



山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited

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

(Stock Code: 8261)

2006

FIRST QUARTERLY REPORT

## **CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)**

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*This report, for which the directors of Shandong Molong Petroleum Machinery Company Limited (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the “GEM Listing Rules”) for the purpose of giving information with regard to the Company. The directors of the Company (the “Directors”), having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) 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 a turnover of approximately RMB231,376,000 for the three months ended 31 March 2006, which represents a growth of approximately 46.4%, as compared to that of the same period last year.
- The net profit increased by approximately 47.2% to approximately RMB24,586,000 as compared to that of the same period last year.
- Earnings per share of the Group was approximately RMB3.8 cents for the three months ended 31 March 2006.
- The Directors do not recommend the payment of an interim dividend for the three months ended 31 March 2006.

## **FIRST QUARTERLY RESULTS (UNAUDITED)**

The board (the "Board") of directors (the "Directors") of the Company is pleased to announce the unaudited results of Shandong Molong Petroleum Machinery Company Limited (the "Company") and its subsidiaries (collectively, the "Group") for the three months ended 31 March 2006.

## UNAUDITED CONDENSED CONSOLIDATED INCOME STATEMENT

For the three months ended 31 March 2006

The unaudited results of the Group for the three months ended 31 March 2006 together with the unaudited comparative figures for the corresponding period in 2005 are as follows:

		<b>Three months ended 31 March</b>	
		<b>2006</b>	2005
	Note	<b>RMB'000</b>	RMB'000
Revenue	(2)	<b>231,376</b>	158,000
Cost of sales		<b>(179,736)</b>	(126,725)
Gross profit		<b>51,640</b>	31,275
Other revenue and gains		<b>7,309</b>	2,969
Selling and distribution costs		<b>(7,137)</b>	(4,067)
Administrative expenses		<b>(9,019)</b>	(4,772)
Other operating expenses		<b>(3,477)</b>	(1,484)
Profit from operating activities		<b>39,316</b>	23,921
Finance costs		<b>(1,461)</b>	(1,023)
Profit before taxation		<b>37,855</b>	22,898
Taxation	(3)	<b>(12,743)</b>	(5,562)
Net profit after taxation		<b>25,112</b>	17,336
Attributable to:			
Shareholders of the Company		<b>24,586</b>	16,704
Minority interest		<b>526</b>	632
Earnings per share - basic			
(RMB cents)	(4)	<b>3.8</b>	3.1
Interim dividend per share			
(RMB cents)		<b>N/A</b>	N/A

NOTES:

1. **BASIS OF PREPARATION**

The quarterly financial statements were unaudited. The quarterly financial statements have been reviewed by the audit committee of the Company.

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 the GEM (the "Listing") on 15 April 2004 in Hong Kong. On 5 July 2004, the Company became a Sino-foreign joint stock limited company.

The unaudited financial statements of the Group have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the GEM Listing Rules.

Except that the Group has adopted certain new/revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("New HKFRSs") which are effective for accounting periods commencing on or after 1 January 2006, the principal accounting policies used in the preparation of the unaudited financial statements are consistent with those used in the preparation of the Company's annual financial statements for the year ended 31 December 2005.

The Directors consider that the adoption of the New HKFRSs has no material impact on the accounting policies of the Group and the methods of computation in the Group's financial statements.

2. **REVENUE AND SEGMENT INFORMATION**

Revenue 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, Europe 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. Save as disclosed below, no further business segment information is presented as over 90% of the Group's revenue and assets relate to the sale of petroleum machinery.

	<b>Three months ended 31 March</b>	
	<b>2006</b>	2005
	<b>RMB'000</b>	RMB'000
PRC	<b>153,788</b>	96,550
United States	<b>31,472</b>	19,652
Europe	<b>37,129</b>	16,781
Other Countries	<b>8,987</b>	25,017
	<hr/>	<hr/>
TOTAL	<b>231,376</b>	158,000
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### 3. TAX

	<b>Three months ended 31 March</b>	
	<b>2006</b>	2005
	<b>RMB'000</b>	RMB'000
Charge comprising PRC income tax	<b>13,801</b>	5,562
Deferred tax	<b>(1,058)</b>	—
	<hr/>	<hr/>
Total tax charge for the period	<b>12,743</b>	5,562
	<hr/> <hr/>	<hr/> <hr/>

The Company is located in the PRC and as a result is subject to the PRC corporate income tax at a rate of 33% on its assessable profits. No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits in Hong Kong during the review period.

A subsidiary of the Company, namely, Weifang Molong Drilling Equipment Company Limited ("Molong Drilling Equipment") was approved by the Ministry of Civil Affairs of Shandong Province (山東省民政廳) as a welfare enterprise (民政福利企業) and hence was entitled to a full exemption from corporate income tax according to the document *Caishui [1994] No. 1 Notice about the several preferential policies on corporate income tax* (關於企業所得稅若干優惠政策的通知) which was issued by the Ministry of Finance, PRC and the State Administration of Taxation PRC. The local tax administration has requested that the exemption is only granted when the application for tax exemption is approved by it. Molong Drilling Equipment has made provision for corporate income tax at the statutory tax rate of 33%.

### 4. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit attributable to shareholders of approximately RMB24,586,000 for the three months ended 31 March 2006 (2005: RMB16,704,000) and on the weighted average number of approximately 647,998,000 (2005: 539,998,000) shares in issue during the period.

Diluted earnings per share is not presented for the three months ended 31 March 2005 and 2006 as there were no potential dilutive securities in existence during the relevant periods.

### 5. RESERVES

There were no movements in reserves of the Group for the three months ended 31 March 2006.

## 6. CAPITAL COMMITMENTS

	<b>31 March 2006 RMB'000</b>	31 December 2005 RMB'000
Contracted, but not provided for:		
Land and buildings	—	25,549
Plant and machinery	<b>73,008</b>	120,790
Intangible assets	—	—
	<hr/> <b>73,008</b>	<hr/> 146,339
Authorized, but not contracted for:		
Plant and machinery	—	—
	<hr/> <b>73,008</b>	<hr/> 146,339
	<hr/> <hr/> <b>73,008</b>	<hr/> <hr/> 146,339

## 7. CONTINGENT LIABILITIES

As at 31 March 2006, the Group and the Company did not have any significant contingent liabilities.

## 8. GEARING RATIO

As at 31 March 2006, the Group's gearing ratio was approximately 58.8% (31 December 2005: 56.7%) which is calculated based on the Group's total liabilities of approximately RMB 629.4 million (31 December 2005: approximately RMB544.06 million) and total assets of approximately RMB1,070.8 million (31 December 2005: approximately RMB959.20 million).

## 9. FOREIGN EXCHANGE EXPOSURE

For the three months ended 31 March 2006, approximately 33.5% of the Group's operating revenue is denominated in US dollars and the rest are denominated in RMB. The Directors consider that the cost of sales and capital of the Group are mainly denominated in RMB. The Group's exposure to fluctuation in foreign exchange rate was minimal and, accordingly, the Group did not employ any financial instruments for hedging purposes.

## 10. INTERIM DIVIDEND

The Directors do not recommend the payment of an interim dividend for the three months ended 31 March 2006 (2005: Nil).

# MANAGEMENT DISCUSSION AND ANALYSIS

## Financial Review

The Group has achieved an encouraging result during the period under review. For the three months ended 31 March 2006, the Group recorded unaudited turnover of approximately RMB231,376,000 (2005: RMB158,000,000). Compared to the corresponding period in the previous year, there is a growth in the turnover of approximately RMB73,376,000 or 46.4%.

Along with the growth in turnover, the Group recorded unaudited net profit attributable to shareholders of approximately RMB24,586,000 for the three months ended 31 March 2006 (2005: RMB16,704,000). Compared to the corresponding period in the previous year, there is a growth in the net profit attributable to shareholders of RMB7,882,000 or 47.2%.

## Business Review

During the period under review, the Group was engaged in the design, manufacture and sale of petroleum exploitation machinery and related accessories. Its major products can be grouped into six categories, namely oil well pipes, casing, oil well sucker rods, oil well pumps, oil well pumping machines and other petroleum exploitation machinery accessories, which are primarily used in upstream petroleum exploitation industry.

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During the period under review, the Group has made improvements to its production techniques in oil well pipes, oil well sucker rods, oil well pumps, and has renewed some of the production and testing equipment. As such, the production techniques have become more satisfactory, the testing techniques have become more advanced and the production output and quality have been further enhanced.

At the same time, equipment installation of the Group's 250,000 tons oil casing production line has been completed and tested. Trial production is expected to commence in May 2006.

Following the implementation of the Group's strategies such as enhancement in the research and development capabilities, improvement to the existing products, expansion of sales networks, leveraging on the Group's excellent quality products and services, the Group has established a strong competitive position in the market and has recorded a steady increase in domestic and overseas sales volume, which together allowed the Group to achieve significant growth in turnover and profits.



During the period under review, the sales of the Group generated from the domestic market and the overseas market were approximately 66.5% and approximately 33.5% respectively.

During the period under review, the Group's domestic customers were mainly oil fields operated by the subsidiaries or branches of PetroChina Company Limited (collectively "PetroChina Group") and China Petroleum & Chemical Corporation (collectively, "Sinopec Group"), including Daqing Oil Field (大慶油田), Shengli Oil Field (勝利油田), Xinjiang oil Field (新疆油田), Zhongyuan Oil Field (中原油田), Liaohe Oil Field (遼河油田) and Changqing Oil Field(長慶油田). The overseas customers of the Group were mainly located in North America, the United Kingdom, Russia, France, Indonesia, Brunei, Egypt and Syria.

## **Outlook**

The Group is full of confidence in the future of the petroleum machinery industry. With the rapid development of the global economy, the demand in crude oil keeps growing. As a result of the increase in output of oil fields in the PRC and around the world, the potential of petroleum exploitation machinery is immense.

The Group will continue to capture the opportunity, and enhance the competitive capability continuously through various strategies, including capacity enhancement, improvement of product quality, strengthening of the research and development capability, enhancement of market exploration ability and cost control. Meanwhile, the Group will continue to develop domestic and oversea markets in order to bring the greatest return to shareholders.

## **Enhancement in Research & Development ("R&D")**

The Group is dedicated to enhance the functions and quality of its existing products, and is proactively engaged in the R&D of new products. The Group also engages industrial experts and keeps abreast of the latest information and technology in the industry, in order to maintain its leading position in terms of technology knowhow and application in the industry.

## **Development of domestic and overseas markets**

In respect of the domestic market, the Group will leverage on the advantage of having established various on-site sales offices and continue to maintain good relationship with existing customers. The Group considers that such on-site offices allow the Group to make timely visits to its customers, and listen to their opinions and collect latest market information, so as to strengthen after-sales services.

In respect of the overseas markets, due to the consolidation of the existing markets, the Group will proactively procure product promotions, continue to explore for other potential markets, so as to increase overseas sales of the Group's products.

## **Enhancement of production capacity**

The Group will adopt a new method under which new constructions and technological innovations will be combined to enhance production capacity. Fine-tuning of the Group's 250,000 tons per year oil casing production line has been completed, and construction of the Group's ancillary thermal treatment and processing production line is under way. Upon completion, they will form an oil casing production line with an annual capacity of 250,000 tons, of which, the casing thermal treatment and processing capacity will be 100,000 tons per year.

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## **MATERIAL ACQUISITION/DISPOSAL AND SIGNIFICANT INVESTMENT**

During the period under review, the Group had no material acquisition or disposal and significant investments.

## **BANK FACILITIES AND PLEDGE OF ASSETS**

As at 31 March 2006, the Group had bank credit loans amounting to RMB100,000,000. In addition, six banks, including the Agricultural Bank of China (Shandong Branch), have granted credit facilities totalling RMB398,670,000 to the Group. None of these credit facilities have been utilized.

## EMPLOYEES

A breakdown of the number of employees of the Group by function as at 31 March 2006 was set out below:

	As at 31 March	
	2006	2005
Research and development	56	48
Production	1,358	1,077
Quality control	93	78
Sales and marketing	58	52
Administration	168	158
	<hr/>	<hr/>
Total	<b>1,733</b>	1,413
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The Group keeps a close watch on the level of remuneration and benefits and rewards staff according to merit. It also offers employee training and development opportunities to enhance their abilities.

## MODEL CODE FOR SECURITIES TRANSACTION BY DIRECTORS

The Company has adopted a model code of practice with standards not lower than those as required under Rules 5.48 to 5.67 of the GEM Listing Rules for securities transactions by Directors. The Company has confirmed after making due enquiries with all the Directors that all the Directors have complied with the standard of dealings and model code of practice in relation to the securities transactions by Directors.

## DISCLOSURE OF DIRECTORS', SUPERVISORS' AND CHIEF EXECUTIVE'S INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 March 2006, the interest and short positions of the Directors, supervisors (the "Supervisors") and chief executive of the Company in the shares, underlying or debentures shares of the Company or any of 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 the Stock Exchange, will be as follows:

### Long positions in shares of the Company

Name	Type of interest	Number of domestic shares	Percentage of domestic shares	Percentage of total registered share capital
Zhang En Rong	Personal	279,517,000	69.58%	43.14%
Lin Fu Long	Personal	34,216,000	8.52%	5.28%
Zhang Yun San	Personal	30,608,000	7.62%	4.72%
Xie Xin Cang	Personal	21,410,000	5.33%	3.30%

Save as disclosed above, to the best knowledge of the Directors, none of the Directors, the Supervisors or chief executive of the Company had any interests or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), will have to be notified to the Company and the Stock Exchange under Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under the SFO) or will be required pursuant to the required standard of dealings by Directors as referred to in Rule 5.46 to 5.48 of the GEM Listing Rules or section 352 of the SFO to be entered in the register of interests reserved to therein.

## DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

None of the Directors or Supervisors or their respective associates (as defined under the GEM Listing Rules) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights as at 31 March 2006.

## SHARE OPTION SCHEME

The Company does not have any share option scheme.

## SUBSTANTIAL SHAREHOLDERS

As at 31 March 2006, so far as the Directors are aware, the following persons (other than Directors or chief executives of the Company) had interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO.

### Long positions in 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%	—	43.14%
Li Xiu Fen ( <i>Note 2</i> )	Interests of spouse	34,216,000	8.52%	—	5.28%
Zhang Xin Lan ( <i>Note 3</i> )	Interests of spouse	30,608,000	7.62%	—	4.72%
Li Bao Hui ( <i>Note 4</i> )	Interests of spouse	21,410,000	5.33%	—	3.30%
Peter Cundill & Associates (Bermuda) Ltd. ( <i>Note 5</i> )	Investment manager	75,000,000	—	30.45%	11.57%
RAB Energy Fund Limited ( <i>Note 5</i> )	Investment manager	33,832,000	—	13.74%	5.22%

Name	Type of interests	Number of shares	Percentage of domestic shares	Percentage of H shares	Percentage of total registered capital
Cheah Cheng Hye (Note 5)	Corporate interest controlled by the significant shareholder	17,212,000	—	6.99%	2.66%
Value Partners Limited (Note 5)	Investment manager	17,212,000	—	6.99%	2.66%
Commonwealth Bank of Australia (Note 5)	Corporate interests controlled by the significant shareholder	19,718,000	—	8.01%	3.04%

*Note 1:* Zhang Xiu Lan is the wife of Zhang En Rong and is taken to be interested in the 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 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 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 21,410,000 domestic shares held by Xie Xin Cang under the SFO.

*Note 5:* Interest in H shares.

Save as disclosed above, so far as the Directors are aware, there are no other persons not being a Director, Supervisors or chief executive of the Company who had interests or short positions in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register required to be kept under section 336 of the SFO.

## **COMPETING INTERESTS**

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

## **COMPLIANCE ADVISER'S INTEREST**

As updated and notified by the Company's compliance adviser, Deloitte & Touche Corporate Finance Limited (the "Compliance Adviser"), neither the Compliance Adviser, nor its directors, employees or associates (as defined under the GEM Listing Rules) had any interest in the share capital of the Company as at 31 March 2006 pursuant to Rule 6.36 of the GEM Listing Rules.

Pursuant to an agreement dated 29 March 2004 entered into between the Company and the Compliance Adviser, the Compliance Adviser will receive a fee for acting as the Company's retained sponsor for the period from 15 April 2004 to 31 December 2006 or until the agreement is terminated in accordance with the terms and conditions set out therein.

## **PURCHASE, SALE OR REDEMPTION OF SECURITIES**

Neither the Company nor its subsidiaries has purchased, sold or redeemed any listed securities of the Company during the three months ended 31 March 2006.

## **AUDIT COMMITTEE**

The Company has set up an audit committee (the "Audit Committee") on 20 March 2004, and has made amendments to its written terms of reference on 18 January 2005 in compliance with the provisions as set out in Rules C.3.1 to C.3.3 of the "Code on Corporate Governance Practices" set out in Appendix 15 of the GEM Listing Rules. The primary duty of the Audit Committee is to review and supervise external auditors, financial information, financial reporting system and internal control procedures. The Audit Committee comprises of three independent non-executive Directors, namely Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam. Mr. Qin Xue Chang is the chairman of the Audit Committee.

The Audit Committee has discussed with the management in respect of the accounting principles and practices adopted, internal controls and financial reporting matters, including a review of the unaudited results of the Group for the three months ended 31 March 2006.

## **DIRECTORS**

As at the date of this report, the executive Directors are Mr. Zhang En Rong, Mr. Zhang Yun San, Mr. Lin Fu Long and Mr. Xie Xin Cang, the non-executive Directors are Mr. Chen Jian Xiong and Mr. Wang Ping and the independent non-executive Directors are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam.

By order of the Board of

**Zhang En Rong**

*Chairman*

Shandong, the PRC

11 May 2006