



山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited

(a joint stock limited company incorporated in the People's Republic of China with limited liability)

(Stock Code: 8261)

Interim Results Report
For the six months ended 30 June 2004

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This report, for which the directors of Shandong Molong Petroleum Machinery Company Limited collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of the Stock Exchange for the purpose of giving information with regard to Shandong Molong Petroleum Machinery Company Limited. The directors of Shandong Molong Petroleum Machinery Company Limited, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

HIGHLIGHTS

Achieved turnover of approximately RMB215,706,000 for the six months ended 30 June 2004, which represents an approximate growth of 53.4% as compared to that of the same period last year.

The net profit increased by approximately 45.5% to approximately RMB25,060,000 as compared to that of the same period last year.

Earnings per share of the Group was approximately RMB5.4 cents for the six months ended 30 June 2004.

The Directors have resolved to pay an interim dividend at RMB2 cents per share for the six months ended 30 June 2004.

The board (the “Board”) of directors of the Company (the “Directors”) is pleased to present the unaudited results of Shandong Molong Petroleum Machinery Company Limited (the “Company”) and its subsidiary (collectively, the “Group”) for the six months ended 30 June 2004.

INTERIM DIVIDEND

Subject to the approval of the shareholders of the Company at an extraordinary general meeting of the Company to be held on 28 September 2004, the Board proposed to declare an interim dividend of RMB2 cents per share in respect of the six months ended 30 June 2004 to shareholders whose names appear on the register of members of the Company as at the close of business on 3 September 2004. The interim dividend will be paid to shareholders of the Company on 8 October 2004. The register of members of the Company will be closed from 28 August 2004 to 27 September 2004, both days inclusive, during which period no share transfer shall be effected. In order to qualify for the interim dividend, all instruments of transfers accompanied by the relevant share certificates must be lodged with the Company’s share registrar, Tricor Investor Services Limited, at G/F., Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong for registration by no later than 4:00 p.m. on 27 August 2004.

UNAUDITED CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the three months and six months ended 30 June 2004

The unaudited results of the Group for the three months and six months ended 30 June 2004 together with the unaudited comparative figures for the corresponding periods in 2003 are as follows:

	Notes	Three months ended 30 June		Six months ended 30 June	
		2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Turnover	(2)	131,180	77,843	215,706	140,640
Cost of sales		(103,876)	(59,530)	(167,978)	(106,181)
Gross profit		27,304	18,313	47,728	34,459
Other revenue and gains	(3)	2,331	4,937	8,629	8,248
Sales and distribution costs		(4,472)	(3,213)	(6,731)	(4,464)
Administrative expenses		(2,310)	(2,878)	(5,486)	(5,516)
Other operating expenses		(1,648)	(2,875)	(2,728)	(3,401)
Profit from operating activities	(4)	21,205	14,284	41,412	29,326
Finance costs		(1,249)	(1,588)	(2,573)	(2,493)
Profit before taxation		19,956	12,696	38,839	26,833
Tax	(5)	(6,277)	(4,151)	(12,690)	(8,816)
Profit before minority interest		13,679	8,545	26,149	18,017
Minority interest		(391)	(365)	(1,089)	(796)
Net profit from ordinary activities attributable to shareholders		13,288	8,180	25,060	17,221
Earnings per share basic (RMB cents)	(6)	2.9	2.0	5.4	4.3
Proposed dividends per share (RMB cents)		N/A	N/A	2.0	N/A

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2004 and 31 December 2003

		(Unaudited) As at 30 June 2004 <i>RMB'000</i>	(Audited) As at 31 December 2003 <i>RMB'000</i>
NON-CURRENT ASSETS			
Fixed assets		91,512	87,043
Long-term investments		<u>6,050</u>	<u>6,050</u>
		<u>97,562</u>	<u>93,093</u>
CURRENT ASSETS			
Inventories	(7)	112,176	67,985
Trade receivables	(8)	91,247	55,319
Notes receivable		2,250	4,500
Prepayment, deposits and other receivables		36,224	54,871
Due from related parties		—	10,429
Cash and bank deposits		<u>108,625</u>	<u>97,159</u>
		<u>350,522</u>	<u>290,263</u>
CURRENT LIABILITIES			
Trade and bill payables	(9)	120,460	120,321
Other payables and accruals		4,815	47,256
Tax payable		16,628	6,880
Due to related parties		377	—
Interest bearing loans and borrowings (secured)		<u>80,000</u>	<u>65,000</u>
		<u>222,280</u>	<u>239,457</u>
NET CURRENT ASSETS		<u>128,242</u>	<u>50,806</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>225,804</u>	<u>143,899</u>

	(Unaudited) As at 30 June 2004 <i>RMB'000</i>	(Audited) As at 31 December 2003 <i>RMB'000</i>
NON-CURRENT LIABILITIES		
Interest-bearing loans and borrowings	—	25,000
MINORITY INTERESTS	<u>5,808</u>	<u>4,814</u>
NET ASSETS	<u><u>219,996</u></u>	<u><u>114,085</u></u>
CAPITAL AND RESERVES		
Issue capital	54,000	40,500
Reserves		
Proposed dividend	10,800	—
Others	<u>155,196</u>	<u>73,585</u>
SHAREHOLDERS' EQUITY	<u><u>219,996</u></u>	<u><u>114,085</u></u>

UNAUDITED CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2004 and 30 June 2003

	Six months ended 30 June	
	2004 <i>RMB'000</i>	2003 <i>RMB'000</i>
Net cash (outflow)/inflow from operating activities	(53,697)	12,692
Net cash (outflow)/inflow from investing activities	(6,728)	2,895
Net cash inflow from financing activities	<u>71,891</u>	<u>3,300</u>
Net increase in cash and cash equivalents	11,466	18,887
Cash and cash equivalents at beginning of the period	<u>97,159</u>	<u>63,739</u>
Cash and cash equivalents at the end of the period	<u><u>108,625</u></u>	<u><u>82,626</u></u>
Analysis of balance of cash and cash equivalents cash and bank balances	<u><u>108,625</u></u>	<u><u>82,626</u></u>

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2004 and 30 June 2003

	Paid-in capital	Share Premium	Capital reserve	Statutory reserve Fund	Statutory welfare & other fund	Retained earnings	Subtotal of reserves	Total
	RMB' 000	RMB' 000	RMB' 000	RMB' 000	RMB' 000	RMB' 000	RMB' 000	RMB' 000
Balance at 1 January 2003	40,500	—	21,278	3,476	2,332	2,522	29,608	70,108
Net profit for the period	—	—	—	—	—	17,221	17,221	17,221
Written back on disposal	—	—	(651)	—	(20)	671	—	—
Balance at 30 June 2003	<u>40,500</u>	<u>—</u>	<u>20,627</u>	<u>3,476</u>	<u>2,312</u>	<u>20,414</u>	<u>46,829</u>	<u>87,329</u>
Balance at 1 January 2004	40,500	—	20,627	7,583	4,370	41,005	73,585	114,085
Net profit for the period	—	—	—	—	—	25,060	25,060	25,060
New issue of H shares upon public listing	13,500	—	—	—	—	—	—	13,500
Increase in share premium	—	86,640	—	—	—	—	86,640	86,640
Share issuing costs	—	(19,289)	—	—	—	—	(19,289)	(19,289)
Balance at 30 June 2004	<u>54,000</u>	<u>67,351</u>	<u>20,627</u>	<u>7,583</u>	<u>4,370</u>	<u>66,065</u>	<u>165,996</u>	<u>219,996</u>

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts expressed in Renminbi unless otherwise stated)

1. BASIS OF PRESENTATION

The interim financial statements was unaudited. The interim financial statements have been reviewed by the audit committee of the Group.

The Company was incorporated as a joint stock company with limited liability in the People's Republic of China (the "PRC") on 30 December 2001 and its H shares were listed on GEM (the "Listing") on 15 April 2004.

The interim financial statements have been prepared in accordance with the Statement of Standard Accounting Practice ("SSAP") 25 "Interim Financial Reporting" issued by the Hong Kong Society of Accountants and the disclosure requirements set out in Chapter 18 of the Rules Governing the Listing of the Securities on GEM of the Stock Exchange. The principal accounting policies used in the preparation of the unaudited results are consistent with those used in the preparation of the Company's annual financial statements for the year ended 31 December 2003.

2. TURNOVER & SEGMENT INFORMATION

Turnover represents the invoiced value of goods sold, and after allowances for goods returned and trade discounts. All significant intra-group transactions have been eliminated on consolidation.

The Group's operating business is with customers based in the PRC, the United States and other countries. Each of the Group's geographical segments represents customer destinations to which the Group sells products or provides services which are subject to risks and returns that are different from those of the other geographical segments. No further business segment information is presented as over 90% of the Group's revenue and assets relate to the sale of petroleum machineries.

For the six months ended 30 June 2004

	PRC RMB'000	United States RMB'000	Other Countries RMB'000	Consolidated RMB'000
TURNOVER				
External sales	175,218	32,242	8,246	215,706
Other revenue	<u>192</u>	<u>—</u>	<u>—</u>	<u>192</u>
Segment result	<u>31,920</u>	<u>7,861</u>	<u>1,177</u>	<u>40,958</u>
Unallocated income				8,437
Unallocated expenses				<u>(7,983)</u>
Profit from operating activities				41,412
Finance costs				<u>(2,573)</u>
Profit before tax				38,839
Tax				<u>(12,690)</u>
Profit before minority interests				26,149
Minority interests				<u>(1,089)</u>
Net profit from ordinary activities attributable to shareholders				<u><u>25,060</u></u>

For the six months ended 30 June 2003

	PRC RMB'000	United States RMB'000	Other Countries RMB'000	Consolidated RMB'000
TURNOVER				
External sales	124,034	16,596	10	140,640
Other revenue	<u>1,033</u>	<u>—</u>	<u>—</u>	<u>1,033</u>
Segment result	<u>25,437</u>	<u>4,646</u>	<u>1</u>	<u>30,084</u>
Unallocated income				7,215
Unallocated expenses				<u>(7,973)</u>
Profit from operating activities				29,326
Finance costs				<u>(2,493)</u>
Profit before taxation				26,833
Taxation				<u>(8,816)</u>
Profit before minority interests				18,017
Minority interests				<u>(796)</u>
Net profit from ordinary activities attributable to shareholders				<u><u>17,221</u></u>

3. OTHER REVENUE AND GAINS

	Three months ended		Six months ended	
	30 June		30 June	
	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Other revenue				
Subcontracting income	192	794	192	977
Interest income	252	307	619	442
Government grant and subsidies	1,800	—	1,902	—
VAT refund	—	1,111	5,231	4,104
Rental income	—	56	587	56
Others	87	11	98	11
	<u>2,331</u>	<u>2,279</u>	<u>8,629</u>	<u>5,590</u>
Gains				
Gain on disposal of subsidiaries	—	2,658	—	2,658
Other revenue and gains	<u>2,331</u>	<u>4,937</u>	<u>8,629</u>	<u>8,248</u>

4. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging:

	Six months ended	
	30 June	
	2004	2003
	RMB'000	RMB'000
Cost of inventories sold	167,978	106,181
Depreciation of fixed assets	4,348	2,774
Provision for obsolete inventories	—	300
Provision for doubtful debts	1,406	1,225
Preliminary expenses	—	779
Research and development costs	<u>496</u>	<u>1,130</u>

5. TAX

	Three months ended		Six months ended	
	30 June		30 June	
	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
The charge comprises				
PRC income tax	<u>6,277</u>	<u>4,151</u>	<u>12,690</u>	<u>8,816</u>

The Company and its subsidiary are located in the PRC and as a result are subject to PRC corporate income tax at a rate of 33% on their assessable profits.

No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits in Hong Kong.

The Group had no significant unprovided deferred tax as at 30 June 2004 and 2003.

6. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit attributable to shareholders of approximately RMB13,288,000 and RMB25,060,000 for the three months and six months ended 30 June 2004 (2003: RMB8,180,000 and RMB17,221,000) and on the weighted average number of approximately 462,114,000 (2003: 405,000,000) shares in issue during the period.

Diluted earnings per share is not presented for the three months and six months ended 30 June 2004 and 2003 as there were no potential dilutive securities in existence during the relevant periods.

7. INVENTORIES

	30 June 2004 RMB'000	31 December 2003 RMB'000
Raw materials	26,006	11,629
Work in progress	4,031	15,867
Finished goods	83,032	41,382
	113,069	68,878
Less: Provision for obsolete inventories	(893)	(893)
	112,176	67,985

8. TRADE RECEIVABLES

An aged analysis of trade receivables, based on invoice date, is as follows:

	30 June 2004 RMB'000	31 December 2003 RMB'000
Trade receivables		
0 to 90 days	75,584	47,615
91 to 180 days	6,617	4,697
181 to 365 days	10,190	3,766
Over 365 days	4,315	3,294
	96,706	59,372
Less: Provision for doubtful debts	(5,459)	(4,053)
	91,247	55,319

9. TRADE AND BILLS PAYABLES

An aged analysis of trade and bills payables is as follows:

	30 June 2004 RMB'000	31 December 2003 RMB'000
Trade and bills payables		
0 to 90 days	80,484	67,261
91 to 180 days	26,737	48,213
181 to 365 days	11,532	3,872
Over 365 days	1,707	975
	<u>120,460</u>	<u>120,321</u>

10. CAPITAL COMMITMENTS

	30 June 2004 RMB'000	31 December 2003 RMB'000
Contracted but not provided in the financial statements	<u>4,022</u>	<u>1,923</u>

11. CONTINGENT LIABILITIES

The Company has provided counter-guarantee to SDITIC in relation to the guarantee granted by SDITIC to the Company for bills payable of RMB6,000,000 as at 30 June 2004. The counter-guarantee provided by the Company to Shandong International Trust and Investment Corporation ("SDITIC") is by way of pledging the Company's beneficiary interests under a Fund Management Trust Agreement entered into between the Company and SDITIC dated 27 September 2003. As at 30 June 2004, the Group and the Company did not have any significant contingent liabilities.

12. RELATED PARTY TRANSACTIONS

During the period, the Group had the following material transactions with related parties:

	<i>Notes</i>	Six months ended	
		30 June	
		2004	2003
		RMB'000	RMB'000
Raw materials purchased from:			
Maolong Machinery	(i), (iv)	187	153
Molong Equipment	(iii), (iv)	15,975	7,116
Goods sold to:			
Yalong Oil Pump	(ii), (vi)	—	8,552
Raw materials sold to:			
Maolong Machinery	(i), (v)	184	882
Molong Equipment	(iii), (v)	344	758
Special steel	(v), (x)	27	328
Rental expenses paid to:			
Maolong Machinery	(i), (vii)	267	84
Rental income received from:			
Maolong Machinery	(i), (viii)	98	49
Subcontracting income received from:			
Maolong Machinery	(i), (ix)	62	489
Molong Equipment	(iii) (ix)	130	487
Subcontracting expense paid to:			
Maolong Machinery	(i), (ix)	245	78
Molong Equipment	(iii), (ix)	63	45

Notes:

- (i) Shouguang Maolong Machinery Company Limited (“Maolong Machinery”) was an associate of the Group before 2 March 2001. The Company disposed of its entire 25.6% equity interest in Maolong Machinery on 2 March 2001 to Zhang Yun Qi, a manager of Molong Machinery from April 2001 to April 2003, who is also the son of Zhang En Rong and the brother of Zhang Yun San. Both Zhang En Rong and Zhang Yun San are shareholders and directors of the Company. The disposal was at a cash consideration of RMB2,000,000 which resulted in a loss on disposal of an associate amounting to RMB189,000. The total consideration is calculated on the basis of the original investment cost in Maolong Machinery. Five shareholders of the Company, including Zhang Yun San, hold a total of 21.65% equity interest in Maolong Machinery since March 2001.
- (ii) Kelayayi Yalong Oil Pump Company Limited (“Yalong Oil Pump”) was an associate of the Group before 29 May 2003. The Company disposed of its entire 30% equity interest in Yalong Oil Pump on 29 May 2003 to Liu Chunyuan, an independent third party. The loss on disposal of Yalong Oil Pump was RMB13,697.
- (iii) Shouguang Molong Electro-mechanical Equipment Company Limited (“Molong Equipment”) is a subsidiary of Maolong Machinery. 55% equity interest in Molong Equipment is held by Maolong Machinery.

- (iv) The Group purchased raw materials from Maolong Machinery and Molong Equipment during the period. Such purchase transactions were made at cost incurred plus a margin of 5% charged by Maolong Machinery and Molong Equipment from 1 March 2001 onwards.
- (v) The Group made sales of spare parts and raw materials to Maolong Machinery, Molong Equipment and Special Steel during the period. Such sale transactions were made at cost incurred plus a margin of 5%.
- (vi) The Group made sales of petroleum machineries to Yalong Oil Pump during the period. Such sale transactions were made with reference to the prevailing market prices.
- (vii) These transactions were determined at rates mutually agreed between the Group and Maolong Machinery, which were lower than the market rates for properties of similar location.
- (viii) Pursuant to an agreement dated 28 July 2002 made between the Company (as lessor) and Maolong Machinery (as lessee), the Company has agreed to lease to Maolong Machinery a factory building with a total gross floor area of 5,083.73 sq.m. for a period of 9 years commencing from 1 August 2002 to 30 December 2011 at the rent of RMB97,970.04 per annum. Pursuant to a supplementary Agreement dated 26 March 2004, the rent has been revised to RMB152,512 per annum.
- (ix) These transactions were conducted on the basis of rates mutually agreed between the Group and Maolong Machinery and Molong Equipment, which were set at cost incurred plus a margin of 5%.
- (x) On 28 February 2003, the Company disposed of all of its 52% equity interest in Shandong Molong Special Steel Company Limited (“Special Steel”). Equity interests of 44.32%, 6.7% and 0.98% were disposed of to Zhang En Rong, a shareholder and a director of the Company, and to Liu Fa You and Xu Shou Lu, both are independent third parties, for consideration of RMB39,000,000, RMB5,900,000 and RMB860,000 respectively, which resulted in a gain on disposal of a subsidiary amounting to RMB2,184,598. The total consideration was calculated on the basis of the original investment cost in Special Steel, which was equivalent to 52% of the registered capital of Special Steel amounting to RMB45,760,000.

INTERIM DIVIDEND

Subject to the approval of the shareholders of the Company at an extraordinary general meeting of the Company to be held on 28 September 2004, the Board proposed to declare an interim dividend of RMB2 cents per share in respect of the six months ended 30 June 2004 to shareholders whose names appear on the register of members of the Company as at the close of business on 3 September 2004. The interim dividend will be paid to shareholders of the Company on 8 October 2004. The dividend as declared should not be taken as an indication of the level of profit or dividend for the full year.

BUSINESS AND FINANCIAL REVIEW

Business Review

The Group principally engages in the design, manufacture and sale of petroleum extraction machinery and related accessories, which can be grouped into 5 main categories of products, namely, oil well pipes, oil well sucker rods, oil well pumps, oil well pumping machines and other petroleum extraction machinery accessories. These products are principally used for petroleum extraction. The products of the Group are largely for sale to domestic oil fields within the PRC and partly for export to overseas. The Group’s main customers are oil fields in the PRC including 大慶油田 (Daqing Oil Field), 勝利油田 (Shengli Oil Field), 新疆油田 (Xinjiang Oil

Field), 中原油田 (Zhongyuan Oil Field) and 遼河油田 (Liaohe Oil Field), all of them being subsidiaries or branch oil fields of PetroChina or Sinopec. The overseas customers of the Company mainly locate in the United States, United Kingdom, Indonesia and Syria.

During the period under review, demand for petroleum extraction machinery has increased significantly. In response to the increase in the market demand, the production capacities of the Group's products have increased progressively according to the schedule as stated in the prospectus of the Company dated 30 March 2004 (the "Prospectus"). Leveraging on its leading position in the petroleum extraction machinery industry, the Group has successfully enlarged its market coverage in the PRC. The Group's overseas market also experienced substantial growth. The export sales on valve and related accessories together with the core products such as oil well pipes and oil well sucker rods have increased significantly. The quality of products was highly recognized by the overseas customers of the Group. In order to keep the latest information for the Group's domestic and overseas customers, the Group's official website has been refined.

In relation to product research and development, the production technology in special seamless oil well pipes, super-strength oil well sucker rods and casing have been successfully developed. Trial production of special seamless oil well pipes was successful. Full production is underway and is six months ahead of the original schedule. Equipment for the production of super-strength oil well sucker rods are in the commissioning stage. Furthermore, the success in the production of special seamless oil well pipes ahead of schedule lay a solid foundation for the Group's future development.

Financial Review

The Group has achieved an encouraging result during the period under review. For the six months ended 30 June 2004, the Group has accomplished revenue of approximately RMB215,706,000 (2003: RMB140,640,000) and a net profit of approximately RMB25,060,000 (2003: RMB17,221,000), representing a growth of 53.4% in revenue and an increase of 45.5% in net profit as compared to the same period in the previous year.

For the three months ended 30 June 2004, the Group has accomplished revenue of approximately RMB131,180,000 (2003: RMB77,843,000) and a net profit of approximately RMB13,288,000 (2003: RMB8,180,000). This represented a growth of 68.5% in total revenue and an increase of 62.4% in net profit as compared to the same period in the previous year.

As at 30 June 2004, the Group had net current assets of RMB128,242,000. The directors believe that the Group would have sufficient capital to meet its liabilities and commitments.

FUTURE PROSPECTS

2004 represented an important milestone for the Group's development, as the Company's H shares were successfully listed on GEM on 15 April 2004, which led the Group into a new phase for further future development.

Research and development

The Group has allocated resources to carry out research and development for new products, in particular, super-strength oil well sucker rods, special seamless oil well pipes and casing. The Directors believe that the Group's commitment to research and development for new products is critical in maintaining the Group's competitive edge in the PRC and overseas market. In addition, the Group will strengthen its research and development capability by recruiting more research personnel with a view to improve the quality and functionality of its products in response to the market trends. The Group also planned to use advanced production lines and new production facilities for future expansion.

The Group expects that through the research and development projects, it would develop new products in order to satisfy the market needs and further expand the existing production line and/or establish new production lines.

Expansion of market coverage

To further enlarge the market coverage, the Group intends to increase its sales presence in both the PRC and overseas markets by expanding its sales force and marketing activities. The sales and marketing staff have increased to 50 in the period. In addition, the Group will participate in petroleum extraction machinery exhibitions, hold regular oilfields visit and strengthen its relationships with existing customers. The Group also intends to expand its sales network by setting up more sales/representative offices and/or appointing more authorized sales agents in overseas markets, particularly in strategic locations such as the South East Asia region and the Middle East. The Group believes that setting up sales offices in such locations would assist the Group to increase sales of its products and to maintain closer contacts with overseas markets.

Expansion of production capacity

In order to cater the increasing demand for the petroleum extraction machinery in the PRC, the Group increased its production capacities by constructing a new production facility. The construction (two factory buildings) with a total gross floor area of 14,489.35 sq.m. and decoration work have been completed in the period. The facility is for the production of special seamless oil well pipes and super-strength oil well sucker rods. Trial production of special seamless oil well pipes was successful and full production is underway while equipment for the production of super-strength oil well sucker rods are in the commissioning stage.

Looking into the future, demand for oil is expected to increase both in the international arena and the PRC. This would lead to an increase in the capital expenditure of the world oil suppliers of the world and would serve as driving force in the demand for petroleum extraction machinery. The Directors expect that the demand for petroleum extraction machinery would continue its growth momentum and thus the Group is confident of further advance in the future.

The Directors strongly believe that with the Group's continuous effort in developing new products, enhancing existing products as well as increasing production capacity, it would grasp the opportunities ahead, satisfy the market needs in order to enlarge the market coverage. At the same time, the increase in profit due to enhancement of the management practice would generate satisfactory returns to our shareholders.

MATERIAL ACQUISITION/DISPOSAL AND SIGNIFICANT INVESTMENT

Saved as disclosed in the subsection headed "Further information about the business" of the Company in the section headed "Statutory and general information" in Appendix V to the Prospectus, the Group had no material acquisition, disposal and investment. At present the Group has no future plan for material acquisitions or disposal of significant investments other than those set out in the section headed "Statement of business objectives" in the Prospectus.

BANK FACILITIES AND PLEDGE OF ASSETS

The Group did not have banking facilities with financial institutions. As at 30 June 2004, the Group borrowed a sum of RMB80,000,000 short term loan which was secured by corporate guarantee and assets of the Group.

EMPLOYEES

A breakdown of the number of employees of the Group by function for six months ended 30 June 2004 were set out below:

	Six months ended	
	30 June	
	2004	2003
Research and development	43	38
Production	919	560
Quality control	78	60
Sales and marketing	50	45
Administration	155	132
	<hr/>	<hr/>
Total	1,245	835
	<hr/> <hr/>	<hr/> <hr/>

The Group keeps a close watch on the levels of remuneration and benefits, rewarding staff according to merit. It also offers employees training and development opportunities to upgrade their abilities.

DISCLOSURE UNDER GEM LISTING RULES 17.15 TO 17.21

Under the Rule 17.15 of the GEM Listing Rules, a disclosure obligation arises, among other situations, where the relevant advances to an entity from an issuer or any of its subsidiaries exceed 8% of the issuer's total assets or market capitalization.

Advance to an entity

The total market capitalization of the Company based on the average closing price of the H Shares of the Company for the five business days from 24 June 2004 to 30 June 2004 was approximately HK\$360,719,000 (the “Market Capitalization”).

Trade receivables of an amount of approximately RMB31,093,000 and notes receivable of an amount of approximately RMB2,150,000 were owing from an independent party, China Petroleum & Chemical Corporation (“Sinopec”), as at 30 June 2004. Such receivables represented approximately 9.2% of the Market Capitalization.

Trade receivables of an amount of approximately RMB35,610,000 were owing from an independent party, PetroChina Company Limited (“PetroChina”), as at 30 June 2004. Such receivables represented approximately 9.9% of the Market Capitalization.

Accordingly, a disclosure obligation under Rule 17.15 of the GEM Listing Rules arises.

As confirmed by the Directors, the trade receivables and notes receivables referred to above were resulted from the sale of the Group’s products to such customers in the ordinary course of business of the Group. The trade receivables and notes receivables were unsecured, interest free and had a credit terms of between 30 to 150 days.

COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

On 15 April 2004, the Company obtained net proceeds, after deducting all relevant expenses, of approximately HK\$70.95 million from the new issue of shares by way of public offer and placing. Up to 30 June 2004, the Group has applied the net proceeds as follows:

	Use of proceeds extracted from the Prospectus HK\$ (in million)	Actual amount used up to 30 June 2004 HK\$ (in million)	Remaining net Proceeds as at 30 June 2004 HK\$ (in million)
Research and development	4.0	1.57	2.43
Expansion of production capacity	1.7	1.9	(0.2)
Production improvement and development	21.5	40.0	(18.5)
Sales and marketing	0.05	0.16	(0.11)
Human resources	0.5	0.52	(0.02)
Certification	0.05	0.06	(0.01)
Total	<u>27.8</u>	<u>44.21</u>	<u>(16.41)</u>

Comparisons of the business objectives with the actual business progress set out in the Prospectus of the Company for the period from 22 March 2004 to 30 June 2004 are as follows:

Business objectives as stated in Prospectus	Actual business progress
<i>Research and development</i>	
Technology for production of super-strength oil well sucker rod	Technology for production of super-strength oil well sucker rod has been developed
Energy conservation technology in oil well pumping machines	The development of the energy conservation technology in oil well pumping machines is still in progress
<i>Expansion of production capacity</i>	
To achieve the annual production capacity of oil well pumps to approximately 10,000 units	The annual production capacity as planned has been achieved
To achieve the annual production capacity of oil well sucker rods to approximately 3,000,000 meters	The annual production capacity of the oil well sucker rods has been increased to approximately 3,200,000 meters
To achieve the annual production capacity of oil well pumping machines to approximately 200 units	The annual production capacity as planned has been achieved
To achieve the annual production capacity of oil well pipes to approximately 35,000 tons	The annual production capacity of the oil well pipes has been increased to approximately 40,000 tons
To maintain the annual production capacity of underground petro-electric pumps to approximately 200 units	The annual production capacity as planned has been maintained
To maintain the annual production capacity of blade-guide pulleys to approximately 150,000 sets	The annual production capacity as planned has been maintained
To achieve the annual production capacity of valves to approximately 60,000 pieces	The annual production capacity as planned has been achieved
To maintain the annual production capacity of fluid injection pumps to approximately 300 units	The annual production capacity as planned has been maintained

Business objectives as stated in Prospectus	Actual business progress
To achieve the annual production capacity of mud pump steel sleeves to approximately 33,000 pieces	The annual production capacity as planned has been achieved

Production improvement and development

To develop oil well pipes which can withstand high pressure	The special seamless oil well pipes have been developed and the new production facilities have been completed with annual production capacity of approximately 60,000 tons
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To develop advance and reliable oil well sucker rods by utilizing high quality steel raw materials and to construct the production facilities of the oil well sucker rods	The development is still in progress
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Sales and marketing

To refine and increase the speed for the Group's official website and to further understand domestic and foreign market of petroleum machinery	The Group's official website has been refined and its speed has also been increased
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Human resources

To expand the Group's work force by recruiting high caliber individuals from time to time	The objective has been achieved
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Certification

To obtain new and/or renew existing National Industrial Product Manufacturing Licenses for oil well pumps, oil well sucker rods and oil well pumping machines	The renewal of existing National Industrial Product Manufacturing Licenses has been completed
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DISCLOSURE OF DIRECTORS' INTERESTS IN SHARES

As at 30 June 2004, the interests of the Directors and chief executives in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which will be required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such

provisions of the SFO) or which will be required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to Rules 5.46 to 5.68 of the GEM Listing Rules, to be notified to the Company and to the Stock Exchange, will be as follows:

Long positions in shares of the Company

Name	Type of interest	Number of shares <i>(Note)</i>	Percentage of domestic shares	Percentage of total registered share capital
Zhang En Rong	Personal	279,517,000	69.58%	51.76%
Lin Fu Long	Personal	34,216,000	8.52%	6.34%
Zhang Yun San	Personal	30,608,000	7.62%	5.67%
Xie Xin Cang	Personal	21,410,000	5.33%	3.96%

(Note: All represented domestic shares)

Other than as disclosed above, none of the Directors and chief executives had any interests or short position in shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the required standard of dealings by Directors of the Company as referred to in Rules 5.46 to 5.68 of the GEM Listing Rules.

DIRECTORS' RIGHTS TO ACQUIRE H SHARES

Save as disclosed above, during the six months ended 30 June 2004, none of the Directors was granted options to subscribe for H shares of the Company. As at 30 June 2004, none of the Directors nor their spouses or children under the age of 18 had any right to acquire H shares in the Company or had exercised any such right during the period.

SHARE OPTION SCHEME

The Company does not have share option scheme.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2004, the following persons (other than Directors or chief executives of the Company) had interests or short positions in the shares and underlying shares of the listed issuer as recorded in the register to be kept under section 336 of the SFO:

Long positions in shares

Name	Type of interests	Number of shares	Percentage of domestic shares	Percentage of H shares	Percentage of total registered capital
Zhang Xiu Lan (<i>Note 1</i>)	Interests of spouse	279,517,000	69.58%	—	51.76%
Li Xiu Fen (<i>Note 2</i>)	Interests of spouse	34,216,000	8.52%	—	6.34%
Zhang Xin Lan (<i>Note 3</i>)	Interests of spouse	30,608,000	7.62%	—	5.67%
Li Bao Hui (<i>Note 4</i>)	Interests of spouse	21,410,000	5.33%	—	3.96%
Martin Currie China Hedge Fund Limited	Investment Manager	12,264,000	—	8.87%	2.27%
Peter Cundill & Associates (Bermuda) Ltd.	Investment Manager	58,468,000	—	42.29%	10.83%

Note 1: Zhang Xiu Lan is the wife of Zhang En Rong and is taken to be interested in the shares in 279,517,000 domestic shares held by Zhang En Rong under the SFO.

Note 2: Li Xiu Fen is the wife of Lin Fu Long and is taken to be interested in the shares in 34,216,000 domestic shares held by Lin Fu Long under the SFO.

Note 3: Zhang Xin Lan is the wife of Zhang Yun San and is taken to be interested in the shares in 30,608,000 domestic shares held by Zhang Yun San under the SFO.

Note 4: Li Bao Hui is the wife of Xie Xin Cang and is taken to be interested in the shares in 21,410,000 domestic shares held by Xie Xin Cang under the SFO.

Save as disclosed above, the Directors were not aware of any other person (other than Directors or chief executives of the Company) who had interests or short positions in the shares and underlying shares of the listed issuer as recorded in the register required to be kept under section 336 of the SFO.

COMPETING INTERESTS

None of the Directors or the management shareholders of the Company and their respective associates (as defined under the GEM Listing Rules) had any interest in a business which competes or may compete with the business of the Group.

SPONSOR'S INTEREST

As updated and notified by the Company's sponsor, Deloitte & Touche Corporate Finance Limited (the "Sponsor") that neither of the Sponsor nor its directors, employees or associates had any interest in the share capital of the Company as at 15 April 2004 (date of the Listing of the Company) pursuant to Note 3 to Rule 6.35 of the GEM Listing Rules.

Pursuant to the agreement dated 29 March 2004 entered into between the Company and the Sponsor, the Sponsor will receive a fee for acting as the Company's retained sponsor for the period from 15 April 2004 to 14 April 2006 or until the sponsor agreement is terminated upon the terms and conditions set out therein.

AUDIT COMMITTEE

The Company established an audit committee on 20 March 2004 with written terms of reference in compliance with the requirements as set out in Rules 5.28 and 5.30 of the GEM Listing Rules. The primary duties of the audit committee are to review and to provide supervision over the financial reporting process and internal control system of the Group. The audit committee comprises the three independent non-executive directors, Mr. Qin Xue Chang and Yan Yi Zhuang and Loke Yu alias Loke Hoi Lam. Mr. Qin Xue Chang is the chairman in the Audit Committee.

The Audit Committee has reviewed with the management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters, including a review of the interim report for the six months ended 30 June 2004, with the Directors.

COMPLIANCE WITH RULES 5.34 TO 5.45 OF THE GEM LISTING RULES

The Company had complied throughout the period under review the minimum standards of good practice concerning the general management responsibilities of the board of directors as set out in Rules 5.34 to 5.45 of the GEM Listing Rules.

CODE OF CONDUCT REGARDING SECURITIES TRANSACTIONS BY DIRECTORS

During the six months ended 30 June 2004, the Company had adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. The Company also had made specific enquiry of all directors and the Company was not aware of any non-compliance with the required standard of dealings and its code of conduct regarding securities transactions by directors.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

Neither the Company nor any of its subsidiary purchased, sold or redeemed any listed securities of the Company during the six months ended 30 June 2004.

On behalf of the Board
Zhang En Rong
Chairman

9 August 2004, Shandong, the PRC