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1. CORPORATE INFORMATION

Shandong Molong Petroleum Machinery Company Limited (the "Company") is a limited liability Company established in the People's Republic of China (the "PRC"). The registered office of the Company is located at No. 99 Beihai Road, Shouguang City, Shandong Province, the PRC.

During the year, the Company and its subsidiaries (the "Group") were involved in the design, manufacture and sale of petroleum extraction machinery and related accessories, which included oil well pipes, oil well sucker rods, oil well pumps, casing and oil well pumping machines.

2.1 BASIS OF PREPARATION

These financial statements 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 the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the remeasurement of certain equity investments as further explained below. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2006. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries.

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The Group has adopted the following new and revised HKFRSs for the first time for the current year's financial statements. Except for in certain cases, giving rise to new and revised accounting policies and additional disclosures, the adoption of these new and revised standards and interpretation has had no material effect on these financial statements.

HKAS 21 Amendment	Net Investment in a Foreign Operation
HKAS 27 Amendment	Consolidated and Separate Financial Statements: Amendments as a consequence of the Companies (Amendment) Ordinance 2005
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements.

HKAS 1 Amendment	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HKFRS 8	Operating Segments
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 *Financial Reporting in Hyperinflationary Economies*
HK(IFRIC)-Int 8	Scope of HKFRS 2
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment
HK(IFRIC)-Int 11	HKFRS 2-Group and Treasury Share Transactions
HK(IFRIC)-Int 12	Service Concession Arrangements

The HKAS 1 Amendment shall be applied for annual periods beginning on or after 1 January 2007. The revised standard will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 7 shall be applied for annual periods beginning on or after 1 January 2007. The standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments and also incorporates many of the disclosure requirements of HKAS 32.

HKFRS 8 shall be applied for annual periods beginning on or after 1 January 2009. The standard requires disclosures of the information about the entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.

HK(IFRIC)-Int 7, HK(IFRIC)-Int 8, HK(IFRIC)-Int 9, HK(IFRIC)-Int 10, HK(IFRIC)-Int 11 and HK(IFRIC)-Int 12 shall be applied for annual periods beginning on or after 1 March 2006, 1 May 2006, 1 June 2006, 1 November 2006, 1 March 2007 and 1 January 2008 respectively.

The Group is in the process of making an assessment of the impact of these new and revised HKFRSs upon initial application. So far, it has concluded that while the adoption of the HKAS 1 Amendment, HKFRS 7 and HKFRS 8 may result in new or amended disclosures, these new and revised HKFRSs are unlikely to have a significant impact on the Group's results of operations and financial position.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Impairment of non-financial assets other than goodwill

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets, and financial assets), the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present values using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises.

Related parties

A party is considered to be related to the Group if:

(a) directly, or indirectly through one or more intermediaries, the party (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Group or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment and the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The estimated useful lives of the items are as follows:

Buildings	20 years
Plant and machinery	2 -10 years
Electronic equipment	3 -5 years
Motor vehicles	5 years
Other equipment	5 years

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal of property, plant and equipment recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents the assets incurred under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction incurred during the period of construction, installation and testing. Construction in progress is reclassified to the appropriate category of property, plant and equipment or investment properties when completed and ready for use.

Investment properties

Investment properties are interests in buildings held to earn rental income, rather than for use in the production or supply of goods or services, or for administrative purposes; or for sale in the ordinary course of business. Such properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and any impairment losses.

Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of the retirement or disposal.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Intangible assets (other than goodwill)

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Know-how

Purchased know-how is stated at cost less any impairment losses and is amortised on the straight-line basis over its estimated useful life of five years.

Research and development costs

All research costs are charged to the income statement as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets, and rentals receivable under the operating leases are credited to the income statement on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

Prepaid land lease payment under operating lease are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms.

Investments and other financial assets

Financial assets in the scope of HKAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group considers whether a contract contains an embedded derivative when the Group first becomes a party to it. The embedded derivative are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristic and risks of embedded derivatives are not closely related to those of the host contract.

The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets *(continued)*

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Gains or losses on investments held for trading are recognised in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified in any of the other two categories. After initial recognition, available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating the fair value, such securities are stated at cost less any impairment losses.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair values are determined by using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; a discounted cash flow analysis; and option pricing models.

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in the income statement.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Impairment of financial assets *(continued)*

Assets carried at amortised cost (continued)

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

Derecognition of financial assets

A financial asset is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Derecognition of financial assets *(continued)*

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities at amortised cost (including interest-bearing bank loans)

Financial liabilities including trade and other payables, and interest-bearing bank loans are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in the income statement.

Interest-bearing bank loans

All loans are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing bank loans are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheets, cash and bank balances comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised directly in equity in the same or a different period.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Income tax *(continued)*

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 deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and deferred tax liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Government grants and subsidies

Government grants and subsidies from the government are recognised at their fair values where there is reasonable assurance that the grant or subsidies will be received and all attaching conditions will be complied with. When the grant or subsidies relates to an expense item, it is recognised as income over the periods necessary to match the grant or subsidies on a systematic basis to the costs that it is intended to compensate. When the grant or subsidies relates to an asset, the fair value of the grant or subsidies is deducted from the carrying amount of the asset and released to the income statement by way of a reduced depreciation charge.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(b) rental income, on a time proportion basis over the lease terms; and

(c) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Retirement benefits

The Company and its PRC subsidiary comprising the Group operating in Mainland China participate in the central pension scheme (the "CPS") operated by the PRC government for all of their staff. The Company and its PRC subsidiary are required to contribute a certain percentage of their covered payroll to the CPS to fund the benefits. The only obligation of the Group with respect to the CPS is to pay the ongoing required contributions under the CPS. Contributions under the CPS are charged to the income statement as they become payable in accordance with the rules of the CPS.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e, assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

Dividends

Final dividends proposed by the Directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the Directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

Foreign currencies

These financial statements are presented in Renminbi ("RMB"), which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions.

The functional currency of an overseas subsidiary is currencies other than the RMB. As at the balance sheet date, the assets and liabilities of this entity are translated into the presentation currency of the Company at the exchange rates ruling at the balance sheet date, and their income statements are translated into RMB at the weighted average exchange rates for the year. The resulting exchange differences are included in the exchange fluctuation reserve, a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flow of an overseas subsidiary is translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiary which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Operating lease commitments - Group as lessor

The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating leases.

Classification between investment properties and owner-occupied properties

The Group determines whether a property qualifies as an investment property and has developed criteria in making that judgement. Investment property is a property held to earn rentals or for capital appreciation or both. Therefore, the Group considers whether a property generates cash flows largely independently of the other assets held by the Group.

Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), the Group accounts for the portions separately. If the portions could not be sold separately, the property is an investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Judgement is made on an individual property basis to determine whether ancillary services are so significant that a property does not qualify as an investment property.

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 discussed below.

(i) Provision against slow-moving inventories

Provision against slow-moving inventories is made based on the aging and estimated net realisable value of inventories. The assessment of the provision amount required involves management judgement and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will impact the carrying value of inventories and provision charge/write-back in the period in which such estimate has been changed.

(ii) Impairment of trade receivables

Provision for doubtful debts is made based on assessment of the recoverability of trade receivables and other receivables. The identification of doubtful debts requires management judgement and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will impact the carrying value of the receivables and doubtful debt expenses/write-back in the period in which such estimate has been changed.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES *(continued)*

Judgements *(continued)*

(iii) Impairment of property, plant and equipment

The carrying value of the property, plant and equipment is reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable in accordance with the accounting policies as disclosed at section 2.4. The recoverable amount of the property, plant and equipment is the greater of fair value less costs to sell and value in use, the calculations of which involve the use of estimates.

(iv) Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies. Further details are contained in note 27 to the financial statements.

4. SEGMENT INFORMATION

Segment information is presented by way of the Group's primary segment reporting basis, by geographical segment. 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. No further business segment information is presented as over 90% of the Group's operations relate to the sale of petroleum machinery.

In determining the Group's geographical segments, revenues and assets are attributed to the segments based on the locations of the customers.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

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4. SEGMENT INFORMATION *(continued)*

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's geographical segments for the years ended 31 December 2006 and 2005:

	PRC		United States		Europe		Others countries		Consolidated	
	2006 RMB'000	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000	**2006 RMB'000**	2005 RMB'000
Segment revenue:										
Sales to external customers	**618,613**	560,992	**163,547**	101,284	**118,288**	69,497	**113,589**	44,749	**1,014,037**	776,522
Other revenue	**5,346**	2,609	**—**	—	**—**	—	**—**	—	**5,346**	2,609
Total revenue	**623,959**	563,601	**163,547**	101,284	**118,288**	69,497	**113,589**	44,749	**1,019,383**	779,131
Segment results	**125,092**	113,252	**32,894**	23,270	**26,172**	12,840	**28,483**	8,803	**212,641**	158,165
Unallocated income (a)									**9,600**	5,888
Unallocated expenses (a)									**(48,378)**	(45,090)
Finance costs									**(12,089)**	(3,444)
Profit before tax									**161,774**	115,519
Tax									**(19,100)**	(27,271)
Profit for the year									**142,674**	88,248
Segment assets and liabilities:										
Segment assets	**1,335,954**	858,972	**72,513**	82,112	**23,034**	5,994	**22,715**	12,051	**1,454,216**	959,129
Total assets									**1,454,216**	959,129
Segment liabilities	**904,501**	534,064	**2,286**	9,976	**5,867**	—	**4,797**	23	**917,451**	544,063
Total liabilities									**917,451**	544,063
Other segment information:										
Depreciation and amortisation	**27,115**	13,697	**—**	—	**—**	—	**—**	—	**27,115**	13,697
Capital expenditure	**205,665**	224,518	**—**	—	**—**	—	**—**	—	**205,665**	224,518
Provision against inventories	**9,193**	4,499	**—**	—	**—**	—	**—**	—	**9,193**	4,499
Impairment/(reversal of provision) of trade receivables	**(3,264)**	3,714	**—**	—	**—**	—	**—**	—	**(3,264)**	3,714

(a) Mainly represent sundry revenue and corporate expenses, as well as the depreciation of fixed assets.

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5. REVENUE, OTHER INCOME AND A GAIN

Revenue, which is also the Group's turnover, represents the net invoiced value of goods sold, after allowances for returns and trade discounts during the year. All significant intra-group transactions have been eliminated on consolidation.

An analysis of revenue, other income and a gain is as follows:

	Notes	Group 2006 RMB'000	2005 RMB'000
Revenue			
Sale of petroleum machinery		**1,014,037**	776,522
Other income			
Subcontract income		**288**	342
Bank interest income	7	**3,887**	2,048
Government subsidies	(i)	**—**	710
VAT refund	(ii)	**5,376**	2,165
Gross rental income	7	**690**	153
Sale of scrap and raw materials	(iii)	**4,187**	1,910
Others		**337**	965
		14,765	8,293
Gain			
Gain on disposal of items of property, plant and equipment	7	**181**	204
		14,946	8,497

Notes:

(i) Government subsidies for the year ended 31 December 2005 represented an export subsidy and a product innovation subsidy, which amounted to RMB160,400 and RMB550,000 respectively.

(ii) VAT refund for the years ended 31 December 2006 and 2005 represented VAT received by Weifang Molong Drilling Equipment Company Limited (濰坊墨龍鑽採設備有限公司) ("Molong Drilling Equipment"), which was approved by the Ministry of Civil Affairs of Shandong Province (山東省民政廳) as a welfare enterprise (民政福利企業). According to the tax document Guo Shui Fa [1994] No.155, "*Notice about the levy of turnover tax of welfare enterprises issued by the State Tax Bureau*" (「國家稅務局關於民政福利企業徵收流轉稅問題的通知」), the output VAT paid by Molong Drilling Equipment was refundable.

(iii) Sale of scrap and raw materials for the years ended 31 December 2006 and 2005 represented sale of scrap and used metals to related parties and third parties. The price was at the fixed rate prescribed by the relevant authorities of the PRC. If no fixed price is prescribed by the relevant authorities of the PRC, the sales price will be negotiated and agreed by both parties with reference to the then prevailing market price.

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6. FINANCE COSTS

	Group	
	2006	2005
	RMB'000	RMB'000
Interest on bank loans wholly repayable within five years	**12,089**	3,444

7. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging/(crediting):

		Group	
	Notes	**2006**	2005
		RMB'000	RMB'000
Cost of inventories sold		**778,488**	596,113
Depreciation	14,15	**26,339**	13,382
Amortisation of intangible asset	17	**284**	39
Recognition of prepaid land lease payments	16	**492**	276
Research and development costs:			
Current year expenditure		**11,667**	5,724
Minimum lease payments under operating leases:			
Plant and machinery		**558**	108
Land and buildings located in the PRC		**81**	434
		639	542
Auditors' remuneration		**1,020**	1,000
Employee benefits expense (including directors' remuneration (note 8)):			
Wages and salaries		**33,184**	24,403
Pension scheme contributions		**3,531**	5,015
		36,715	29,418
Foreign exchange differences, net		**2,403**	1,314
Provision against inventories		**9,193**	4,499
Impairment / (reversal of provision) of trade receivables		**(3,264)**	3,714
Rental income	5	**(690)**	(153)
Bank interest income	5	**(3,887)**	(2,048)
Gain on disposal of items of property, plant and equipment	5	**(181)**	(204)

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8. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to Rule 18.28 and 18.29 of the Growth Enterprise Market (the "GEM") Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	Group	
	2006	2005
	RMB'000	RMB'000
Fees	**—**	—
Other remuneration:		
Salaries, allowances and benefits in kind	**348**	270
Performance related bonuses	**1,180**	578
Retirement benefits scheme contributions	**9**	9
	1,537	857

(a) Independent non-executive directors

The salaries, allowances and benefits in kind paid to independent non-executive Directors were as follows:

	2006	2005
	RMB'000	RMB'000
Mr. Qin Xue Chang (秦學昌)	**30**	30
Mr. Yan Yi Zhuang (閆翊莊)	**60**	63
Mr. Loke Yu, alias Loke Hoi Lam (陸海林)	**60**	63
	150	156

There was no other remuneration payable to the independent non-executive Directors during the year (2005: Nil).

8. DIRECTORS' REMUNERATION

(b) Executive directors and non-executive directors

	Salaries, allowances and benefits in kind RMB'000	Performance related bonuses RMB'000	Retirement benefits scheme contributions RMB'000	Total RMB'000
2006				
Executive directors:				
Mr. Zhang En Rong (張恩榮)	65	500	—	565
Mr. Zhang Yun San (張雲三)	56	320	3	379
Mr. Lin Fu Long (林福龍)	34	150	3	187
Mr. Xie Xin Cang (謝新倉)	43	210	3	256
	198	1,180	9	1,387
Non-executive directors:				
Mr. Chen Jian Xiong (陳建雄)	—	—	—	—
Mr. Wang Ping (王平)	—	—	—	—
	198	1,180	9	1,387
2005				
Executive directors:				
Mr. Zhang En Rong (張恩榮)	32	208	—	240
Mr. Zhang Yun San (張雲三)	28	135	3	166
Mr. Lin Fu Long (林福龍)	26	135	3	164
Mr. Xie Xin Cang (謝新倉)	28	100	3	131
	114	578	9	701
Non-executive directors:				
Mr. Chen Jian Xiong (陳建雄)	—	—	—	—
Mr. Wang Ping (王平)	—	—	—	—
	114	578	9	701

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

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9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included four (2005: four) Directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining one (2005: one) non-Director, highest paid employee for the year are as follows:

	Group	
	2006	2005
	RMB'000	RMB'000
Salaries, allowances and benefits in kind	**44**	192
Performance related bonuses	**200**	—
Retirement benefits scheme contributions	**3**	—
	247	192

10. TAX

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

Molong Drilling Equipment, the Company's subsidiary, was approved by the Ministry of Civil Affairs of Shandong Province (山東省民政廳) as a welfare enterprise (民政福利企業) and hence was entitled to a full exemption from corporate income tax for years 2005 and 2006 respectively according to the tax document Cai Shui Zi [1994] No.1, "*Notice about the several preferential policies on corporate income tax*" (「關於企業所得稅若干優惠政策的通知」).

	Group	
	2006	2005
	RMB'000	RMB'000
Current - PRC tax charge for the year	**22,804**	32,509
Deferred *(note 27)*	**(3,704)**	(5,238)
Total tax charge for the year	**19,100**	27,271

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10. TAX *(continued)*

A reconciliation of the tax expense applicable to profit before tax using the statutory rates for the PRC in which the Company and its subsidiaries are domiciled to the tax expense at the effective tax rate, and a reconciliation of the applicable rate (i.e., the statutory tax rate) to the effective tax rate, are as follows:

	2006		2005	
	RMB'000	**%**	RMB'000	%
Profit before tax	**161,774**		115,519	
Tax at the statutory tax rate	**53,385**	**33.00**	38,122	33.00
Additional research and development expenses deductible due to increase in research and development expenses in the current year by more than 10%	**—**	**—**	(944)	(0.82)
Expenses not deductible for tax	**86**	**0.05**	114	0.10
Tax exemption granted to a welfare enterprise for the year	**(10,664)**	**(6.59)**	(10,021)	(8.67)
Tax exemption of purchased fixed assets used for qualified technological improvement projects	**(22,357)**	**(13.82)**	—	—
Accrued expenses in prior year and deductible in current year	**(1,350)**	**(0.83)**	—	—
Tax charge at the Group's effective tax rate	**19,100**	**11.81**	27,271	23.61

11. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The consolidated profit attributable to equity holders of the parent for the year ended 31 December 2006 includes a profit of RMB110,226,000 (2005: RMB58,039,000) which has been dealt with in the financial statements of the Company (note 29(b)).

12. DIVIDENDS

	Note	**2006**	2005
		RMB'000	RMB'000
Interim – RMB0.015 (2005: RMB0.02) per ordinary share		**9,708**	12,982
Proposed final – RMB0.02 (2005: RMB0.017) per ordinary share	36(b)	**12,960**	11,016
		22,668	23,998

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

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13. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share amounts is based on the net profit for the year attributable to ordinary equity holders of the parent of RMB139,404,000 (2005: RMB85,227,000), and the weighted average number of ordinary shares in issue during the year which is 647,998,000 (2005: 604,798,000).

No diluted earnings per share amounts have been presented for the year as no diluting events existed during the year.

14. PROPERTY, PLANT AND EQUIPMENT

Group	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2005	29,904	73,687	1,791	6,061	2,222	38,414	152,079
Additions	523	19,899	354	1,742	657	199,843	223,018
Transferred from construction in progress	52,685	2,461	—	—	24	(55,170)	—
Transferred from a related party (note 34(a))	—	1,300	—	—	—	—	1,300
Transferred to investment properties (note15)	(8,069)	—	—	—	—	—	(8,069)
Disposals	(229)	(708)	(72)	(953)	(34)	—	(1,996)
At 31 December 2005	74,814	96,639	2,073	6,850	2,869	183,087	366,332
Additions	13,115	103,730	760	418	965	82,352	201,340
Transferred from construction in progress	16,114	198,512	—	1,163	—	(215,789)	—
Transferred from a related party (note 34(a))	—	4,058	—	—	3	—	4,061
Transferred to a related party (note34(a))	—	(225)	—	—	—	—	(225)
Disposals	—	(2,127)	—	(353)	(349)	—	(2,829)
At 31 December 2006	104,043	400,587	2,833	8,078	3,488	49,650	568,679
Accumulated depreciation							
At 1 January 2005	5,018	18,559	663	2,669	840	—	27,749
Provided during the year	1,611	9,874	324	1,121	420	—	13,350
Transferred from a related party (note 34(a))	—	495	—	—	—	—	495
Disposals	(45)	(294)	(72)	(939)	(26)	—	(1,376)
At 31 December 2005	6,584	28,634	915	2,851	1,234	—	40,218
Provided during the year	4,481	19,126	404	1,462	493	—	25,966
Transferred to a related party(note 34(a))	—	(121)	—	—	—	—	(121)
Disposals	—	(1,928)	—	(272)	(339)	—	(2,539)
At 31 December 2006	11,065	45,711	1,319	4,041	1,388	—	63,524
Net carrying amount							
At 31 December 2006	92,978	354,876	1,514	4,037	2,100	49,650	505,155
At 31 December 2005	68,230	68,005	1,158	3,999	1,635	183,087	326,114

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14. PROPERTY, PLANT AND EQUIPMENT *(continued)*

Company	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2005	29,890	63,583	1,791	6,061	2,222	38,414	141,961
Additions	588	19,444	352	1,742	646	199,804	222,576
Transferred from construction in progress	52,632	2,514	—	—	24	(55,170)	—
Transferred from a related party	—	1,300	—	—	—	—	1,300
Transferred to investment properties (note 15)	(12,123)	—	—	—	—	—	(12,123)
Disposals	(229)	(3,582)	(90)	(953)	(34)	—	(4,888)
At 31 December 2005	70,758	83,259	2,053	6,850	2,858	183,048	348,826
Additions	13,040	101,868	760	418	965	82,200	199,251
Transferred from construction in progress	16,114	198,392	—	1,163	—	(215,669)	—
Transferred from a related party	—	3,839	—	—	3	—	3,842
Transferred to a related party	—	(159)	—	—	—	—	(159)
Transferred to a subsidiary	—	(4,708)	(7)	—	—	—	(4,715)
Transferred to investment properties (note 15)	(2,944)	—	—	—	—	—	(2,944)
Disposals	—	(1,364)	—	(353)	(349)	—	(2,066)
At 31 December 2006	96,968	381,127	2,806	8,078	3,477	49,579	542,035
Accumulated depreciation							
At 1 January 2005	5,016	15,119	662	2,669	840	—	24,306
Provided during the year	1,316	8,788	322	1,121	418	—	11,965
Transferred from a related party	—	495	—	—	—	—	495
Transferred to investment properties (note 15)	(1,492)	—	—	—	—	—	(1,492)
Disposals	(45)	(1,883)	(78)	(939)	(26)	—	(2,971)
At 31 December 2005	4,795	22,519	906	2,851	1,232	—	32,303
Provided during the year	4,164	17,758	400	1,462	491	—	24,275
Transferred to a related party	—	(89)	—	—	—	—	(89)
Transferred to a subsidiary	—	(2,653)	(3)	—	—	—	(2,656)
Transferred to investment properties (note 15)	(365)	—	—	—	—	—	(365)
Disposals	—	(1,393)	—	(272)	(339)	—	(2,004)
At 31 December 2006	8,594	36,142	1,303	4,041	1,384	—	51,464
Net carrying amount							
At 31 December 2006	88,374	344,985	1,503	4,037	2,093	49,579	490,571
At 31 December 2005	65,963	60,740	1,147	3,999	1,626	183,048	316,523

The Group's buildings included above are all situated in Shouguang, Shandong Province, the PRC.

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15. INVESTMENT PROPERTIES

	Note	Group		Company	
		2006	2005	**2006**	2005
		RMB'000	RMB'000	**RMB'000**	RMB'000
Cost:					
At 1 January		8,069	—	12,123	—
Transferred from owner occupied properties	14	—	8,069	2,944	12,123
At 31 December		8,069	8,069	15,067	12,123
Accumulated depreciation:					
At 1 January		32	—	1,821	—
Transferred from owner occupied properties	14	—	—	365	1,492
Recognised depreciation in current year		373	32	687	329
At 31 December		405	32	2,873	1,821
Carrying amount at 31 December		7,664	8,037	12,194	10,302

As at 31 December 2006, the fair value of the Group's investment properties was RMB9,031,000 (2005: RMB9,373,000), according to a valuation by Shouguang Lu Dong Certified Public Accountants, an independent professionally qualified valuer, on an open market, existing use basis. The investment properties are leased to related parties under operating leases.

16. PREPAID LAND LEASE PAYMENTS

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Carrying amount at 1 January	**20,690**	9,128
Additions	**—**	11,838
Recognised during the year	**(492)**	(276)
Carrying amount at 31 December	**20,198**	20,690
Current portion included in prepayments, deposits and other receivables	**(489)**	(489)
Non-current portion	**19,709**	20,201

The leasehold land is situated in Mainland China and is held under a medium lease term.

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17. INTANGIBLE ASSET

Know-how	Group and Company 2006 RMB'000	2005 RMB'000
Cost at 1 January, net of accumulated amortisation	**273**	112
Additions	**264**	200
Amortisation provided during the year	**(284)**	(39)
At 31 December	**253**	273
At 31 December		
Cost	**584**	320
Accumulated amortisation	**(331)**	(47)
Net carrying amount	**253**	273

18. INTERESTS IN SUBSIDIARIES / DUE TO SUBSIDIARIES

	Company 2006 RMB'000	2005 RMB'000
Unlisted shares, at cost	**12,676**	12,420
Due to subsidiaries	**(46,924)**	(21,989)
	(34,248)	(9,569)

The amounts due to subsidiaries included in the Company's current liabilities are unsecured, interest-free and are repayable on demand or within one year. The carrying amounts of these amounts due to subsidiaries approximate to their fair values.

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18. INTERESTS IN SUBSIDIARIES / DUE TO SUBSIDIARIES *(continued)*

Particulars of the subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity directly attributable to the Company	Principal activities
Weifang Molong Drilling Equipment Company Limited ("Molong Drilling Equipment") (a)	The PRC/ Mainland China	RMB6,000,000	90	Manufacture and sale of petroleum extraction machinery
MPM International Limited ("MPM") (formerly, Molong (Asia) Holding Limited)	Hong Kong	HK$7,800,000	90	Note (b)

Notes:

(a) Molong Drilling Equipment is a welfare enterprise established on 29 September 2004.

(b) MPM was established in Hong Kong on 24 May 2004, which had no trading activity during the year.

19. AVAILABLE-FOR-SALE INVESTMENT

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Unlisted equity investment, at cost	**50**	50

The unlisted equity investment represented a 10% equity interest held in Shouguang Maolong Old Metals Recycle Company Limited (壽光市懋隆廢舊金屬回收有限公司), which was incorporated in the PRC on 13 December 2002 with a registered capital of RMB500,000.

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20. INVENTORIES

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Raw materials	**118,855**	60,670	**106,740**	44,757
Work in progress	**205,967**	60,466	**200,360**	56,569
Finished goods	**122,757**	92,718	**113,209**	75,148
	447,579	213,854	**420,309**	176,474

None of these balances was carried at net realisable value.

21. TRADE RECEIVABLES

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of three months, extending up to six months for major customers. Each customer has a maximum credit limit. The Group seeks to maintain strict control over its outstanding receivables to minimise credit risk. Overdue balances are reviewed regularly by senior management. Receivables are non-interest-bearing.

An aged analysis of the trade receivables as at the balance sheet date, based on invoice date, and net of provisions, is as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within three months	**155,018**	73,461	**153,223**	73,055
Three to six months	**14,145**	999	**14,145**	999
Six months to one year	**715**	1,284	**715**	1,284
	169,878	75,744	**168,083**	75,338

22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Prepayments	**31,212**	13,578	**28,885**	11,797
Deposits and other receivables	**6,596**	1,103	**6,367**	1,021
	37,808	14,681	**35,252**	12,818

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23. CASH AND BANK BALANCES AND PLEDGED DEPOSITS

	Note	Group 2006 RMB'000	Group 2005 RMB'000	Company 2006 RMB'000	Company 2005 RMB'000
Cash and bank balances		**34,138**	110,166	**32,459**	107,312
Time deposits pledged as security for bills payable	24	**219,254**	147,630	**219,254**	147,630
		253,392	257,796	**251,713**	254,942
Less: Time deposits with an original maturity of over three months when acquired, pledged as security for bills payable		**(218,177)**	(72,102)	**(218,177)**	(72,102)
Cash and cash equivalents		**35,215**	185,694	**33,536**	182,840

At the balance sheet date, the cash and bank balances of the Group denominated in RMB amounted to RMB32,333,000 (2005: RMB108,042,000). The RMB is not freely convertible into other currencies, however, under the PRC Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

The carrying amounts of the cash and bank balances and the pledged deposits approximate to their fair values.

24. TRADE AND BILLS PAYABLES

An aged analysis of the trade and bills payables as at the balance sheet date, based on invoice date, is as follows:

	Group 2006 RMB'000	Group 2005 RMB'000	Company 2006 RMB'000	Company 2005 RMB'000
Within three months	**362,625**	237,954	**358,783**	219,720
Three to six months	**234,639**	173,551	**234,183**	172,959
Six months to one year	**6,843**	4,752	**6,588**	4,206
One to two years	**2,667**	3,946	**2,704**	3,924
Two to three years	**4,947**	986	**4,852**	986
	611,721	421,189	**607,110**	401,795

The Group and the Company's bills payable of RMB485,481,000 (2005: RMB325,711,000) were secured by the pledge of certain of the time deposits amounting to RMB219,254,000 (2005: RMB 147,630,000) (note 23). The payables are non-interest-bearing and are normally settled on terms of six months.

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25. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Advance from customers	**33,506**	7,863	**33,506**	7,863
Payroll payable	**11,292**	11,675	**11,149**	10,614
Welfare payable	**3,595**	2,416	**2,954**	2,090
Other payables	**2,917**	10,938	**6,213**	10,325
Accruals	**7,714**	5,985	**7,223**	5,616
	59,024	38,877	**61,045**	36,508

Other payables are non-interest-bearing and have an average term of three months.

26. INTEREST-BEARING BANK LOANS

	Effective interest rate (%)	Maturity	Group and Company **2006** **RMB'000**	Group and Company 2005 RMB'000
Current				
Unsecured	6.12	2007	**135,000**	50,000
Non-Current				
Unsecured	6.12 - 6.30	2008	**70,000**	—
			205,000	50,000

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Analysed into:		
Bank loans repayable:		
Within one year	**135,000**	50,000
Beyond one year	**70,000**	—
	205,000	50,000

All loans are in RMB at a fixed interest rates.

The carrying amounts of the Group's and the Company's loans approximate to their fair values.

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27. DEFERRED TAX

The movements in deferred tax assets are as follows:

Deferred tax assets

	Group and Company	
	2006 Provision available for offset against future taxable profit RMB'000	2005 Provision available for offset against future taxable profit RMB'000
At 1 January	**5,238**	—
Deferred tax credit to the income statement during the year (note 10)	**3,704**	5,238
Gross deferred tax assets at 31 December	**8,942**	5,238

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

28. SHARE CAPITAL

	Group and Company	
	2006	2005
Shares	**RMB'000**	RMB'000
Authorised:		
647,998,000 (2005: 647,998,000) ordinary shares of RMB0.10 (2005: RMB0.10) each	**64,800**	64,800
Issued and fully paid:		
647,998,000 (2005: 647,998,000) ordinary shares of RMB0.10 (2005: RMB0.10) each	**64,800**	64,800

The Company's H shares were listed on the GEM on 15 April 2004. Pursuant to the special resolution (the "Special Resolution") passed in the extraordinary general meeting (the "EGM") and the two separate class meetings held on 30 December 2005, the Board was authorised to propose migration of the listing of the Company's H shares from the GEM to the Main Board of the Stock Exchanges of Hong Kong Limited (the "SEHK"). Pursuant to the approval documents issued by the China Securities Regulatory Commission and SEHK on 26 January 2007 and 6 February 2007 respectively, the listing of the Company's H-shares has been changed from the GEM to the Main Board on 7 February 2007.

29. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on pages 41 of the financial statements.

Pursuant to the relevant laws and regulations for business enterprises, a portion of the profits of the Group's entities which are incorporated in the PRC has been transferred to the statutory reserve fund and statutory welfare fund which are restricted as to use.

(b) Company

	Notes	Capital reserve RMB'000	Statutory reserve fund RMB'000	Statutory welfare fund RMB'000	Retained profits RMB'000	Total RMB'000
Balance at 1 January 2005		85,977	8,772	4,385	79,913	179,047
Issue of shares		94,831	—	—	—	94,831
Share issue expenses		(5,155)	—	—	—	(5,155)
Profit for the year	11	—	—	—	58,039	58,039
Interim 2005 dividend	12	—	—	—	(12,982)	(12,982)
Proposed final 2005 dividend	12	—	—	—	(11,016)	(11,016)
Transfers from retained profits to statutory fund		—	7,926	3,963	(11,889)	—
At 31 December 2005 and 1 January 2006		175,653	16,698	8,348	102,065	302,764
Profit for the year	11	—	—	—	110,226	110,226
Interim 2006 dividend	12	—	—	—	(9,708)	(9,708)
Proposed final 2006 dividend	12	—	—	—	(12,960)	(12,960)
Transfers from retained profits to statutory fund		—	13,936	—	(13,936)	—
At 31 December 2006		175,653	30,634	8,348	175,687	390,322

For the details of the statutory funds, please refer to the consolidated statement of changes in equity on pages 41 of the financial statements.

30. CONTINGENT LIABILITIES

As at 31 December 2005 and 2006, neither the Group, nor the Company had any significant contingent liabilities.

31. PLEDGE OF ASSETS

There were no assets pledged for bank loans at the balance sheet date.

31 December 2006

32. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Group leases its investment properties (note 15 to the financial statements) under operating lease arrangements, with leases negotiated for terms ranging from 10 to 20 years.

At 31 December 2006, the Group and the Company had total future minimum lease receivables under non-cancellable operating leases with its tenants falling due as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within one year	**690**	690	**1,006**	1,006
In the second to fifth years, inclusive	**2,070**	1,908	**3,019**	2,856
After five years	**2,613**	3,150	**3,879**	4,731
	5,373	5,748	**7,904**	8,593

(b) As lessee

The Group leases certain production facilities and staff dormitories under operating lease arrangements. Leases for properties are negotiated for terms ranging from 2 to 10 years.

At 31 December 2006, the Group and the Company had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Within one year	**558**	516
In the second to fifth years, inclusive	**1,674**	1,304
After five years	**1,189**	1,499
	3,421	3,319

31 December 2006

33. COMMITMENTS

In addition to the operating lease commitments detailed in note 32(b) above, the Group and the Company had the following commitments at the balance sheet date:

Capital commitments

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Contracted, but not provided for:		
Land and buildings	**6,147**	25,549
Plant and machinery	**46,292**	120,790
	52,439	146,339

34. RELATED PARTY TRANSACTIONS

(a) In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year:

	Notes	**2006**	2005
		RMB'000	RMB'000
Purchases of raw materials:			
from a company in which a director of the Company is a shareholder	(i)	**—**	623
from other related parties	(i)	**282,065**	60,861
		282,065	61,484
Sales of scrap and raw materials:			
to a company in which a director of the Company is a shareholder	(ii)	**—**	624
to another related party	(ii)	**3,994**	1,053
		3,994	1,677
Subcontract income:			
from a company in which a director of the Company is a shareholder	(iii)	**—**	258
from other related parties	(iii)	**194**	—
		194	258

31 December 2006

34. RELATED PARTY TRANSACTIONS *(continued)*

(a) In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year: *(continued)*

	Notes	2006 RMB'000	2005 RMB'000
Subcontract fees:			
to a company in which a director of the Company is a shareholder	(iii)	—	151
to other related parties	(iii)	299	474
		299	625
Fixed assets transfers:			
from a company in which a director of the Company is a shareholder	(iv)	—	805
from another related party	(iv)	4,061	—
		4,061	805
Fixed assets transfers:			
to another related party	(iv)	104	—
		104	—
Rental income:			
from a company in which a director of the Company is a shareholder	(v)	—	103
from other related parties	(v)	690	50
		690	153
Rental expenses:			
to a company in which a director of the Company is a shareholder	(v)	390	390
to another related party	(v)	168	—
		558	390

31 December 2006

34. RELATED PARTY TRANSACTIONS *(continued)*

(a) In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year: *(continued)*

Notes:

(i) The purchase of raw materials from other related parties represented purchase from Weihai Baolong Special Petrolium Materials Co., Ltd. ("Weihai Baolong") of RMB189,070,000 (2005: RMB2,434,000) and Shouguang Molong Electro-mechanical Equipment Company Limited ("Molong Equipment") of RMB92,995,000 (2005: 58,427,000).

The purchase of raw materials from Weihai Baolong were made by the prevailing market price less an agreed discount of not more than RMB100 per ton. In addition, Weihai Baolong undertook that the supply price offered to the Company would not be higher than the supply price of the same goods offered to independent third parties over the same time.

The purchases of raw materials from Molong Equipment were made at the fixed rates prescribed by relevant authorities of the PRC (if any). If no fixed rates are prescribed by the relevant authorities of the PRC, the purchase price will be negotiated and agreed to by both parties with reference to the then prevailing market price, subject to adjustment.

(ii) The sales of scrap and raw materials were made at the fixed rates prescribed by relevant authorities of the PRC (if any). If no fixed rates are prescribed by the relevant authorities of the PRC, the selling price will be negotiated and agreed to by both parties with reference to the then prevailing market price, subject to adjustments.

(iii) These transactions were conducted on the basis of rates mutually agreed to by the related parties, which were set at cost incurred plus a margin of 5%.

(iv) The fixed asset transfers included machinery, which was transferred at its net book value amounts.

(v) The transactions were determined at rates mutually agreed by the related parties, which were lower than the market rates for properties of similar locations.

(b) Outstanding balances with related parties:

(i) Included in the balance due from related parties in the consolidated balance sheet at 31 December 2005 were advances to Weihai Baolong of RMB21,197,000 and receivables of RMB780,000 from Shouguang Maolong Machinery Company Limited ("Maolong Machinery"). There were no such balances at 31 December 2006.

(ii) Included in the balance due to related parties in the consolidated balance sheet at 31 December 2006 were trade payables of RMB12,322,000 to Weihai Baolong and RMB10,644,000 to Molong Equipment (2005: Payable to Molong Equipment of RMB8,368,000 and payable to Maolong Machinery of RMB2,274,000).

The balances due from and to the related parties at 31 December 2006 are interest-free, unsecured and are repayable on demand or within one year.

31 December 2006

34. RELATED PARTY TRANSACTIONS *(continued)*

(c) Compensation of key management personnel of the Group:

	2006	2005
	RMB'000	RMB'000
Short term employee benefits	2,068	1,219
Post-employment benefits	19	19
Total compensation paid to key management personnel	2,087	1,238

Further details of directors' remuneration are included in note 8 to the financial statements.

The related party transactions above also constitute connected transactions or continuing connected transactions as defined in Chapter 20 of the the GEM Listing Rules.

35. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise interest-bearing bank loans, cash and bank balances and pledged deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

It is, and has been, throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are cash flow interest rate risk, foreign currency risk, credit risk and liquidity risk.

The Group does not have written risk management policies and guidelines. However, the management meets periodically to analyse and formulate measurements to manage the Group's exposure to financial risks. Generally, the Group employs a conservative strategy regarding its risk management.

(i) Cash flow interest rate risk

The interest rates and the terms of repayment of the Group's interest-bearing bank loans are disclosed in note 26 to the financial statements. The Group has no significant exposure to interest rate risk.

(ii) Foreign currency risk

The Group's exposure to market risk for changes in foreign currency exchange rates relates primarily to certain trade receivable and certain cash and cash equivalents in currencies other than the functional currency of RMB.

35. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

(iii) Credit risk

The Group trades mainly with recognised and 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 and the Group's exposure to bad debts is not significant. For transactions that are not denominated in the functional currencies of the relevant operating units, the Group does not offer credit terms without specific approval of the Head of Credit Control.

With respect to credit risk arising from the other financial assets of the Group, comprising cash and cash equivalents, available-for-sale financial assets and other receivables, the Group's exposure to credit risk arises from default of the other parties, with a maximum exposure equal to the carrying amount of these instruments. There are no significant concentrations of credit risk within the Group in relation to the other financial assets.

Since the Group trades mainly with recognised and creditworthy third parties, there is no requirement for collateral.

(iv) Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of interest-bearing bank loans.

36. POST BALANCE SHEET EVENT

(a) Pursuant to the EGM and the Class Meeting on 30 December 2005, the directors of the Company approved the Migration. The Migration was finished on 7 February 2007 (note 28).

(b) Pursuant to the board resolution on 29 March 2007, the directors recommended the payment of a final cash dividend of RMB0.02 per share (inclusive of tax).

It is also recommended that four bonus shares be issued for each share held by the shareholders. Two shares will be issued by way of conversion of capital reserve and two shares will be issued and credited as fully paid by capitalising the distributable retained profits (the "Bonus Issue"). The Bonus Issue is subject to the approval of the Company's shareholders at the forthcoming annual general meeting and the approval of the relevant government authorities of the PRC.

(c) Pursuant to the board resolution on 29 March 2007, a joint venture company is going to be established by the Company, MPM and a third party, for production and sale petroleum pipe billets and couplings of petroleum drilling and extraction machinery accessories.

(d) During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ("the New Corporate Income Tax Law") was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group cannot be reasonably estimated at this stage.

37. COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified to conform with the current year's presentation.

38. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors of the Company on 29 March 2007.