | 364,294,820.87 | 136,598,198.21 | 99,387,420.86 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XV. SUPPLEMENTAL INFORMATION ON CHANGE IN ACCOUNTING POLICIES AND CORRECTIONS OF ACCOUNTING ERRORS OF PRIOR PERIODS *(Continued)*

The Company *(Continued)*

| Item | 31 December 2014 | 31 December 2013 (restated) | <i>Unit: RMB</i> |
|--|-------------------------|--------------------------------|------------------------------|
| | | | 1 January 2013 (restated) |
| TOTAL LIABILITIES | 1,379,979,035.42 | 1,112,823,301.22 | 890,871,409.30 |
| Shareholders' equity: | | | |
| Share capital | 531,081,103.00 | 531,081,103.00 | 531,081,103.00 |
| Capital reserve | 27,303,321.72 | 27,303,321.72 | 27,303,321.72 |
| Surplus reserve | 117,077,019.33 | 117,077,019.33 | 116,508,002.60 |
| Retained earnings | 390,145,312.31 | 598,077,145.03 | 591,874,362.44 |
| TOTAL SHAREHOLDERS' EQUITY | 1,065,606,756.36 | 1,273,538,589.08 | 1,266,766,789.76 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | <u>2,445,585,791.78</u> | <u>2,386,361,890.30</u> | <u>2,157,638,199.06</u> |

XVI. NET CURRENT ASSETS

| Item | <i>Unit: RMB</i> | | | |
|---------------------------|-------------------|------------------|---------------------|------------------|
| | The Group 2014 | 2013 (restated) | The Company 2014 | 2013 (restated) |
| Current assets | 1,753,078,243.58 | 1,664,514,122.79 | 1,393,296,221.72 | 1,327,317,272.73 |
| Less: current liabilities | 1,276,706,555.56 | 1,283,997,629.60 | 1,015,684,214.55 | 976,225,103.01 |
| Net current assets | 476,371,688.02 | 380,516,493.19 | 377,612,007.17 | 351,092,169.72 |

XVII. TOTAL ASSETS LESS CURRENT LIABILITIES

| Item | <i>Unit: RMB</i> | | | |
|---------------------------------------|-------------------|------------------|---------------------|------------------|
| | The Group 2014 | 2013 (restated) | The Company 2014 | 2013 (restated) |
| Total assets | 2,815,121,513.91 | 2,764,961,985.20 | 2,445,585,791.78 | 2,386,361,890.30 |
| Less: current liabilities | 1,276,706,555.56 | 1,283,997,629.60 | 1,015,684,214.55 | 976,225,103.01 |
| Total assets less current liabilities | 1,538,414,958.35 | 1,480,964,355.60 | 1,429,901,577.23 | 1,410,136,787.29 |

NOTES TO THE FINANCIAL STATEMENTS

(All amounts expressed in RMB unless otherwise specified)

XVIII. EXTRAORDINARY GAINS AND LOSSES FOR THE YEAR 2014

The Group

| Item | <i>Unit: RMB</i> Amount |
|--|-----------------------------------|
| Net loss of Disposal of non-current assets (“()” for loss) | (117,122.40) |
| 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) | 7,315,597.49 |
| Gain on debt restructuring of account payable | 7,657,445.80 |
| Investment income of disposal of long-term equity investment | 7,538,290.55 |
| Net amount of other non-operating income and expenses besides items above | 394,706.37 |
| Effect of income tax | (2,287,594.09) |
| Effect of non-controlling interests | (426,892.64) |
| Total | <u>20,074,431.08</u> |

Note: The above extraordinary gains and losses items listed before tax.

XIX. 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:

| Earnings during the reporting period | Weighted average of return on net assets (%) (restated) | Earnings per share | |
|--|--|-------------------------------------|---------------------------------------|
| | | Basic earnings per share | Diluted earnings per share |
| Net earnings attributable to the ordinary shareholders of the Company (“()” for net loss) | (17.08%) | (0.3843) | (0.3843) |
| Net earnings attributable to the ordinary shareholders of the Company excluding extraordinary gains and losses (“()” for net loss) | (18.92%) | (0.4221) | (0.4221) |

DOCUMENTS AVAILABLE FOR INSPECTION

1. Financial statements signed and stamped by legal representative and financial officer of the Company
2. Original copy of Auditors' Report bearing the signatures and seals of the Accounting Firm and Certified Public Accountants
3. 2014 Annual Report
4. Written confirmation for the 2014 Annual Report by directors and senior management officers
5. Written approval by supervisory committee for 2014 Annual Report prepared by the Board

Shenji Group Kunming Machine Tool Company Limited

Wang Xing

Chairman

30th March 2015