



Chairman's Statement



Zhou Zhiyan, Chairman

The Board of Directors (the "Board") of Shanghai Prime Machinery Company Limited (the "Company") is pleased to announce the annual results of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2006. The Group's results have been audited by Ernst & Young.

Turnover of the Group for the year ended 31 December 2006 was RMB 2,867 million (2005: RMB 1,425 million), representing a year-on-year increase of 101%. Profit attributable to equity holders of the Company was RMB 231 million (2005: RMB 135 million), representing a year-on-year increase of 71%. Basic earnings per share amounted to RMB 18.98 cents. The Board has proposed a final dividend of RMB 4 cents per share, which is subject to approval by the shareholders of the Company at the annual general meeting.

Business Review

2006 was an important year for the Company. On 27 April 2006, the Company was successfully listed on the Main Board of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") and entered the international capital markets. With the efforts of the management, and employees, the Group achieved encouraging operating results. Our businesses in turbine blades, bearings and fasteners have been on a fast growth track.

With a view to become the leading international supplier of industrial parts and components, the Company has taken an active approach in research and development, increase of production capability and expansion of the domestic and overseas markets. During the year, the Group undertook the following actions:

Launched various investment projects for business development

The Group has launched several investment projects, such as improving production technology of high-precision turbine blades and numerically-controlled machine cutting tools, developing logistics system, escalating existing equipment and production capacity, and lifting railway bearing speed for Eighty-tonne cargo trains. Through the implementation of these projects, the Group was able to fasten the pace of growth.

Explored overseas market while maintained domestic market

The Group has further expanded both the domestic and overseas markets by leveraging on existing sales



network and relationship with our core clients. By capitalizing on stable domestic market and fast growing overseas markets, turbine blade segment improved the product quality and increased technical sophistication of the products. Export sales in 2006 amounted to RMB 102 million, representing a year-on-year increase of 168%. After being awarded the "Chinese Famous Brandname" for the products of "Shanggong" ("上☆工") branded cutting tools, the number of distributors increased from around 70 in 2005 to over 100 in 2006. While seeking to replace the imported cutting tools in domestic market, the cutting tool segment accelerated exports to promote the brand name's reputation in the international market. The fastener segment has sustained the rapid growth in overseas market by improving product quality and service level. The export sales for fasteners reached a record-high of RMB 1,110 million.

Developed high value-added products through technology innovation

The Group has focused on developing high value-added precision products to replace imported products by closely following the trends of similar products in the world. The proportion of high value-added products was further increased in the product portfolio. After developing the H1200 mega-kilowatt scale terminal turbine blade, H990 nuclear-powered terminal turbine blade, and H680 air-conditioning terminal turbine blade, turbine blade segment further improved the relevant manufacturing technology. Seizing the opportunity of major cus-

tomers marching into the advanced high technology field, the bearing segment has explored bearing market for products used in precision aerospace and heavy-load and high-speed railway fields. The sales amount of precision bearings and railway bearings in 2006 were RMB 36 million and RMB 72 respectively, representing a year-on-year increase of 13% and 67%. Under the initiative of replacing the imported cutting tools with numerically-controlled machine cutting tools, the cutting tool business has focused on developing brand-new cutting tools such as high-speed gear-cutting tool, carbon alloy metal cutting tool, compound-coating cutting tools and convertible cast iron cutting tools. Leveraging on the new product developments, the Group timely grasped the market trends in the various business segments and strived to seize a leading position in the market.

Increased management efficiency and improved operation quality

The Group has maintained a smooth and healthy operation through strict compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and the applicable laws and regulations. In accordance with the requirements of the regulatory institutions, the Company established an effective internal control system in 2006 to streamline its management structure and to further enhance the control environment. The Company has also tightened corporate financial management by establishing a cash-pool system to centralize the capital management. At the same time,



Chairman's Statement



the Group has strengthened various types of fundamental management, standardized investment management and established an internal audit system to avert risk and maintain a healthy and sustainable growth of the Group.

Business Prospects

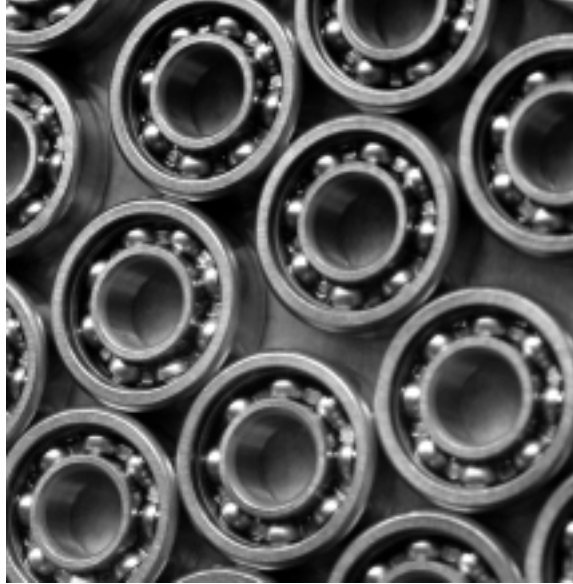
The "Eleventh Five-Year Period" is crucial to the Company, it provides a favorable external operating environment to the Group. The State Council has already promulgated "Several Opinions on accelerating the Invigoration of Equipment Manufacturing Industry", of which the essence has become the national strategy. Meanwhile, Shanghai municipal government has also formulated the development strategy to reinforce the modern service industry and the manufacturing industry as the two major priorities. In terms of the internal operating environment, the Group can further strengthen its

operations through technology innovation and capital investment. At the same time, the Group has strong competitive edges and growth potential by having access to foreign funds and local resources and human capital.

Looking forward, the Company will further enhance its management, optimize its corporate governance structure and operation mechanism, and actively communicate with investors. The Company, targeting itself as a both service provider and manufacturer, has been building up a new information platform of supply chain management service. By facilitating the interaction between business operation and capital operation, the Group is determined to become an international leading supplier of industrial parts and components for the manufacturing industry.

Turbine Blade Business

It is predicted that the domestic demand for turbine blades used in coal-fired power generation equipment will become stable in 2007. Therefore, the Group plans to increase the production capacity for turbine blades used in non-coal-fired power generation, including ultra-super-critical power generation turbines, gas turbine compressors and nuclear power generation turbines. In addition, the Group schedules to broaden its product portfolio by expanding to the aviation field and developing the market for small to medium high-precision turbine blades and medium to large blade forgings. Furthermore, the Group is endeavored to explore the overseas market .



Bearing Business

With the growth of the bearing industry, the Group expects the demand of bearings will continue to increase. The Group plans to increase the production capacity of speed-lifting railway bearings for heavy cargo trains and high-precision aviation bearings, while developing large and extra-large windmill bearing and automobile bearing. The Group will maintain its leading position in the domestic middle to high-end bearing market while increasing capital investment in the bearing business for improving its production equipment and technology.

Cutting Tool Business

With China gradually becoming a global manufacturing center, the domestic consumption of cutting tools is on a fast growing track, especially reflected on high-end imported cutting tools. This growth trend has set the focus of the Group's business strategy of cutting tools on the high value-added high-end cutting tools, particularly in improving the production technology of high-precision cutting tools such as numerically-controlled cutting tools, POD, and polycrystalline diamonds in order for them to reach the international standards.

Electric Motor Business

The competition of electric motor industry in China is keen. As a result, it is anticipated that the price and profit margin of electric motors will decrease. Through research and development, the Group plans to design and manufacture electric motors catering to the cus-

tomers' needs, to provide customers with customized solutions in order to maintain its competitive edges.

Fastener Business

The Group will continue to improve its production facilities, logistics system and sales network of the fastener business in order to rapidly expand its production capacity to meet the market demand. The Group believes that the fastener business will make greater contribution to the Group in the future.

Conclusion

The Group and its employees are confident of the future. We will strive for excellence and create value for the shareholders. Through our ceaseless efforts we believe, the Group will gradually become the leading international supplier of industrial parts and components.

Last but not least, I would like to take this opportunity to thank all the shareholders for their support and trust, and all the directors, supervisors, management members and all the staff for their contributions and devotion during the past year.

Zhou Zhiyan

Chairman
Shanghai, PRC
30 March 2007