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

INTERIM REPORT

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET ("GEM") OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE "STOCK EXCHANGE")

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board of the Stock Exchange and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. GEM-listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at "www.hkgem.com" in order to obtain up-to-date information on GEM-listed issuers.

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 revenue of approximately RMB443,398,000 for the six months ended 30 June 2006, which represents a growth of approximately 36.9% as compared to that of the same period last year.
- The net profit increased by approximately 37.9% to approximately RMB50,424,000 as compared to that of the same period last year.
- Earnings per share of the Group were approximately RMB7.8 cents for the six months ended 30 June 2006.
- The Directors have resolved to pay an interim dividend of RMB1.5 cents per share for the six months ended 30 June 2006, subject to the approval of the shareholders of the Company.

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 six months ended 30 June 2006 (the "period under review").

INTERIM DIVIDEND

Subject to the approval of the shareholders of the Company at the next extraordinary general meeting ("EGM") to be convened by the Company, the Board proposes to declare and pay an interim dividend of RMB1.5 cents per share in respect of the six months ended 30 June 2006. Further details in relation to the closure of register of members of the Company for the purpose of the GEM will be further announced.

UNAUDITED CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the three months and six months ended 30 June 2006

The unaudited results of the Group for the three months and six months ended 30 June 2006 together with the unaudited comparative figures for the corresponding periods in 2005 are as follows:

		Three months ended 30 June		Six months ended 30 June	
		2006	2005	**2006**	2005
	Notes	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Revenue	(2)	**212,022**	165,866	**443,398**	323,866
Cost of sales		**(155,042)**	(128,653)	**(334,778)**	(255,378)
Gross profit		**56,980**	37,213	**108,620**	68,488
Other income and gains	(3)	**12,167**	939	**19,476**	3,908
Selling and distribution costs		**(6,005)**	(5,273)	**(13,142)**	(9,340)
Administrative expenses		**(5,674)**	(5,495)	**(14,693)**	(10,267)
Other operating expenses		**(16,095)**	(129)	**(19,572)**	(1,613)
Profit from operating activities	(4)	**41,373**	27,255	**80,689**	51,176
Finance costs		**(2,342)**	(654)	**(3,803)**	(1,677)
Profit before tax		**39,031**	26,601	**76,886**	49,499
Tax	(5)	**(12,631)**	(6,120)	**(25,374)**	(11,682)
Profit for the period		**26,400**	20,481	**51,512**	37,817
Attributable to:					
Shareholders of the Company		**25,838**	19,852	**50,424**	36,556
Minority interests		**562**	629	**1,088**	1,261
		26,400	20,481	**51,512**	37,817
Earnings per share					
— basic (RMB cents)	(6)	**4.0**	3.5	**7.8**	6.4
Interim dividend per share (RMB cents)		**N/A**	N/A	**1.5**	2.0

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2006 and 31 December 2005

	Notes	**As at 30 June 2006 (unaudited) RMB'000**	As at 31 December 2005 (audited) RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment		**422,500**	326,114
Investment properties		**7,851**	8,037
Prepaid land lease payments		**20,032**	20,201
Intangible assets		**—**	273
Available-for-sale equity investment/ long term investment		**50**	50
Deferred fax assets		**5,712**	5,238
Total non-current assets		**456,145**	359,913
CURRENT ASSETS			
Inventories	(7)	**248,220**	213,854
Trade receivables	(8)	**156,155**	75,744
Note receivables		**9,065**	15,164
Prepayment, deposits and other receivables		**102,339**	14,681
Due from related parties		**23,661**	21,977
Pledged deposits		**206,339**	147,630
Cash and bank balances		**43,774**	110,166
Total current assets		**789,553**	599,216

	Notes	As at 30 June 2006 (unaudited) RMB'000	As at 31 December 2005 (audited) RMB'000
CURRENT LIABILITIES			
Trade and bill payables	(9)	**567,194**	421,189
Other payables and accruals		**41,196**	38,877
Tax payable		**37,881**	23,355
Interest-bearing bank loans		**108,000**	50,000
Due to related parties		**5,865**	10,642
Total current liabilities		**760,136**	544,063
NET CURRENT ASSETS		**29,417**	55,153
TOTAL ASSETS LESS CURRENT LIABILITIES		**485,562**	415,066
NON - CURRENT LIABILITIES			
Interest bearing bank loans		**(30,000)**	—
NET ASSETS		**455,562**	415,066
EQUITY			
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT			
Issued capital		**64,800**	64,800
Reserves		**375,063**	334,359
Proposed interim/final dividend		**9,720**	11,016
		449,583	410,175
MINORITY INTERESTS		**5,979**	4,891
TOTAL EQUITY		**455,562**	415,066

UNAUDITED CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2006 and 30 June 2005

	Six months ended 30 June	
	2006	2005
	RMB'000	RMB'000
Net cash inflow from operating activities	**28,302**	74,956
Net cash outflow from investment activities	**(128,517)**	(97,642)
Net cash inflow from financing activities	**84,438**	77,314
Net (decrease)/ increase in cash and cash equivalents	**(15,777)**	54,628
Cash and cash equivalents at the beginning of the period	**110,166**	57,528
Cash and cash equivalents at the end of the period	**94,389**	112,156
Analysis of balances of cash and cash equivalents		
Cash and bank balances	**43,774**	72,137
Time deposits with original maturity of less than three months when acquired, pledged as security for bills payable	**50,615**	40,019
	94,389	112,156

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2006 and 30 June 2005

	Paid-in capital	Capital reserve	Statutory reserve fund	Statutory welfare & other fund	Retained earnings	Subtotal of reserves	Proposed interim/ final dividend	Total	Minority interests	Total equity
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2005	54,000	88,036	16,039	8,019	71,360	183,454	8,100	245,554	1,090	246,644
Net profit for the period	—	—	—	—	36,556	36,556	—	36,556	1,261	37,817
Placing of new H shares	10,800	—	—	—	—	—	—	10,800	—	10,800
Increase in share premium	—	94,831	—	—	—	94,831	—	94,831	—	94,831
Share issuing costs	—	(5,155)	—	—	—	(5,155)	—	(5,155)	—	(5,155)
Dividend paid	—	—	—	—	—	—	(8,100)	(8,100)	—	(8,100)
Proposed dividend for the period	—	—	—	—	(12,960)	(12,960)	12,960	—	—	—
At 30 June 2005	64,800	177,712	16,039	8,019	94,956	296,726	12,960	374,486	2,351	376,837
At 1 January 2006	64,800	177,712	23,965	11,982	120,700	334,359	11,016	410,175	4,891	415,066
Net profit for the period	—	—	—	—	50,424	50,424	—	50,424	1,088	51,512
Dividend paid	—	—	—	—	—	—	(11,016)	(11,016)	—	(11,016)
Proposed divided for the period	—	—	—	—	(9,720)	(9,720)	9,720	—	—	—
At 30 June 2006	64,800	177,712	23,965	11,982	161,404	375,063	9,720	449,583	5,979	455,562

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts expressed in Renminbi unless otherwise stated)

1. GENERAL INFORMATION AND BASIS OF PREPARATION

The interim financial statements were unaudited. The interim 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. 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 Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of chapter 18 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "GEM Listing Rules")

The principal accounting policies used in the preparation of the unaudited financial statements are consistent with those used in the preparation of the Group's annual financial statements for the year ended 31 December 2005.

The Group has adopted the following standards that have been issued and effective for the periods beginning on or after 1 January 2006. The adoption of such standards did not have material effect on these financial statements.

HKAS 19 (Amendment)	Actuarial gains or losses, group plans and disclosures
HKAS 21 (Amendment)	Net Investment in a Foreign Operation
HKAS 39 (Amendment)	The Fair Value Option

The Group has not early adopted the following standards that have been issued but not yet effective. The adoption of such standards will not result in substantial changes to the Group's accounting policies.

HKAS 1 (Amendment)	Capital Disclosures
HKFRS 7	Financial Instruments - Disclosures

2. **REVENUE & 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 sales of petroleum machinery.

	For the six months ended 30 June 2006				
	PRC	**United States**	**Europe**	**Other countries**	**Consolidated**
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue					
Sales to external customers	290,852	78,861	50,057	23,628	443,398
Other revenue	14,392	—	—	—	14,392
Total revenue from continuing operations	305,244	78,861	50,057	23,628	457,790
Segment results	64,200	18,865	10,691	5,016	98,772
Unallocated income					5,084
Unallocated expenses					(23,167)
Profit from operating activities					80,689
Finance costs					(3,803)
Profit before tax					76,886
Tax					(25,374)
Profit for the period					51,512

	For the six months ended 30 June 2005				
	PRC	**United States**	**Europe**	**Other countries**	**Consolidated**
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue					
Sales to external customers	222,262	43,038	27,755	30,811	323,866
Other revenue	97	—	—	—	97
Total revenue from continuing operations	222,359	43,038	27,755	30,811	323,963
Segment results	37,749	9,247	5,765	6,400	59,161
Unallocated income					3,811
Unallocated expenses					(11,796)
Profit from operating activities					51,176
Finance costs					(1,677)
Profit before tax					49,499
Tax					(11,682)
Profit for the period					37,817

3. **OTHER INCOME AND GAINS**

	Three months ended 30 June		**Six months ended 30 June**	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Other income and gains				
Sale of materials	**8,547**	—	**14,392**	—
Subcontracting income	**77**	97	**258**	97
Interest income	**749**	499	**1,632**	1,004
Government grant and subsidies	**—**	—	**—**	160
VAT refund	**2,794**	—	**2,794**	2,165
Rental income	**—**	—	**172**	98
Others	**—**	343	**228**	384
	12,167	939	**19,476**	3,908

4. **PROFIT FROM OPERATING ACTIVITIES**

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

	Six months ended 30 June	
	2006	2005
	RMB'000	RMB'000
Cost of inventories sold	**334,778**	255,253
Depreciation of fixed assets	**7,557**	5,250
Provision for obsolete inventories	**1,836**	855
Provision for doubtful debts	**(410)**	(980)
Research and development costs	**5,780**	989

5. **TAXATION**

	Three months ended 30 June		Six months ended 30 June	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
The charge comprises				
PRC income tax	**12,037**	6,120	**25,845**	11,682
Deferred tax	**594**	—	**(471)**	—
	12,631	6,120	**25,374**	11,682

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 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 during the period under review.

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 as a welfare enterprise and hence is entitled to a full exemption from corporate income tax. However, the exemption is only granted after the approval from the local tax administration. As at 30 June 2006, Molong Drilling Equipmant did not receive the approval document of the exemption for 2006.

The Group has no significant unprovided deferred tax as at 30 June 2005 and 2006.

6. **EARNINGS PER SHARE**

The calculation of the basic earnings per share is based on the profit attributable to shareholders of approximately RMB25,838,000 and RMB50,424,000 for the three months and six months ended 30 June 2006 (2005: RMB19,852,000 and RMB36,556,000) and on the weighted average number of approximately 647,998,000 shares (2005: 569,832,000 shares) in issue during the period.

Diluted earnings per share is not presented for the three months and six months ended 30 June 2006 and 2005 as there were no potential dilutive securities in existence during the relevant periods.

7. **INVENTORIES**

	30 June 2006 (unaudited)	31 December 2005 (audited)
	RMB'000	RMB'000
Raw materials	**69,351**	60,670
Work in progress	**72,603**	60,466
Finished goods	**106,266**	92,718
Total	**248,220**	213,854

None of the above balance was carried at net realizable value.

8. **TRADE RECEIVABLES**

An aged analysis of the trade receivables as at 31 December 2005 and 30 June 2006, based on invoice date, and net of provisions, is as follows:

	30 June 2006 (unaudited) RMB'000	31 December 2005 (audited) RMB'000
Trade receivables		
0 to 90 days	**148,762**	73,461
91 to 180 days	**3,394**	999
181 to 365 days	**3,999**	1,284
Over 365 days	**—**	—
Total	**156,155**	75,744

9. **TRADE AND BILLS PAYABLES**

An aged analysis of trade and bills payables as at 31 December 2005 and 30 June 2006, based on invoice date, is as follows:

	30 June 2006 (unaudited) RMB'000	31 December 2005 (audited) RMB'000
Trade and bill payables		
0 to 90 days	**261,908**	237,954
91 to 180 days	**294,949**	173,551
181 to 365 days	**7,094**	4,752
Over 365 days	**3,243**	4,932
Total	**567,194**	421,189

As at 30 June 2006, the Group's bills payables of RMB464,164,000 (31 December 2005: RMB325,711,000) were secured by the pledge of certain time deposits amounting to RMB206,339,000 (31 December 2005: RMB124,822,000)

10. **CAPITAL COMMITMENTS**

	30 June 2006 (unaudited) RMB'000	31 December 2005 (audited) RMB'000
Contracted, but not provided for:		
Land and buildings	**—**	25,549
Plant and machinery	**70,365**	120,790
Intangible assets	**—**	—
	70,365	146,339
Authorised, but not contracted for:		
Plant and machinery	**—**	—
	70,365	146,339

11. **CONTINGENT LIABILITIES**

As at 30 June 2006, the Group did not have any significant contingent liabilities.

12. **GEARING RATIO**

As at 30 June 2006, the Group's gearing ratio was approximately 63.4% (31 December 2005: 56.7%) which is calculated based on the Group's total liabilities of approximately RMB790,136,000 (31 December 2005: approximately RMB544,100,000) and total assets of approximately RMB1,245,698,000 (31 December 2005: approximately RMB959,129,000).

13. **FOREIGN EXCHANGE EXPOSURE**

For the six months ended 30 June 2006, approximately 34.4% of the Group's operating revenue is denominated in US dollars and the rest are denominated in RMB. The cost of sales and capital of the Group are mainly denominated in RMB. The official exchange rate between US dollars and RMB has generally been stable in recent years. The Directors consider that 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.

14. **RELATED PARTY TRANSACTIONS**

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

The Group	Notes	**Six months ended 30 June** **2006** **RMB'000**	2005 RMB'000
Purchases of raw materials from a company in which a director of the Company is a shareholder	(i)	**—**	125
Purchases of raw materials from other related parties	(i)	**106,496**	18,025
Sales of raw materials to a company in which a director of the Company is a shareholder	(ii)	**—**	590
Sales of raw materials to other related parties	(ii)	**4,183**	349
Rental paid to a company in which a director of the Company is a shareholder	(iii)	**67**	374
Rental paid to other related parties	(iii)	**42**	—
Rental received from a company in which a director of the Company is a shareholder	(iv)	**—**	76
Rental received from other related parties	(iv)	**173**	—
Subcontracting income received from a company in which a director of the Company is a shareholder	(v)	**—**	4
Subcontracting income received from other related parties	(v)	**192**	76
Subcontracting fees paid to a company in which a director of the Company is a shareholder	(v)	**—**	98
Subcontracting fees paid to other related parties	(v)	**203**	341
Purchases of equipment from other related parties	(vi)	**3,490**	—

Notes:

(i) The Directors consider that the purchases of raw materials were made according to the published prices and conditions similar to those offered to the major customers of the suppliers. The balance owing to the suppliers as at 30 June 2006 was RMB1,113,000 (2005: RMB148,000) and prepayments made to suppliers was RMB 23,661,000 (2005: nil) which was unsecured, interest-free and had no fixed terms of repayment.

(ii) The sales to the related parties were determined at rates mutually agreed between the Group and the related parties, which were set at cost incurred plus 5% of profit margin. The amounts due from the related parties as at 30 June 2006 was RMB23,661,000 (2005: RMB260,000), which was unsecured, interest-free and had no fixed terms of repayment.

(iii) These transactions were determined at rates mutually agreed between the Group and the related parties, which were lower than the market rates of the properties of similar locations.

(iv), (vi) These transactions were determined at rates mutually agreed between the Group and the related parties, which were fair and reasonable.

(v) These transactions were determined at rates mutually agreed between the Group and the related parties, which were set at cost incurred plus 5% of profit margin.

The purchase transactions were made at cost. The related party transactions in respect of items (i), (ii), (iii), (iv), (v) and (vi) also constitute connected transactions or continuing connected transactions as defined in Chapter 20 of the GEM Listing Rules.

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Review

The Group has achieved a satisfactory result during the period under review. For the six months ended 30 June 2006, the Group recorded an unaudited revenue of approximately RMB443,398,000 (2005: RMB323,866,000) and an unaudited net profit of approximately RMB50,424,000 (2005: RMB36,556,000). Compared to the corresponding period in the previous year, the revenue has a growth of approximately RMB119,532,000 or 36.9%, and the net profit has a growth of approximately RMB13,868,000 or 37.9%.

For the three months ended 30 June 2006, the Group recorded an unaudited revenue of approximately RMB212,022,000 (2005: RMB165,866,000) and an unaudited net profit of approximately RMB25,838,000 (2005: RMB19,852,000). Compared to the corresponding period in the previous year, the revenue has a growth of RMB46,156,000 or 27.8%, and the net profit has a growth of RMB5,986,000 or 30.2%.

Business Review

During the period under review, the Group was engaged in the design, manufacture and sale of petroleum drilling and extraction 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 drilling and extraction machinery accessories. These products are primarily used in petroleum drilling and extraction and are necessary equipments of the industry.

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, and along with 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 revenue and profits.

As for the market development, the Group's current customers are still mainly oil fields operated by PetroChina Company Limited and its subsidiaries (collectively "PetroChina Group") and China Petroleum & Chemical Corporation and its subsidiaries (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) and Liaohe Oil Field (遼河油田). Apart from its continued efforts in consolidating relationships with the existing customers and securing new ones, the Group has also placed great emphasis on further exploring overseas markets. At present, the Group has built up solid export businesses to regions such as North America, Europe, Russia and South East Asia, which sales growth contributed to the Group will be reflected in the annual report. The Group has established and maintained close cooperation with various international petroleum service corporations which favours the sales of its products in the overseas markets. During the period under review, export sales of the Group increased significantly to 34.4% of its sales income, laying a solid foundation for the Group's future development in the overseas markets.

During the period under review, the construction of the Group's oil casing production line with an annual capacity of 250,000 tons has been completed. Trial production commenced in May 2006.

Outlook

With the development of the global economy, the continuous keen demand in crude oil from various countries and the steady growth of market demand in petroleum drilling and extraction machinery resulting from the exploitation of oil fields to increase output, which increases the usage and consumption of petroleum drilling and extraction machinery, the Group is highly confident in the future of the petroleum machinery industry.

The Group will continue to capture opportunities, and further enhance its competitive capability through various strategies, including capacity enhancement, improvement of product quality, strengthening of its research and development capability, enhancement of market promotion and effective cost control. Meanwhile, the Group will continue to develop domestic and overseas markets in order to increase its market share in the industry.

Enhancement of production capacity

The Group will adopt a new method under which new construction and technological innovations will be combined to enhance production capacity. The Group's 250,000 tons per year oil casing production line has gone into trial production, and installation of the ancillary thermal treatment and processing production line is in progress and under testing. Upon operation, they will form an oil casing production line with an annual capacity of 250,000 tons, of which, the processing capacity of the casing thermal treatment will be 100,000 tons per year.

Improvement of product quality and strengthening of Research & Development ("R&D") capacity

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

Enhancement of market promotion and development of domestic and overseas markets

In respect of the domestic market, the Group has successfully employed market sales and executive personnel and will continue to maintain good relationships with existing customers. The Group considers that such on-site offices at oil fields allow the Group to make timely visits to its customers to listen to their opinions and collect the latest market information, which enables the Group to better understand customer needs, strengthen after-sales services and develop the domestic market.

In respect of the overseas markets, on the basis of the consolidation of the existing markets, the Group will proactively procure product promotions and continue to explore potential markets and customers, so as to increase overseas sales of the Group's products.

Proposed listing on the Main Board of the Stock Exchange by way of introduction

To enhance the profile of the Group in the international investment market and the liquidity of the H Shares of the Company, it is proposed that the Company shall be listed on the Main Board of the Stock Exchange by way of introduction subject to, among other things, the regulatory approvals in Hong Kong and the PRC. The Directors consider that this will be beneficial to the future growth, financial flexibility and business development of the Company.

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 30 June 2006, the Group had bank credit loans amounting to RMB138,000,000. In addition, six banks, including the Agricultural Bank of China (Shandong Branch), have granted credit facilities totaling RMB410,000,000 to the Group. None of these credit facilities have been utilized.

EMPLOYEES

For the period under review, the breakdown of the number of employees of the Group is set out below:

	Six months ended 30 June	
	2006	2005
Research and development	**57**	49
Production	**1,324**	1,194
Quality control	**92**	78
Sales and marketing	**63**	52
Administration	**168**	156
Total	**1,704**	1,529

The Group keeps a close watch on the levels of employees' remuneration and benefits, and rewards staff according to the results of the Group's operating achievement. Furthermore, the Group also offers training and development opportunities to employees.

COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

The net proceeds from the placing and public offer of H shares by the Company on 15 April 2004, which amounted to approximately HK$76,350,000, was intended to be used by the Directors as stated in the Prospectus and out of which approximately HK$5,400,000 was used for general working capital. As at 30 June 2006, the Group has utilized the proceeds as follows:

	Use of proceeds extracted from the Prospectus	**Actual amount used up to 30 June 2006**	**Remaining net proceeds as at 30 June 2006**
	HK$ (in million)	HK$ (in million)	HK$ (in million)
Research and development	6.20	6.20	0.20
Expansion of production capacity	37.00	37.30	—
Product improvement and development	23.10	23.10	0.20
Sales and marketing	1.75	1.75	0.20
Human resources	1.30	1.30	0.20
Certification	0.40	0.35	0.15
Total	69.75	70.00	0.95

The Group has accelerated its production capacity expansion and certain projects were completed prior to their scheduled time as set out in the Prospectus owing to the rising demand for petroleum drilling and extraction machinery.

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 2006 are as follows:

Business objectives as stated in Prospectus	Actual business progress
Research and development	
Technology for production of super-strength oil well sucker rods	Technology for production of super-strength oil well sucker rods has been developed
Energy conservation technology in oil well pumping machines	Energy conservation technology has been developed
To develop a packer jointly with the Zhongyuan Institute	The development of the packer has been completed
To continue the research and development on petroleum drilling and extraction machinery and related accessories	The planned research and development has been achieved
Expansion of production capacity	
To achieve annual production capacity of oil well pumps to approximately 10,000 units	The planned annual production capacity has been achieved
To achieve annual production capacity of oil well sucker rods to approximately 3,000,000 meters	The annual production capacity of oil well sucker rods has been increased to approximately 3,500,000 meters
To achieve annual production capacity of oil well pumping machines to approximately 200 units	The planned annual production capacity has been achieved

To maintain annual production capacity of underground petro-electric pumps to approximately 200 units	The planned annual production capacity has been maintained
To maintain annual production capacity of blade-guide pulleys to approximately 150,000 sets	The planned annual production capacity has been maintained
To achieve annual production capacity of valves to approximately 60,000 pieces	The planned annual production capacity has been achieved
To maintain annual production capacity of fluid injection pumps to approximately 300 units	The planned annual production capacity has been maintained
To achieve annual production capacity of mud pump steel sleeves to approximately 33,000 pieces	The planned annual production capacity has been achieved
To complete the construction of new production facilities for super-strength oil well sucker rods and to achieve annual production capacity to approximately 40,000 tons	The construction of new production facilities for super-strength oil well sucker rods has been completed and the planned annual production capacity has been achieved
To complete the construction of new production facilities for special seamless oil well pipes to achieve annual capacity to approximately 60,000 tons	The construction of new production facilities for special seamless oil well pipes has been completed with an annual production capacity of approximately 60,000 tons
To achieve the annual production capacity of oil well pipes to approximately 50,000 tons	The annual production capacity of oil well pipes has reached 60,000 tons

Production improvement and development

To develop oil well pipes which can withstand high pressure	Successfully developed special seamless oil well pipes which can withstand high pressure
To develop advanced 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	Advanced and reliable oil well sucker rods have been developed. Construction of production facilities of the oil well sucker rods has been completed
To enhance oil well pumps performance under specific oil well conditions, such as anti-corrosion, sand-proof, etc	The objective has been achieved
To enhance system operations for oil well pumping machines	The objective has been achieved
To continue to improve and develop products in response to market trends and changes	Successfully developed a number of oil well sucker rods of various specifications

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 drilling and extraction machinery	The official website's content of the Group has been modified and its connection speed has been improved
To reinforce current sales network (domestic and foreign) and simultaneously to further explore markets in North America and the Middle East by sending sales principals to North America and the Middle East	Sales principals have been sent to North America and the Middle East, sales agents were appointed and direct business relationships with certain clients has been established
To further explore market in North America and the Middle East	The objective has been achieved

Human resources

To expand the Group's work force by recruiting high caliber individuals from time to time	The objective, including the recruitment of suitable personnel responsible for research and development, production, quality control, sales and marketing and administration, has been achieved

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
To renew the right to use API Monogram for oil well pumps, oil well sucker rods and oil well pipes	The renewal of the right to use API Monogram for oil well pumps, oil well sucker rods and oil well pipes has been completed
To apply for the right to use API Monogram for oil well pumping machines	The application for the right to use API Monogram for oil well pumping machines has been postponed
To apply for rights to use API Monogram for newly developed petroleum drilling and extraction machineries	No fresh application for API Monogram is required for the oil well pumping machines being developed

The net proceeds from the placing on 12 May 2005 amounted to approximately HK$94.80 million. As at 30 June 2006, the Group has utilized the proceeds as follows:

	Use of proceeds extracted from the Placing Announcement HK$ (in million)	Actual amount used up to 30 June 2006 HK$ (in million)	Remaining net proceeds as at 30 June 2006 HK$ (in million)
Purchase of the production line of oil casing and related accessories	94.80	94.80	0.00

Comparisons of the business objectives with the actual business progress set out in the Placing Announcement of the Company for the period from 13 May 2005 to 30 June 2006 are as follows:

Business objective as stated in the Placing Announcement	Actual business progress
Purchase of the production line of oil casing and related accessories	The construction has been completed and has gone into trial production

CORPORATE GOVERNANCE

The Company has complied throughout the period under review with the code provisions set out in the "Code on Corporate Governance Practices" contained in Appendix 15 of the GEM Listing Rules.

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 systems and internal control procedures. The Audit Committee is comprised 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 accounting principles and practices adopted by the Group, internal control and financial reporting matters, including review of the unaudited results for the six months ended 30 June 2006.

REMUNERATION COMMITTEE

The Company set up a remuneration committee (the "Remuneration Committee") on 18 January 2005. The Remuneration Committee is comprised of Mr. Zhang Yun San, who is an executive Director and Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam who are independent non-executive Directors. Mr. Loke Yu alias Loke Hoi Lam is the chairman of the Remuneration Committee. The primary duties of the Remuneration Committee is to make proposals to the Board on the remuneration adjustment policy and structure in respect of the Directors and senior management of the Company and to determine the designated remuneration for all the executive Directors and senior management.

NOMINATION COMMITTEE

The Company set up a nomination committee (the "Nomination Committee") on 18 January 2005, which aims to ensure the procedures for the appointment of Directors to comply with the principle of fairness and transparency. The principal rights and duties of the Nomination Committee are to regularly review the structure, number and composition (including skill, knowledge and experience) of the Board and to make recommendations to the Board on any intended change. Currently, members of the Nomination Committee include Mr. Zhang Yun San, who is an executive Director, and Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu, alias Loke Hoi Lam, who are independent non-executive Directors. Mr. Yan Yi Zhuang is the chairman of the Nomination Committee.

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 in accordance with the code of practice that all the Directors have complied with the standard of dealings and model code of practice in relation to the securities transaction by Directors.

DISCLOSURE OF DIRECTORS', SUPERVISORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 June 2006, the interest and short positions of the Directors, supervisors (the "Supervisors") and chief executives of the Company in the shares, debentures or underlying 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 executives 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 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 30 June 2006.

SHARE OPTION SCHEME

The Company does not have any share option scheme.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 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 *(Note 1)*	Interests of spouse	279,517,000	69.58%	—	43.14%
Li Xiu Fen *(Note 2)*	Interests of spouse	34,216,000	8.52%	—	5.28%
Zhang Xin Lan *(Note 3)*	Interests of spouse	30,608,000	7.62%	—	4.72%
Li Bao Hui *(Note 4)*	Interests of spouse	21,410,000	5.33%	—	3.30%
Peter Cundill & Associates (Bermuda) Ltd. *(Note 5)*	Investment manager	69,500,000	—	28.22%	10.73%
RAB Energy Fund Limited *(Note 5)*	Investment manager	33,832,000	—	13.74%	5.22%
Commonwealth Bank of Australia *(Note 5)*	Corporate interest controlled by the substantial shareholder	19,718,000	—	8.01%	3.04%
Martin Currie Investment Management Limited *(Note 5)*	Investment manager	12,400,000	—	5.04%	1.91%

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: Interests 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 executives 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 30 June 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 six months ended 30 June 2006.

DIRECTORS

As at the date of this report, the executive Directors of the Company 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 Directors
Zhang En Rong
Chairman

Shandong, the PRC
15 August 2006