Notes to the Financial Statements

For the year ended 31 December 2005

1. GROUP RESTRUCTURING AND BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

The Company is a company incorporated in the Cayman Islands under the Companies Law as an exempted company with limited liabilities under the Companies Law (2000 Revision) Chapter 22 of the Cayman Islands on 11 May 2004 and its shares have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 17 November 2005. In the opinion of the directors, the ultimate holding company of the Company is China Longgong Group Holdings Limited, a company incorporated in the British Virgin Islands on 3 June 2004 with limited liability.

Pursuant to a group reorganisation scheme to rationalise the structure of the Group in preparation for the listing of the Company's shares on the Stock Exchange (the "Group Reorganisation"), the Company became the holding company of the Group on 6 December 2004. The Company is an investment holding company and the companies now comprising the Group are principally engaged in the manufacturing of wheel loaders. The Group's assets and liabilities for the manufacture of wheel loaders (the "Business") were transferred from Shanghai Longgong Machinery Limited (上海龍工機械有限公司) ("Shanghai Longgong Machinery") and Fujian Longyan Construction Machinery (Group) Limited (福建龍岩工程機械(集團)有限公司) ("Fujian Longyan"), both of which were establish in the PRC, to companies now comprising the Group pursuant to the Group Reorganisation. Prior to the transfer of the Business on 6 December 2004, Shanghai Longgong Machinery and Fujian Longyan were owned and operated by the beneficial owners of the Company. As part of the Group Reorganisation, the Business is now assumed by the Group and Shanghai Longgong Machinery and Fujian Longyan have thereafter ceased to carry on the Business. Accordingly, for the purpose of preparing the consolidated financial statements, the relevant assets, liabilities, and results of operation of the Business are included in the consolidated income statement, consolidated cash flow statement and consolidated statement of changes in equity of the Group for the year ended 31 December 2004.

In connection with the Group Reorganisation, the Company acquired the entire issued share capital of China Dragon Development Holdings Limited ("China Dragon Development") and China Dragon Investment Holding Limited ("China Dragon Investment") from their then shareholders in consideration of the Company issuing 2 shares to their then shareholders. Further details of the Group Reorganisation are set out in the prospectus issued by the Company dated 8 November 2005.

The group comprising the Company and its subsidiaries (the "Group") and the Business resulting from the Group Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group have been prepared on the basis as if the Company had always been the holding company of the Group using the principles of merger accounting in accordance with the Statement of Standard Accounting Practice 27 "Accounting for Group Reconstructions" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"). The principal activities of the Company's subsidiaries are set out in note 32.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared under the historical cost convention and in accordance Hong Kong Financial Reporting Standards ("HKFRSs") issued by the HKICPA. The consolidated financial statements also include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance.

The HKICPA has issued the following standards and interpretations ("INT") that are not yet effective. The Group has considered the following standards and interpretations but does not expect they will have a material effect on how the results of operations and financial position of the Group are prepared and presented.

HKAS 1 (Amendment)	Capital Disclosure
HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 21 (Amendment)	Net Investment In A Foreign Operation
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC) – INT 4	Determining whether an Arrangement contains a Lease
HK(IFRIC) – INT 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
HK(IFRIC) – INT 6	Liabilities arising from participating in a specific market, waste electrical and electronic equipments
HK(IFRIC) – INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary economies

The Group is currently assessing the potential impact of HKAS 39 and HKFRS 4 (Amendment) "Financial Guarantee Contracts" that will be affective for accounting period commencing 1 January 2006 but is not yet in a position to determine the impact on the financial position of the Group although the Group does not expect this will have a material effect on the results of operation. Under HKAS 39 and HKFRS 4 (Amendment) "Financial Guarantee Contracts" financial guarantee contracts are required to be initially measured at fair value.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of any entity so as to obtain benefits from its activities.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of consolidation (continued)

The results of subsidiaries acquired, other than under the Group Reorganisation, or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination (see below) and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Business combinations

The acquisition of subsidiaries, other than under the Group Reorganisation, is accounted for using the purchase method. The cost of the acquisition is measured as the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities meeting the conditions for recognition under HKFRS 3 "Business Combinations" are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, after reassessment, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the net fair values of the identifiable assets, liabilities and contingent liabilities of the subsidiary recognised at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually and whenever there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable, which is the rate that exactly discount estimated future cash receipt through the expected life of the financial assets to that assets net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment has been established.

Leasing

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Government grants

Government grants including government subsidy are recognised when there is reasonable assurance that the Group will comply with the conditions attaching to them and the grants will be received.

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Foreign currencies

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each entity are expressed in Renminbi, which is the functional currency of the Company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the year. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the year except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations (including comparatives) are expressed in Renminbi using exchange rates prevailing on the balance sheet date. Income and expense items (including comparatives) are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during the period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised in profit or loss in the year in which the foreign operation is disposed of.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currencies (continued)

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

Retirement benefit costs

Payments to defined contribution retirement benefit plans are charged as an expense as they fall due. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution plans where the Group's obligations under the plans are equivalent to those arising in a defined contribution retirement benefit plan.

Income tax expense

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on the results for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes income statement items that are never taxable or deductible. The liability for current tax of the Group is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary differences are related to goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction which affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax expense (continued)

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled. Deferred tax is charged or credited to the income statement, except when it relates to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment

Construction in progress

Construction in progress are stated at cost, which includes construction costs and other direct costs, capitalised in accordance with the Group's accounting policies less any identified impairment loss. No depreciation or amortision is provided until the construction is completed and the properties and assets are ready for use. Cost of completed construction work is transferred to the appropriate category of property, plant and equipment.

Other property, plant and equipment

Property, plant and equipment are stated at cost less any accumulated depreciation, amortisation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment over their estimated useful lives after taking into account of their estimated residual values, using the straight-line method.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

Lease premium for land

Leasehold land premiums are up-front payments to acquire long-term leasehold land interests. The premiums are stated at cost and are charged to the income statement over the period of the lease term on a straight line basis.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of tangible assets

At each balance sheet date, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour cost those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the first-in, first-out method.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Trade receivables, bills receivables, other receivables and amounts due from a director/related parties

Trade receivables, bills receivables, other receivables and amount due from a director/related parties are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Financial liabilities and equity

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

Bank borrowings

Interest-bearing bank loans and overdrafts are initially measured at fair value, and subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings in accordance with the Group's accounting policy for borrowing costs.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Trade payables, other payables, bills payables and amounts due to a director/related parties

Trade payables, other payables, bills payables and amounts due to a director/related parties are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

3. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

Provision for warranty costs

The Group offers a standard six-month warranty for the wheel loaders, during which free warranty service for the repair and maintenance of parts and components under normal usage is provided to the customers. The provision for warranty costs are estimated based on the percentage of warranty costs to turnover for the previous financial years.

4. TURNOVER AND BUSINESS AND GEOGRAPHICAL SEGMENT

Turnover is measured at the fair value of the consideration received and receivable for goods sold, net of returns, and allowances.

During the years ended 31 December 2005 and 2004, the principal activity of the Group was engaged in the manufacture and sales of wheel loaders in the PRC and accordingly, no analysis of business and geographical segment is presented.

5. PROFIT BEFORE TAXATION

	2005	2004
	RMB'000	RMB'000
Profit before taxation has been arrived at after charging:		
Cost of inventory recognised as expenses	**2,125,934**	1,688,603
Staff costs, including directors' remuneration		
Salaries and allowances	**83,870**	65,049
Contributions to retirement benefit scheme	**4,564**	1,539
Total staff costs	**88,434**	66,588
Auditors' remuneration	**1,672**	67
Allowance for bad and doubtful debts	**91**	177
Write down of inventory	**409**	–
Depreciation	**26,357**	18,639
Amortisation of lease land premium	**1,038**	908
Loss on disposal of property, plant and equipment	**2,584**	247
Research and development expenditures	**1,540**	4,912
and after crediting:		
Discount on acquisition *(Note 25)*	**7,415**	–
Interest income on bank deposit	**4,812**	1,433
Interest income on loan receivables	**–**	80
Government subsidy income *(Note)*	**–**	9,543

Note: The government subsidy income represents subsidy from Shanghai Xinmin District Economic Zone Administrative Committee ("Committee") determined by reference to the monthly income tax payment made by the Group. The subsidy amounts were entirely based on the mandate of the Committee adjusted from time to time and the grant of the government subsidy depends on the approval by the Committee.

6. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS

(a) Directors' emoluments

	2005 RMB'000	2004 RMB'000
Fees	**364**	–
Other emoluments:		
Salaries and allowances	**1,780**	828
Contributions to retirement benefits scheme	**9**	–
	1,789	828
	2,153	828

Details of emoluments of individual directors are set out as follows:

	2005 RMB'000	2004 RMB'000
Fees:		
Mr. Li San Yim	**–**	–
Mr. Qiu Debo	**–**	–
Mr. Luo Jianru	**–**	–
Ms. Feng Wanru	**–**	–
Mr. Chen Chao	**–**	–
Mr. Zhu Yongsheng	**–**	–
Dr. Zhang Hong	**–**	–
Ms. Ngai Ngan-Ying	**100**	–
Mr. Zhu, Mantian Myron	**35**	–
Professor Yang Hongqi	**55**	–
Dr. Qian Shizheng	**87**	–
Mr. Lo Peter	**87**	–
	364	–

6. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS (continued)

(a) Directors' emoluments (continued)

Salaries, allowances and Contributions to retirement benefits scheme:

	2005		2004	
	Salaries and allowances RMB'000	Contributions to retirement benefits scheme RMB'000	Salaries and allowances RMB'000	Contributions to retirement benefits scheme RMB'000
Mr. Li San Yim	600	–	240	–
Mr. Qiu Debo	300	1	42	–
Mr. Luo Jianru	200	2	42	–
Ms. Feng Wanru	200	–	42	–
Mr. Chen Chao	120	6	42	–
Mr. Zhu Yongsheng	120	–	–	–
Dr. Zhang Hong	120	–	–	–
Ms. Ngai Ngan-Ying	120	–	420	–
Mr. Zhu, Mantian Myron	–	–	–	–
	1,780	9	828	–

(b) Employees' emoluments

The five highest paid individuals included five and two directors of the Company for the year ended 31 December 2005 and 2004 respectively, details of whose emoluments are set out above. The emoluments of the remaining highest paid individuals are as follows:

	2005 RMB'000	2004 RMB'000
Salaries and allowances	–	298
Retirement benefits scheme contributions	–	1
	–	299

6. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS (continued)

(b) Employees' emoluments (continued)

During the both years ended 31 December 2005 and 2004, no emoluments were paid by the Group to any of the directors or five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors waived any emoluments during the years ended 31 December 2005 and 2004.

7. INCOME TAX EXPENSE

	2005	2004
	RMB'000	RMB'000
The charge comprises:		
PRC Enterprise Income Tax ("EIT")	**29,141**	60,121
Deferred tax credit *(Note 13)*	**–**	(14,893)
	29,141	45,228
Deferred tax charge arising from the Group Reorganisation *(Note 14)*	**–**	36,771
	29,141	81,999

No provision for profits tax has been made for the Company, China Dragon Development and China Dragon Investment, which are established in the Cayman Islands and British Virgin Islands.

7. INCOME TAX EXPENSE (continued)

The entities located in PRC were entitled to tax rate for the year ended 31 December 2005 and 2004 as follows:

	Note	**2005 EIT rate**	2004 EIT rate
Longgong Shanghai Machinery Company Limited ("Longgong Shanghai")	*(1)*	**Exempted**	N/A
Longgong Fujian Machinery Company Limited ("Longgong Fujian")	*(1)*	**27%**	N/A
Longgong (Shanghai) Qiaoxiang Company Limited ("Shanghai Qiaoxiang")	*(2)*	**13.5%**	Exempted
Fujian Longyan Longgong Machinery Components Company Limited ("Longyan Components")	*(3)*	**27%**	27%
Herkules (Shanghai) Hydraulic System Company Limited ("Hydraulic Company")	*(4)*	**Exempted**	N/A
Refined (Shanghai) Machinery Company Limited ("Pipe Company")	*(4)*	**Exempted**	N/A
Jiangxi Monarch Gear Company Limited ("Gear Company")	*(5)*	**33%**	N/A
Jiangxi Longgong Machinery Company Limited ("Jiangxi Machinery")	*(5)*	**33%**	N/A
Shanghai Longgong	*(6)*	**N/A**	33%
Fujian Longgong	*(6)*	**N/A**	33%

7. INCOME TAX EXPENSE (continued)

(1) Longgong Shanghai and Longgong Fujian are entitled to an exemption from EIT for the two years starting from its first profit-making year in 2005, follows by a 50 per cent tax relief for the following three years. Accordingly, Longgong Shanghai is exempt from EIT in 2005. However, Longgong Fujian paid tax at their full EIT rate for the year ended 31 December 2005 because the exemption conditions for this year are eventually not fulfilled.

(2) Shanghai Qiaoxiang is entitled to an exemption from EIT for the two years starting from its first profit-making year in 2003, follows by a 50 per cent tax relief for the following three years. For the year ended 31 December 2005 and 2004, Shanghai Qiaoxiang was subject to EIT together with the local income tax at a rate of 13.5 per cent and Zero respectively.

(3) Longyan Components was entitled to an exemption from EIT for the two years starting from its first profit-making year in 1999, follows by a 50 per cent tax relief for the following three years. For the year ended 31 December 2005 and 2004, Longyan Components was subject to EIT together with the local income tax at a rate of 27 per cent.

(4) Hydraulic Company and Pipe Company are entitled to an exemption from EIT for the two years starting from its first profit-making year in 2005, so that these two companies are subject to zero tax rate of EIT in 2005.

(5) Gear Company and Jiangxi Machinery were subject to EIT together with the local income tax at an aggregate rate of 33 percent for the year ended 31 December 2005 and 2004.

(6) As disclosed in Note 1, the results of operation of Shanghai Longgong Machinery and Fujian Longyan for the year ended 31 December 2004 were included, both of which were subject to EIT together with the local income tax at a rate of 33%.

Notes to the Financial Statements

For the year ended 31 December 2005

7. INCOME TAX EXPENSE (continued)

The tax charge for the year ended 31 December 2005 and 2004 can be reconciled to the profit per the income statement as follows:

	2005		2004	
	RMB'000	**%**	RMB'000	%
Profit before taxation	**265,822**		213,904	
Tax at the domestic tax rate of 33%	**87,721**	**33**	70,588	33.0
Tax effect of expenses that are not deductible in determining taxable profit	**94**	**–**	5,359	2.5
Tax effect of income that is not taxable in determining in taxable profit	**(2,500)**	**(0.9)**	(62)	(0.1)
Reversal as a result of the Group Reorganisation *(Note 13)*	**–**	**–**	36,771	17.2
Tax effect of deferred tax assets not recognized	**4**	**–**	–	–
Effect of tax exemptions and income tax on concessionary rate granted to PRC subsidiaries	**(56,178)**	**(21.1)**	(30,657)	(14.3)
Tax charge and effective tax rate for the year	**29,141**	**11.0**	81,999	38.3

8. DIVIDENDS

During the year ended 31 December 2005, the Company declared and paid interim dividends of RMB67,684,000 represents RMB9.7 cents per ordinary share. In respect of the year ended 31 December 2004, dividends were paid by the companies now comprising the Group to its shareholders prior to the Group Reorganisation:

	2005	2004
	RMB'000	RMB'000
Dividend paid	**67,684**	45,435

9. EARNINGS PER SHARE

The calculation of the basic earning per share is based on the profit for the year attributable to the equity holders of the company of approximately RMB235,906,000 (2004: RMB131,905,000) and on the weighted average number of 740,031,507 (2004: 700,000,000) shares in issue during the year.

The weighted average number of shares are computed assuming that the Group Reorganisation was effective on 1 January 2004 and throughout the two years ended 31 December 2005. There were no potential ordinary shares outstanding in the year ended 31 December 2004 and 2005.

10. PROPERTY, PLANT AND EQUIPMENT

	Building	Plant and Machinery	Motor Vehicles	Furniture and Fixtures	Construction-in-progress	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
COST						
At 1 January 2004	107,639	96,340	9,663	5,146	21,617	240,405
Additions	5,713	45,897	1,093	736	43,364	96,803
Transfers	13,740	6,646	–	–	(20,386)	–
Disposals	(335)	(685)	–	–	–	(1,020)
At 31 December 2004	126,757	148,198	10,756	5,882	44,595	336,188
Acquisition of subsidiaries	1,567	26,625	2,297	1,107	1,304	32,900
Additions	9,204	13,351	1,248	4,972	94,430	123,205
Transfers	57,626	19,592	–	823	(78,041)	–
Disposals	(271)	(6,194)	(2,239)	(1,032)	–	(9,736)
At 31 December 2005	194,883	201,572	12,062	11,752	62,288	482,557
ACCUMULATED DEPRECIATION						
At 1 January 2004	13,738	13,724	3,347	2,968	–	33,777
Charge for the year	4,989	11,452	1,503	695	–	18,639
Disposals	(71)	(702)	–	–	–	(773)
At 31 December 2004	18,656	24,474	4,850	3,663	–	51,643
Charge for the year	6,265	17,182	1,569	1,341	–	26,357
Disposals	(262)	(2,061)	(2,164)	(987)	–	(5,474)
At 31 December 2005	24,659	39,595	4,255	4,017	–	72,526
NET BOOK VALUE						
At 31 December 2005	170,224	161,977	7,807	7,735	62,288	410,031
At 31 December 2004	108,101	123,724	5,906	2,219	44,595	284,545

10. PROPERTY, PLANT AND EQUIPMENT (continued)

The buildings of the Group are situated in the PRC under medium term land use rights.

The construction in progress are mainly related to the construction of factory premise and production plants which had not been completed at the balance sheet dates.

Depreciation and amortisation are provided to write off the cost of property, plant and equipment, other than construction in progress, over their estimated useful lives and after taking into account their estimated residual value, using the straight-line method, as follows:

Buildings	Over the shorter of the term of the land use rights or 30 years
Plant and machinery	4 to 11 years
Furniture, fixtures and equipment	4 to 6 years
Motor vehicles	5 to 6 years

11. LEASE PREMIUM FOR LAND

	2005 **RMB'000**	2004 RMB'000
Balance at beginning of the year	**43,090**	43,449
Acquisition of subsidiaries	**14,359**	–
Additions	**69,820**	549
Amortisation	**(1,038)**	(908)
Balance at end of the year	**126,231**	43,090
Less: Amount to be amortised within one year	**(2,559)**	(910)
Non-current portion	**123,672**	42,180

The carrying amount of land represented medium-term land use rights situated in the PRC. The Group has pledged its land use rights to secure borrowings of the Group.

The lease premium for land is charged to profit or loss over the term of the land use rights.

12. LOAN RECEIVABLES

The amounts represented advances made to suppliers by the Group. Amounts were unsecured and were fully repaid in 2005 and were interest free except for an amount of RMB1,500,000 as at 31 December 2004 which carried interest at 6% per annum.

13. DEFERRED TAX ASSETS

The following are the major deferred tax assets recognised and movements thereon during the years:

	Allowance for bad and doubtful debts	Provision for products warranty	Allowance for inventories	Unrealised profit in inventory	Accrued sales promotion cost	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004	1,420	4,179	314	8,935	6,689	341	21,878
Credit (charge) to income statement for the year	58	327	302	8,557	5,990	(341)	14,893
Reversal for deferred tax assets as a result of Group Reorganisation *(Note)*	(1,478)	(4,506)	(616)	(17,492)	(12,679)	–	(36,771)
At 31 December 2004 and 2005	–	–	–	–	–	–	–

Note: Prior to the transfer of Business to Longgong Shanghai and Longgong Fujian, deferred tax assets had been recognised by Shanghai Longgong Machinery and Fujian Longyan in respect of certain deductible temporary differences in accordance with their respective enacted tax rates. These deductible temporary differences are reversed upon the transfer of Business and the cessation of the operation of Shanghai Longgong Machinery and Fujian Longyan. Accordingly, the previous recognised deferred tax assets were charged back to income statement.

14. INVENTORIES

	2005	2004
	RMB'000	RMB'000
Raw materials	**145,901**	204,014
Work in progress	**64,589**	27,096
Finished goods	**493,516**	388,200
	704,006	619,310

15. TRADE RECEIVABLES, BILL RECEIVABLES, OTHER RECEIVABLES AND PREPAYMENTS

The Group has a policy of allowing an average credit periods ranging from 30 to 180 days to its trade customers other than major customers with whom specific terms will be agreed.

The aged analysis of trade receivables is as follows:

	2005 RMB'000	2004 RMB'000
0 – 90 days	**188,714**	185,763
91 – 180 days	**1,563**	11,486
181 – 270 days	**1,491**	2,809
271 days to 1 year	**418**	353
1 to 2 years	**806**	1,011
2 to 3 years	**530**	275
	193,522	201,697

Bills receivable are aged within one year from the respective balance sheet date. The directors consider that the carrying amounts of bills receivable approximate their fair value.

The breakdown of major items in other receivables and prepayments of the Group is as follows:

	2005 RMB'000	2004 RMB'000
Deposits for purchase of supplies and raw materials	**45,287**	59,977
Value-added tax receivables	**–**	26,101
Government subsidy income receivable	**–**	8,179
Advance to sale agents	**–**	4,390
Others	**16,674**	7,749
	61,961	106,396

The directors consider that the carrying amount of trade and other receivables approximate their fair value.

16. AMOUNT DUE FROM A DIRECTOR

			Maximum amount outstanding during the year ended	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Mr. Li San Yim	**–**	1,829	**–**	1,829

The amount was unsecured, interest free and was fully settled in 2005.

The directors consider that the carrying amount of amount due from a director approximates its fair value.

17. AMOUNTS DUE FROM RELATED PARTIES

		2005	2004
	Note	**EIT rate**	EIT rate
Hydraulic Company	*1*	**–**	3,019
Longgong (Fujian) Gear Co., Ltd. ("Fujian Gear")	*2*	**–**	436
		–	3,455
Maximum amount outstanding during the year			
Hydraulic Company		**–**	8,000
Fujian Gear		**–**	3,620

Notes:

1. Ms. Li Hang Li, a daughter of Mr. Li San Yim and Madam Ngai Ngan Ying, who are the shareholders and directors of the Company, held beneficial interests in this company prior to it being acquired by the Group.

2. Mr. Li Jun who is the son of Mr. Li San Yim and Madam Ngai Ngan Ying and his wife held beneficial interests in this company.

The amounts were unsecured, interest free and the amount due from Fujian Gear was fully repaid during the year ended 31 December 2005, while the amount due from Hydraulic Company has been eliminated upon the completion of acquisition of Hydraulic Company.

The directors consider that the carrying amounts of amounts due from related parties approximate their fair value.

18. TRADE PAYABLES, BILL PAYABLES AND OTHER PAYABLES

The aged analysis of trade payables is as follows:

	2005 RMB'000	2004 RMB'000
Within 1 year	**274,724**	308,788
1 to 2 years	**3,150**	1,343
2 to 3 years	**1,180**	2,266
Over 3 years	**904**	635
	279,958	313,032

The directors consider that the carrying amounts of trade payables, bill payables and other payables approximate their fair values.

19. PROVISIONS

	2005 RMB'000	2004 RMB'000
At beginning of year	**13,654**	12,664
Provision for the year	**42,108**	36,291
Utilisation of provision	**(28,863)**	(35,301)
At end of year	**26,899**	13,654

The provisions represents the obligation for warranty costs to the customers.

20. AMOUNT DUE TO A DIRECTOR

The amount represents:

	2005 RMB'000	2004 RMB'000
Madam Ngai Ngan Ying	**–**	4,724

The amount was unsecured, non-interest bearing and was fully repaid before 31 December 2005.

20. AMOUNT DUE TO A DIRECTOR (continued)

The directors consider that the carrying amount of amounts due to director approximated its fair value.

21. AMOUNTS DUE TO RELATED PARTIES

The amounts represent:

	Note	**2005 EIT rate**	2004 EIT rate
Mr. Ngai Ngan Gui	*1*	**–**	1,244
Mr. Ngai Ngan Cun	*1*	**–**	151
Longgong Holdings (HK) Limited	*2*	**343**	1,985
Pipe Company	*3*	**–**	3,985
Gear Company	*4*	**–**	188
China Longgong Group Holdings Limited		**5,743**	1,754
		6,086	9,307

Notes:

1. Brother of Madam Ngai Ngan Ying.

2. Mr. Li San Yim and Madam Ngai Ngan Ying hold beneficial interest in this company.

3. Mr. Li Bin, a son of Mr. Lin San Yim and Madam Ngai Ngan Ying, held beneficial interest in this company prior to it being acquired by the Group.

4. Mr. Li Jun, a son of Mr. Lin San Yim and Madam Ngai Ngan Ying, held beneficial interest in this company prior to it being acquired by the Group.

Except for the amounts due to Pipe Company and Gear Company which were of trade nature, the remaining amounts are payment of expense made on behalf of the Company. All the amounts are unsecured, non-interest bearing and repayable on demand.

The directors consider that the carrying amounts of amounts due to related parties approximate their fair values.

22. BANK BORROWINGS

	2005	2004
	RMB'000	RMB'000
Short term bank borrowings	**455,320**	427,000
Trust receipt loan	**–**	45,000
	455,320	472,000
Analysed as:		
Secured	**820**	45,000
Unsecured	**454,500**	427,000
	455,320	472,000

At the respective balance sheet dates, the Group had bank facilities which were secured by the following assets of the Group:

	2005	2004
	RMB'000	RMB'000
Land use rights	**–**	16,217
Bank deposits	**14,008**	34,710
	14,008	50,927

The bank borrowings of the Group at 31 December 2004 were also secured by the guarantees of Mr. Li San Yim and Madam Ngai Ngan Ying. The directors' guarantee has been released in 2005.

The borrowings of the Group are fixed-rate borrowings which carry interests ranging from 4.8% to 5.9% during the year ended 31 December 2005 (2004: 4.7% to 5.6%) and therefore exposed to fair value interest rate risk. All of the Group's borrowings that are denominated in Renminbi, all the bank borrowing will be matured within one year.

The directors consider that the carrying amounts of bank borrowings approximate their fair value.

23. SHARE CAPITAL

	Number of shares	Amounts
		US$
Authorised:		
Ordinary shares of US$1.00 each		
At date of incorporation and at 31 December 2004	50,000	50,000
		HK$
Redominated to ordinary shares of HK$0.10 each on 10 October 2005 and 4 November 2005	3,900,000	390,000
Increase in authorised capital	4,996,100,000	499,610,000
Oridinary shares of HK$0.10 each		
At 31 December 2005	5,000,000,000	500,000,000

	Number of shares	Amounts
		US$
Issued and fully paid:		
Allotted and issued on date of incorporation	100	100
Issue of shares	18	18
At 31 December 2004	118	118
		HK$
Re-dominated to ordinary shares of HK$0.10 each on 10 October 2005 and 4 November 2005	9,204	920
Issue of shares by capitalisation of share premium account	699,990,796	69,999,080
Issue of shares for placing and public offer	337,050,000	33,705,000
At 31 December 2005	1,037,050,000	103,705,000

23. SHARE CAPITAL (continued)

	RMB'000
Shown on the balance sheet at	
31 December 2004	1
31 December 2005	107,886

The Company was incorporated in the Cayman Islands on 11 May 2004 with an authorised capital of US$50,000 divided into 50,000 shares of US$1.00 each. On that date, 100 shares were allotted and issued for cash at par to provide the initial capital of the Company.

On 23 August 2004, 4 shares were allotted and issued for cash at par to the then shareholder of the Company to provide working capital for the Company.

On 6 December 2004, 1, 1 and 10 shares were allotted and issued for cash, at the respective consideration of HK$27,670,000, HK$4,860,000 and HK$53,470,000 respectively to the then shareholder of the company to finance the acquisition of business in the PRC.

On 6 December 2004, pursuant to a share swap agreement dated on the same date, 2 shares were alloted and issued to the then shareholders of the Company to acquire the entire issued share capital of China Dragon Development and China Dragon Investment as part of the Group Reorganization.

On 10 October 2005 and 4 November 2005, China Longgong Group Holdings Limited (being the then sole shareholder of the Company) passed a sole shareholder's resolutions to re-denominate the share capital of the Company from US$ to HK$ at the rate of exchange of US$1.00 to HK$7.80 and then each such re-denominated share of HK$7.80 each was sub-divided into 78 shares of HK$0.10 each such that the authorised share capital of the Company became HK$390,000.00 divided into 3,900,000 shares of HK$0.10 each and the issued share capital of the Company became HK$920.40 divided into 9,204 shares of HK$0.10 each (the "Re-denomination"), and that conditional on the Company's global offering of its shares becoming unconditional, the authorised share capital of the Company will further be increased to HK$500,000,000 divided into 5,000,000,000 shares of HK$0.10 each and the Directors were authorised to allot and issue a total of 699,990,796 shares credited as fully paid at par to the then shareholders by capitalising the sum of HK$69,999,079.60 standing to the credit of the share premium account of the Company

On 17 November 2005, by means of a global offering, the Company issued a total of 300,000,000 new ordinary shares of HK$0.10 each at a price of HK$1.43 per share. The proceeds are to be used to expand the production capacity to upgrade the research and development capabilities and to provide additional working capital for the Group.

23. SHARE CAPITAL (continued)

On 12 December 2005, by means of the excises of an over-allotment option under the global offering, the Company issued an additional 37,050,000 new ordinary share of HK$0.10 each at a price of HK$1.43 per share.

The share capital of the Group as at 31 December 2004 represents the share capital of the Company as if the Group Reorganisation had been completed as at 1 January 2004.

All the shares which were issued during the year rank pari passu with the then existing shares in all respects.

24. SPECIAL RESERVE AND NON-DISTRIBUTABLE RESERVE

The special reserve of the Group represents the difference between the nominal value of the share capital issued by the Company and the nominal value of the share capital of the subsidiaries acquired pursuant to the Group Reorganisation.

The non-distributable reserve of the Group represents the statutory reserve which comprised of capital reserve and statutory reserve funds appropriated from the profit after taxation of subsidiaries established in the People's Republic of China (the "PRC") in accordance with the PRC laws and regulations.

25. ACQUISITION OF SUBSIDIARIES

In 2005, the Group acquired 100 percent of the interests in Pipe Company, Hydraulics Company and Gear Company for a total consideration of RMB43,689,000 from the children of Mr. Li San Yim and Madam Ngai Ngan Ying. These transactions have been accounted for by the purchase method of accounting.

The fair value and the carrying amount of the net assets acquired in these transactions are as following:

	Pipe Company RMB'000	Hydraulics Company RMB'000	Gear Company RMB'000	Total RMB'000
Property, plant and equipment	2,972	17,840	12,088	32,900
Lease premium for land	6,807	7,053	499	14,359
Inventories	2,625	18,865	13,604	35,094
Trade accounts receivables	267	–	624	891
Bill receivables	5,700	5,346	5,300	16,346
Other receivables and prepayments	31	1,937	9,157	11,125
Amounts due from related parties	6,718	8,069	3,259	18,046
Bank balances and cash	4,892	1,662	766	7,320
Trade payables	(7,846)	(11,372)	(4,678)	(23,896)
Bill Payables	(9,455)	–	–	(9,455)
Other payables	(260)	(207)	(1,532)	(1,999)
Amounts due to related parties	(1,424)	(30,122)	–	(31,546)
Tax payables	–	–	(4,181)	(4,181)
Bank borrowings	(3,000)	(8,000)	(2,900)	(13,900)
	8,027	11,071	32,006	51,104
Share of net assets	8,027	11,071	32,006	51,104
Discount on acquisition	(2,192)	(3,787)	(1,436)	(7,415)
Total consideration, satisfied by cash	5,835	7,284	30,570	43,689
Net cash outflow arising on acquisition:				
Cash consideration paid	(5,835)	(7,284)	(30,570)	(43,689)
Cash and cash equivalents acquired	4,892	1,662	766	7,320
	(943)	(5,622)	(29,804)	(36,369)

25. ACQUISITION OF SUBSIDIARIES (continued)

The discount on acquisition represents the profit generated by the subsidiaries between the date the consideration is determined and the acquisition date the Group obtained control over these companies.

The acquired companies contribute RMB1 million revenue and no significant profit to the Group's profit before tax for the period between the date of acquisition and the balance sheet date.

If the acquisition had been completed on 1 January 2005, the total group revenue for the year would have been approximately RMB2,682 million, and profit for the year would have been approximately RMB243 million. The proforma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2005, nor is it intended to be a projection of future results.

26. OPERATING LEASE COMMITMENTS

	2005 **RMB'000**	2004 RMB'000
Minimum lease payments paid under operating leases in respect of premises during the year	**2,386**	1,678

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	2005 **RMB'000**	2004 RMB'000
Within one year	**3,462**	1,839
In the second to fifth year inclusive	**3,695**	5,851
Over five years	**864**	5,237
	8,021	12,927

Operating lease payments represent rentals payable by the Group for certain of its office premises and staff quarters. Leases are negotiated for an average term ranging of five to eight years and rentals are fixed for an average of five years.

27. COMMITMENTS

	2005	2004
	RMB'000	RMB'000
Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of property, plant and equipment	**41,016**	65,737

28. CONTINGENT LIABILITIES

As at 31 December 2004, the Group had the following corporate guarantees to secure the following parties' payment obligations to the banks:

	RMB'000
Independent third parties, other than sale agents	6,650
Related parties	
– Hydraulic Company	3,000
– Pipe Company	8,000
	17,650

As at 31 December 2005, the Group had no corporate guarantee to secure the above parties' payment obligations to the banks.

Also, as at 31 December 2005, the Group had issued corporate guarantees to the extent of RMB185,000,000 (31 December 2004: RMB129,000,000) to the banks to secure certain banking facilities of the Group's sales agents. The amount of such facilities being utilised as at 31 December 2005 amounted RMB87,559,000 (31 December 2004: RMB51,672,000).

29. RELATED PARTY TRANSACTIONS

In addition to notes 16, 17, 20, 21, 22, 25 and 28, the following related party transactions took place during the year ended 31 December 2005:

Name of related party	*Note*	Nature of transactions	2005 RMB'000	2004 RMB'000
Pipe Company	1	Purchases of goods	**38,172**	–
		Sales of goods	**120**	–
Gear Company	1	Purchase of goods	**27,188**	24,180
		Sales of goods	**12**	–
Hydraulic Company	1	Purchase of goods	**36,781**	10,333
Longyan Shangda Metal Co., Ltd	2	Purchase of goods	**–**	1,516
Fujian Gear		Sale of goods	**–**	745
Ngai Ngan Gui		Carriage inwards	**–**	14,213
LongOu Logistic Co., Ltd.	2	Carriage inwards	**10,216**	–
Ngai Ngan Cun		Carriage inwards	**2,907**	2,921

Notes:

1. Represent transactions prior to these companies being acquired by the Group

2. The company is established by Mr. Ngai Ngan Gui, a brother of Madam Ngai Ngan Ying.

For the year ended 2004, the Group purchased plant and equipment from third party suppliers through a company controlled by Mr. Li San Yim, Longgong Holdings (HK) Limited, as an intermediary agent, amounted to RMB19,994,000.

All the transaction with Pipe Company, Hydraulics Company and Gear Company have been regarded as inter group transaction upon the completion of the acquisition of the companies by the Group. All the other transactions described above except for the transaction of LongOu Logistic Company has been terminated following the listing of the Company's shares on The Stock Exchange of Hong Kong Limited.

30. RETIREMENT BENEFIT SCHEME

The employees employed by the Group in the PRC are members of the stated-managed retirement benefit schemes operated by the government of the PRC. The Group is required to contribute a certain percentage of its payroll costs to the retirement benefit schemes to fund the benefit. The only obligation of the Group with respect to the retirement benefit scheme is to make the specific contributions.

31. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments to raise finance for the Group's operations comprise bank borrowings and cash and short-term deposits. The Group has various other financial instruments such as trade and bill receivables and trade and bill payables, which arise directly from its operations.

It is, and has been throughout the year, the Group's policy not to enter into trading of financial instruments including derivative transactions.

The main risks arising from the Group's financial instruments are commodity price risk, credit risk, interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Foreign currency risk

The Group's exposure to foreign currency risk arises mainly from the exchange rate movements of Hong Kong Dollars, as the Group has bank deposits denominated in Hong Kong Dollars. The Group has not entered into any contracts to hedge the exposure.

Commodity price risk

The Group's exposure to commodity price risk relates primarily to the cost of raw materials, outsourced parts and components for the manufacturing of the goods. The Group has not entered into any contracts to hedge the exposure.

Credit risk

The Group trades only with recognised, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

Also, it's the Group policy to give corporate guarantees to banks to secure certain sales agents' payment obligation to the banks. The Group would only consider that with good repayment history and financial strengths, and also subject to the Group's credit verification procedures and monitory on an ongoing basis. The Group dose not expect any significant loans from providing the guarantees.

31. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Credit risk (continued)

With respect to credit risk arising from the other financial assets of the Group which comprise cash and cash equivalents and amounts due from related companies the Group's exposure to credit risk arising from default of counter parties is limited as the counter parties have good credit standing and the Group does not expect any significant loss for uncollected advances/deposits from these entities.

The Group has no significant concentrations of credit risk, with exposure spread over a large number of counter parties and customers.

Interest rate risk

The Group's fair value interest rate risk relates to bank balances and fixed-rate borrowings. The Group has not entered into any interest rate hedging contracts or any other derivative financial instrument.

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank borrowings. In the opinion of the Directors, most of the borrowings that mature within one year are able to be renew and the Group expects to have adequate source of funding to finance the Group and manage the liquidity position.

32. SUBSIDIARIES

Details of the Company's subsidiaries as at 31 December 2005 are as follows:

Name	Date and place of establishment/ incorporation	Registered and paid-up capital	Attributable equity interest *(Note)*	Principal activities
Longgong Shanghai (龍工(上海)機械有限公司)	13 August 2005 PRC	HK$48,000,000	99%	Manufacture and distribution of wheel loaders
Shanghai Qiaoxiang (龍工(上海)橋箱有限公司)	17 September 2001 PRC	HK$28,000,000	100%	Manufacture and distribution of axles and gear-boxes

Notes to the Financial Statements

For the year ended 31 December 2005

32. SUBSIDIARIES (continued)

Name	Date and place of establishment/ incorporation	Registered and paid-up capital	Attributable equity interest *(Note)*	Principal activities
Longgong Fujian (龍工(福建)機械有限公司)	15 September 2005 PRC	HK$158,000,000	100%	Manufacture and distribution of wheel loaders
Longyan Components (龍岩龍工機械配件有限公司)	1 March 1999 PRC	RMB5,000,000	100%	Manufacture and distribution of wheel loader component
Hydraulics Company 海克力斯(上海)液壓機械有限公司	30 September 2003 PRC	USD3,860,000	100%	Manufacture and distribution of wheel loader component
Pipe Company 鋭帆德(上海)機械有限公司	27 November 2003 PRC	HK$13,000,000	100%	Manufacture and distribution of wheel loader component
Gear Company 江西摩鋼凱齒輪有限公司	12 September 2003 PRC	RMB20,000,000	100%	Manufacture and distribution of wheel loader component
Jiangxi Machinery 江西龍工機械有限公司	12 September 2003 PRC	RMB10,000,000	100%	Manufacturing hydraulic parts and other machinery products
China Dragon Development (中國龍工發展有限公司)	3 May 2005 British Virgin Islands ("BVI")	US$50,000	100%	Investment holding
China Dragon Investment (中國龍工投資控股有限公司)	3 May 2005 BVI	US$50,000	100%	Investment holding

Note: The Company directly holds the interest in China Dragon Development and China Dragon Investment. All other interests shown above are indirectly held by the Company.