Notes to the Consolidated Financial Statements

FOR THE YEAR ENDED 31 DECEMBER, 2006

1. GENERAL

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.

The immediate and 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. The addresses of the registered office and principal place of business of the Company are disclosed in the introduction to the annual report.

The principal activities of the Group are the manufacture and distribution of wheel loaders, the detail activities of the Group's subsidiaries are set out in note 30.

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRS")

In current year, the Group has applied, for the first time, a number of new standard, amendments and interpretations ("new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. The adoption of the new HKFRSs had no material effect on how the results and financial position for the current or prior accounting period have been prepared and presented. Accordingly, no prior period adjustment has been required.

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

HKAS 1 (Amendment)	Capital Disclosures [1]
HKFRS 7	Financial Instruments: Disclosures [1]
HK(IFRIC) – INT 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies [2]
HK(IFRIC) – INT 8	Scope of HKFRS 2 [3]
HK(IFRIC) – INT 9	Reassessment of Embedded Derivatives [4]
HK(IFRIC) – INT 10	Interim Financial Reporting and Impairment [5]
HK(IFRIC) – INT 11	HKFRS 2 – Group and Treasury Share Transactions [6]

1 Effective for annual periods beginning on or after 1 January, 2007.
2 Effective for annual periods beginning on or after 1 March, 2006.
3 Effective for annual periods beginning on or after 1 May, 2006.
4 Effective for annual periods beginning on or after 1 June, 2006.
5 Effective for annual periods beginning on or after 1 November, 2006.
6 Effective for annual periods beginning on or after 1 March, 2007.

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared under the historical cost convention and in accordance with HKFRSs issued by 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.

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 an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired 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 presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination 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 is accounted for using the purchase method. The cost of the acquisition is measured at 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 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, after reassessment, 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, 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.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold 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 from a financial asset 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.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as leasee

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 recognised as a reduction of rental expense over the lease term on a straight-line basis.

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs. The grants are recognised when there is reasonable assurance that the grants will be recovered unconditionally.

Research 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 Group, 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.

Foreign currencies - continued

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.

Borrowing costs

All borrowing costs are recognised as and included in finance costs in the consolidated income statement in the period in which they are incurred.

Retirement benefit costs

Payments to defined contribution retirement benefit plans are charged as an expense when employees have rendered service entitling them to contributions. 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.

Taxation

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

Notes to the Consolidated Financial Statements

The tax currently payable is based on the results for the year. Taxable profit differs from profit as reported in the consolidated 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.

Taxation– 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 asset to be recovered.

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 consolidated 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 is stated at cost, which includes construction costs and other direct costs, capitalised less any identified impairment loss. No depreciation is provided until the construction is completed and the assets are ready for intended 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, 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 consolidated 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 consolidated income statement over the period of the lease term on a straight line basis.

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.

Impairment of tangible assets– continued

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.

Notes to the Consolidated Financial Statements

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average 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.

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, bill receivables, other receivables, bank balances and pledged bank deposits

Trade receivables, bill receivables, other receivables, bank balances and pledged bank deposits are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest 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.

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 are initially measured at fair value, and subsequently measured at amortised cost, using the effective interest 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.

Trade payables, other payables, bill payables and amounts due to related parties

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

Equity instruments

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

4. 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

Starting from 18 December 2006, the Group offers a standard one-year warranty (previously 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.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments to raise finance for the Group's operations comprise bank borrowings and bank balances and cash. 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.

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. The management closely monitors such risks and will consider hedging significant commodity price risk exposure should the need arises.

Notes to the Consolidated Financial Statements

Credit risk

As at 31 December 2006, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties is the carrying amount of the respective recognised financial assets as stated in the consolidated balance sheet.

In order to minimise the credit risk in relation to trade receivables, the Group trades only with recognised, creditworthy third parties and has made policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced. The amounts presented in the consolidated balance sheet are net of allowances for doubtful receivables, if any, estimated by the Group's management based on prior experience and their assessment of the current economic environment.

The Group considers the credit risk on bill receivables is limited because the bill receivables are accepted by banks with high credit ratings assigned by international credit-rating agencies.

Also, it is the Group policy to give corporate guarantees to banks to secure certain sales agents' payment obligation to the banks in respect of issuing bank acceptance draft in the Group's favour for the settlement of the purchase from the Group. ?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 does not expect any significant loans from providing the guarantees.

Credit risk - continued

With respect to credit risk arising from the other financial assets of the Group which comprise bank balances and pledged bank deposits, the Group's exposure to credit risk arising from default of counterparties is limited as the counterparties are banks with high credit rating assigned by international credit-rating agencies.

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. The management closely monitors such risks and will consider hedging significant interest rate risk exposure should the need arise.

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 renewed and the Group expects to have adequate unutilised bank facilities to finance the Group and manage the liquidity position.

6. TURNOVER AND BUSINESS AND GEOGRAPHICAL SEGMENT

Turnover represents the net amounts received and receivable for goods sold by the Group to outside customers during the year.

Business segments

The Group's operation is regarded as a single business segment, being engaged in the manufacture and sales of wheel loaders. An analysis of the consolidated turnover and operating results of the Group by business segment is not presented.

Geographical segments

As over 90% of the consolidated turnover and operating results of the Group for the years is derived in the PRC, an analysis of the consolidated turnover and operating results of the Group by geographic location is not presented.

No geographic segments information of the Group's assets and liabilities is shown as the Group's assets and liabilities are substantially located in the PRC.

7. PROFIT BEFORE TAXATION

	2006	2005
	RMB'000	RMB'000
Profit before taxation has been arrived at after charging:		
Cost of inventory recognised as expense	**2,756,215**	2,125,934
Staff costs, including directors' remuneration		
Salaries and allowances	**162,691**	83,870
Contributions to retirement benefit scheme	**7,134**	4,564
Total staff costs	**169,825**	88,434
Auditors' remuneration	**2,160**	1,672
Allowance for bad and doubtful debts	**14,069**	91
Allowance for inventory	**4,653**	409
Depreciation	**32,548**	26,357
Amortisation of lease land premium	**3,416**	1,038
Loss on disposal of property, plant and equipment	**5,531**	2,584
Research and development expenditures	**18,091**	1,540
and after crediting:		
Discount on acquisition (Note 24)	**-**	7,415
Interest income on bank deposit	**2,970**	4,812
Government subsidy income (Note)	**7,180**	-

Note: The government subsidy income represents the subsidy from the National Tax Bureau of Fujian Longyan Economic Zone in respect of the Company's reinvestment by way of capital injection of dividends obtained from a subsidiary in PRC and the subsidy from Shanghai Xinmin District Economic Zone Administrative Committee ("Committee") and was determined by reference to the monthly tax payment made by the Group, which were entirely based on the mandate of the Committee adjusted from time to time. All the grant of the government subsidies were approved and received in current year.

8. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS

(a) Directors' emoluments

	2006 **RMB'000**	2005 RMB'000
Fees	**638**	364
Other emoluments:		
Salaries and allowances	**3,179**	1,780
Contributions to retirement benefits scheme	**14**	9
	3,193	1,789
	3,831	2,153

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

	2006 **RMB'000**	2005 RMB'000
Fees:		
Ms. Ngai Ngan Ying	**240**	100
Mr. Zhu, Mantian Myron	**99**	35
Professor Yang Hongqi	**100**	55
Dr. Qian Shizheng	**100**	87
Mr. Lo Peter	**99**	87
	638	364

Notes to the Consolidated Financial Statements

Details of salaries, allowances and contributions to retirement benefits scheme are set out as follows:

	2006		2005	
	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	**1,498**	**-**	600	-
Mr. Qiu Debo	**698**	**7**	300	1
Mr. Luo Jianru	**300**	**-**	200	2
Ms. Feng Wanru	**150**	**-**	200	-
Mr. Chen Chao	**216**	**4**	120	6
Mr. Zhu Yong Sheng	**120**	**-**	120	-
Dr. Zhang Hong	**100**	**-**	120	-
Ms. Ngai Ngan Ying	**-**	**-**	120	-
Mr. Mou Yan Qun	**75**	**3**	-	-
Mr. Lin Zhong Ming	**22**	**-**	-	-
	3,179	**14**	1,780	9

(b) Employees' emoluments

All the five highest paid individuals are directors of the Company for the year ended 31 December, 2006 and 2005 respectively, details of whose emoluments are set out above.

During both years ended 31 December, 2006 and 2005, 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, 2006 and 2005.

9. INCOME TAX (CREDIT) EXPENSE

	2006	2005
	RMB'000	RMB'000
The (credit) charge comprises:		
Current tax:		
PRC Enterprise Income Tax ("EIT")	**19,843**	29,141
Deferred tax credit (Note 14)	**(24,731)**	-
	(4,888)	29,141
Over provision in prior year	**(4,384)**	-
	(9,272)	29,141

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.

The entities located in the PRC were entitled to tax rates for the year ended December 31 2006 and 2005 as follows:

Notes to the Consolidated Financial Statements

	Note	**2006 EIT rate**	2005 EIT rate
Longgong Shanghai Machinery Company Limited ("Longgong Shanghai")	(1)	**Exempted**	Exempted
Longgong Fujian Machinery Company Limited ("Longgong Fujian")	(1)	**Exempted**	27%
Longgong (Shanghai) Qiaoxiang Company Limited ("Shanghai Qiaoxiang")	(2)	**12%**	13.5%
Fujian Longyan Longgong Machinery Components Company Limited ("Longyan Components")	(3)	**27%**	27%
Herkules (Shanghai) Hydraulic System Company Limited ("Hydraulic Shanghai")	(4)	**Exempted**	Exempted
Refined (Shanghai) Machinery Company Limited ("Pipe Company")	(4)	**Exempted**	Exempted
Jiangxi Monarch Gear Company Limited ("Gear Company")	(5)	**Exempted**	33%
Jiangxi Longgong Machinery Company Limited ("Jiangxi Machinery")	(6)	**33%**	33%
Herkules (Fujian) Qiaoxiang Company Limited ("Fujian Qianxiang")	(7)	**Exempted**	N/A
Herkules (Fujian) Hydraulic System Company Limited ("Hydraulic Fujian")	(7)	**Exempted**	N/A
Longgong (Shanghai) Excavator Manufacturing Company Limited ("Shanghai Excavator")	(7)	**Exempted**	N/A
Monarch (Shanghai) Forklife Company Limited ("Shanghai Forklife")	(7)	**Exempted**	N/A
Monarch (Shanghai) Machinery Company Limited ("Shanghai Monarch")	(7)	**Exempted**	N/A
Longgong (Shanghai) Road Machinery Manufacturing Company Limited ("Shanghai Road")	(7)	**Exempted**	N/A

(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, followed by a 50 per cent tax relief for the following three years. Accordingly, Longgong Shanghai is exempt from EIT in 2006 and 2005. However, Longgong Fuj ian paid tax at their full EIT rate for the year ended 31 December 2005 because the exemption conditions for that year were eventually not fulfilled. Longgong Fujian has met the exemption condition in 2006.

(2) Shanghai Qiaoxiang is entitled to an exemption from EIT for the two years starting from its first profit-making year in 2003, followed by a 50 per cent tax relief for the following three years. For the year ended 31 December 2005, Shanghai Qiaoxiang was subject to EIT together with the local income tax at a rate of 13.5 per cent. For the year 2006, Shanghai Qiaoxiong is exempt from the local income tax and accordingly is subject to EIT at a rate of 12 per cent.

(3) For the year ended 31 December, 2006 and 2005, Longyan Components was subject to EIT together with the local income tax at a rate of 27 per cent.

(4) Hydraulic Shanghai and Pipe Company is entitled to an exemption from EIT for the two years starting from its first profit-making year in 2005.

(5) Gear Company is entitled to an exemption from EIT from the two years starting from its first profit-making year in 2006.

(6) Jiangxi Machinery is subject to EIT together with the local income tax at a rate of 33 per cent. As the company is dormant, there is no income tax charge in 2006.

(7) These six companies were established in 2006, and are entitled to an exemption from EIT for the two years starting from its first profit-making year, followed by a 50 per cent tax relief for the following three years. Accordingly these companies are exempt from EIT in 2006.

The tax charge for the year ended 31st December, 2006 and 2005 can be reconciled to the profit per the consolidated income statement as follows:

Notes to the Consolidated Financial Statements

	2006		2005	
	RMB'000	**%**	RMB'000	%
Profit before taxation	**616,076**		265,822	
Tax at the domestic tax rate of 33%	**203,305**	**33.0**	87,721	33
Tax effect of expenses that are not deductible in determining taxable profit	**2,814**	**0.5**	94	-
Tax effect of income that is not taxable in determining in taxable profit	**(1,023)**	**(0.2)**	(2,500)	(0.9)
Tax effect of deferred tax assets not recognised	**2,017**	**0.3**	4	-
Over provision in respect of prior years	**(4,384)**	**(0.7)**	-	-
Temporary differences not recognised in previous year	**(30,947)**	**(5.0)**	-	-
Effect of tax exemptions and income tax on concessionary rate granted to PRC subsidiaries	**(181,054)**	**(29.4)**	(56,178)	(21.1)
Tax charge and effective tax rate for the year	**(9,272)**	**(1.5)**	29,141	11.0

10. DIVIDENDS

	2006	2005
	RMB'000	RMB'000
Dividend paid	**-**	67,684

During the year ended 31 December, 2005, the Company declared and paid interim dividends of RMB 67,684,000 represents RMB9.7 cents per ordinary share.

A final dividend of HKD 22 cents (Equivalent to RMB 22 cents) per ordinary share for the year ended 31 December, 2006 has been proposed by the Directors and it subject to approval by the shareholders in the annual general meeting to be held on 26 April, 2007.

11. 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 parent of approximately RMB624,154,000 (2005: RMB235,906,000) and on the number of 1,037,050,000 (2005: weighted average number of 740,031,507) shares in issue during the year.

No diluted earnings per share has been presented for both 2006 and 2005 as there were no potential dilutive shares in issue in both years ended.

12. PROPERTY, PLANT AND EQUIPMENT

	Buildings RMB'000	Plant and Machinery RMB'000	Motor Vehicles RMB'000	Furniture and Fixtures RMB'000	Construction in progress RMB'000	Total RMB'000
COST						
At 1 January 2005	126,757	148,198	10,756	5,882	44,595	336,188
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)
Acquisition of subsidiaries (Note 24)	1,567	26,625	2,297	1,107	1,304	32,900
At 31 December 2005	194,883	201,572	12,062	11,752	62,288	482,557
Additions	11,803	44,901	9,206	11,608	263,650	341,168
Transfers	60,824	106,548	-	1,470	(168,842)	-
Disposals	(20,745)	(7,534)	(2,465)	(592)	-	(31,336)
At 31 December, 2006	246,765	345,487	18,803	24,238	157,096	792,389
ACCUMULATED DEPRECIATION						
At 1 January 2005	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
Charge for the year	8,746	18,875	2,912	2,015	-	32,548
Disposals	(5,900)	(4,490)	(1,953)	(435)	-	(12,778)
At 31 December 2006	27,505	53,980	5,214	5,597	-	92,296
CARRYING AMOUNT						
At 31 December 2006	219,260	291,507	13,589	18,641	157,096	700,093
At 31 December 2005	170,224	161,977	7,807	7,735	62,288	410,031

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

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

Depreciation is 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
Motor vehicles	5 to 6 years
Furniture and fixtures	4 to 6 years

13. LEASE PREMIUM FOR LAND

	2006 **RMB'000**	2005 RMB'000
Balance at beginning of the year	**126,231**	43,090
Acquisition of subsidiaries (Note 24)	**-**	14,359
Additions	**26,381**	69,820
Amortisation	**(3,416)**	(1,038)
Balance at end of the year	**149,196**	126,231
Less: Amount to be amortised within one year	**(2,984)**	(2,559)
Non-current portion	**146,212**	123,672

The carrying amount represented medium-term land use rights situated in the PRC.

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

14. 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	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2006	-	-	-	-	-	-
Credit to income statement for the year	2,394	3,496	715	6,894	11,232	24,731
At 31 December 2006	2,394	3,496	715	6,894	11,232	24,731

Deferred tax assets recognised during the year represents the tax effect of temporary differences expected to be utilised in the year following the year that the entities enjoy full exemption from taxation.

At the balance sheet date, the Group has unused tax losses of RMB 6 million (2005: Nil) available for offset against future profits that may be carried forward indefinitely. No deferred tax asset has been recognised in respect of the tax losses due to the unpredictability of future profit streams. The tax losses will be expired in 2011.

15. INVENTORIES

	2006	2006
	RMB'000	RMB'000
Raw materials	**225,321**	145,901
Work in progress	**95,726**	64,589
Finished goods	**631,722**	493,516
	952,769	704,006

16. 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 some customers with whom specific terms will be agreed.

The aged analysis of trade receivables is as follows:

	2006	2005
	RMB'000	RMB'000
0 - 90 days	**224,022**	188,714
91 - 180 days	**13,219**	1,563
181 - 270 days	**10,015**	1,491
271 days to 1 year	**5,366**	418
1 to 2 years	**-**	806
2 to 3 years	**-**	530
	252,622	193,522

Bill receivables are aged within one year at both balance sheet dates.

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

	2006	2005
	RMB'000	RMB'000
Deposits for purchase of supplies and raw materials	**104,409**	45,287
Value-added tax recoverable	**34,624**	-
Others	**7,158**	16,674
	146,191	61,961

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

17. BANK BALANCES AND PLEDGED BANK DEPOSITS

The pledged deposits are secured for banking facilities from the banks in respect of purchases of raw materials for manufacturing and are therefore classified as current assets. The bank balances and pledged deposits are carrying interest at an effective interest rate of 1.98%.

The directors consider that the carrying amounts of pledged bank deposits and bank balances and cash approximate their fair value.

18. TRADE PAYABLES, BILL PAYABLES AND OTHER PAYABLES

The aged analysis of trade payables is as follows:

	2006 **RMB'000**	2005 RMB'000
Within 1 year	**328,120**	274,724
1 to 2 years	**1,897**	3,150
2 to 3 years	**1,655**	1,180
Over 3 years	**750**	904
	332,422	279,958

Bill payables are aged within one year at both balance sheet dates.

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

19. PROVISIONS

	2006 **RMB'000**	2005 RMB'000
At beginning of year	**26,899**	13,654
Provision for the year	**53,061**	42,108
Utilisation of provision	**(52,859)**	(28,863)
At end of year	**27,101**	26,899

The Group offers a standard six-month warranty (a standard one-year warranty starting from 18 December 2006) for the wheel loaders. The provisions represent the obligation for warranty costs to the customers.

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20. AMOUNTS DUE TO RELATED PARTIES

	2006 RMB'000	2005 RMB'000
Shanghai Longgong Machinery Co., Ltd. (note)	**1,848**	-
Longgong Holdings (HK) Limited (note)	**-**	343
China Longgong Group Holdings Limited	**5,545**	5,743
	7,393	6,086

Note: Mr. Li San Yim and Madam Ngai Ngan Ying hold beneficial interest in these companies.

20. AMOUNTS DUE TO RELATED PARTIES - continued

The amounts due to Shanghai Longgong Machinery Co, Ltd. was dividends payable declared during the year ended 31 December, 2006 by a non-wholly owned subsidiary whose minority shareholder is Shanghai Longgong Machinery Co, Ltd.

The amounts due to China Longgong Group Holdings Limited 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.

21. BANK BORROWINGS

	2006 RMB'000	2005 RMB'000
Short-term bank borrowings	**266,869**	455,320
Analysed as:		
Secured	**1,869**	820
Unsecured	**265,000**	454,500
	266,869	455,320

At the respective balance sheet dates, the Group had bank facilities, including insurance of bill payables and utilisation of bank borrowings, which were secured by the following assets of the Group:

	2006	2005
	RMB'000	RMB'000
Bank deposits	**59,593**	14,008

The borrowings of the Group are fixed-rate borrowings which carry interests ranging from 4.86% to 5.8% during the year ended 31 December, 2006 (2005: 4.8% to 5.9%) and therefore exposed to fair value interest rate risk. All of the Group's borrowings are denominated in Renminbi and will mature within one year.

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

22. SHARE CAPITAL

	Number of shares	Amounts
		US$
Authorised:		
Ordinary shares of US$1.00 each		
At date of incorporation and		
At 1 January 2005	**50,000**	50,000
		HK$
Redenominated 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
Ordinary shares of HK$0.10 each		
At 31 December 2005 and 2006	**5,000,000,000**	500,000,000

Notes to the Consolidated Financial Statements

	Number of shares	Amounts
		US$
Issued and fully paid:		
At 1 January 2005	**118**	118
		HK$
Redenominated 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 and 2006	**1,037,050,000**	103,705,000
Shown on the consolidated balance sheet at		RMB '000
31 December, 2005 and 2006		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.

22. SHARE CAPITAL - continued

On 10 October, 2005 and 4 November, 2005, China Longgong Group Holdings Limited (being the then sole shareholder of the Company) passed a shareholder's resolution 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 divided into 3,900,000 shares of HK$0.10 each and the issued share capital of the Company became HK$920 divided into 9,204 shares of HK$0.10 each (the "Re-denomination"), and the authorised share capital of the Company has further been 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 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.

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.

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

23. 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 a group reorganisation in 2004.

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 PRC in accordance with the PRC laws and regulations.

24. 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 of net assets acquired in these transactions are as following:

	Pipe Company	Hydraulics Company	Gear Company	Total
	RMB'000	RMB'000	RMB'000	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)

The discount on acquisition arises from the appreciation of assets value from operations for the period between the pricing decision date and the acquisition date which the Group got the capability to control over these companies.

The acquired companies contribute RMB 1 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 RMB 2,683 million, and profit for the year would have been RMB 241 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.

25. OPERATING LEASE COMMITMENTS

	2006 **RMB'000**	2005 RMB'000
Minimum lease payments paid under operating leases in respect of premises during the year	**4,552**	2,386

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

	2006 **RMB'000**	2005 RMB'000
Within one year	**2,780**	3,462
In the second to fifth year inclusive	**1,865**	3,695
Over five years	**821**	864
	5,466	8,021

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 from five to thirteen years and rentals are fixed for the relevant lease terms.

26. CAPITAL COMMITMENTS

	2006 RMB'000	2005 RMB'000
Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of property, plant and equipment	**98,848**	41,016

27. CONTINGENT LIABILITIES

As at 31 December, 2006, the Group had issued corporate guarantees to the extent of RMB325,600,000 (31 December, 2005: RMB185,000,000) to the banks to secure certain banking facilities of the Group's sales agents, such banking facilities being used by the sales agents to issue bank acceptance drafts in the Group's favour for the settlement of the purchase from the group. The amount of such facilities being utilised as at 31 December, 2006 amounted RMB273,210,000 (31 December, 2005: RMB87,559,000).

28. RELATED PARTY TRANSACTIONS

The following related party transactions took place during the year:

Name of related party	*Note*	Nature of transactions	2006 RMB'000	2005 RMB'000
Pipe Company	1	Purchases of goods	-	38,172
		Sales of goods	-	120
Gear Company	1	Purchase of goods	-	27,188
		Sales of goods	-	12
Hydraulic Company	1	Purchase of goods	-	36,781
Wuxi Longgong Property Development Co., Ltd	2	Purchase of property, plant and equipment	**542**	-
Li Jun	3	Purchase of property, plant and equipment	**1,060**	-
LongOu Logistic Co., Ltd.	4	Carriage inwards	-	10,216
Ngai Ngan Cun	5	Carriage inwards	-	2,907

Notes:

1. Represent transactions prior to these companies being acquired by the Group.
2. The company is established by Mr. Li Bin, the son of Mr. Li Sam Yim and Madam Ngai Ngan Ying.
3. Mr. Li Jun is the son of Mr. Li Sam Yim and Madam Ngai Ngan Ying.
4. The company is established by Mr. Ngai Ngan Gui, a brother of Madam Ngai Ngan Ying.
5. Mr. Ngai Ngan Cun is a brother of Madam Ngai Ngan Ying.

The remuneration of directors and other members of key management during the year was as follows:

	2006	2005
	RMB'000	RMB'000
Short-terms benefits	**3,831**	2,153

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trend.

29. 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.

30. SUBSIDIARIES

Details of the Company's subsidiaries as at 31 December, 2006 are as follows:

Name	Date and place of establishment/ incorporation	Paid-up issued/ registered ordinary	Attributable equity interest (Note)	Principal activities
Longgong Shanghai (龍工(上海)機械有 限公司)	13 August 2004 PRC Sino foreign equity joint venture	HK$128,000,000	99.625%	Manufacture and distribution of wheel loaders
Shanghai Qiaoxiang (龍工(上海)橋箱有限公司)	17 September 2001 PRC wholly-owned foreign investment enterprise ("WOFE")	HK$78,000,000	100%	Manufacture and distribution of axles
Longgong Fujian (龍工(福建)機械有限公司)	15 September 2004 PRC WOFE	HK$178,000,000	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 WOFE	HK$29,268,000	100%	Manufacture and distribution of wheel loader component
Hydraulics Shanghai 海克力斯(上海)液壓機械有限公司	30 September 2003 PRC WOFE	USD3,860,000	100%	Manufacture and distribution of wheel loader component
Pipe Company 銳帆德(上海)機械有限公司	27 November 2003 PRC WOFE	HK$13,000,000 distribution of wheel	100%	Manufacture and loader component
Gear Company 江西摩綱凱齒輪有限公司	12th September 2003 PRC WOFE	RMB28,000,000/ RMB60,000,000	100%	Manufacture and distribution of wheel loader component

Jiangxi Machinery 江西龍工機械有限公司	12 September 2003 PRC WOFE products	RMB10,000,000	100%	Manufacturing hydraulic parts and other machinery
Hydraulics Fujian 海克力斯(福建)液壓機械有限公司	15 January 2006 PRC WOFE	HK$50,000,000	100%	Manufacture and distribution of wheel loader component
Fujian Qiaoxiang 海克力斯(福建)橋霜有限公司	16 January 2006 PRC WOFE	HK$10,000,000	100%	Manufacture and distribution of axles and great-boxes
Shanghai Road 龍工(上海)路面機械制造有限公司	12 September 2006 PRC WOFE	HK$10,000,000/ HK$50,000,000	100%	Manufacture and distribution of wheel loader component
Shanghai Excavator 龍工(上海)挖掘機制造有限公司	**12 September 2006** PRC	**HK$20,000,000/** HK$50,000,000 WOFE	**100%**	**Manufacture and** distribution of grab
Shanghai Monarch 摩納凱(上海)機械有限公司	1 January 2006 PRC WOFE	HK$20,000,000/ HK$83,600,000	100%	Manufacture and distribution of hydraulic parts and other machinery products
China Dragon Development (中國龍工發展有限公司)	3 May, 2004 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, 2004 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.

None of the subsidiaries had issued any debt securities at the end of the year.

Notes to the Consolidated Financial Statements

31. EVENTS AFTER THE BALANCE SHEET DATE

On 12 March, 2007, the directors proposed a final dividend of HKD 0.22 (Equivalent to RMB 022) per share to the shareholders on the register of members on 30 March, 2007, amounting to approximately HKD 228 million (Equivalent to RMB 229 million).