

Report of the Directors



Property, Plant and Equipment

Details of movements in the property, plant and equipment of the Company and the Group during the year are set out in note 14 to the financial statements, respectively.

The Group's properties and land, included in notes 14 and 15 to the financial statements at cost, were valued at RMB 146,940,000 as at 28 February 2006 in the Prospectus issued on 13 April 2006 in connection with the listing of the Company's shares on 27 April 2006. Had the Group's properties and land been included in these financial statements at such valuation amount throughout the year ended 31 December 2006, an additional depreciation charge of RMB 200,000 would have been charged to the consolidated income statement for the year ended 31 December 2006.

Share capital

Details of movements in the Company's share capital during the year are set out in note 33 to the financial statements.

Pre-emptive rights

There are no provisions for pre-emptive rights under the Company's bye-laws/articles of association or the laws of the People's Republic of China ("the PRC") which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Purchase, redemption or sale of listed securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 34 to the financial statements and in the consolidated statement of changes in equity, respectively.

Distributable reserves

At 31 December 2006, the Company's reserves available for distribution, calculated in accordance with the relevant regulations, amounted to RMB 169,810,000, of which RMB 57,531,000 has been proposed as a final dividend for the year. In addition, the Company's share premium account, in the amount of RMB 691,217,000, may be distributed in the form of fully paid bonus shares.

Major customers and suppliers

In the year under review, sales to the Group's five largest customers accounted for less than 30% of the total sales for the year. Purchases from the Group's five largest suppliers also accounted for less than 30% of the total purchases for the year.

Directors

The directors of the Company during the year were set out on page 18.



The independent non-executive directors are appointed for a period of three years.

The Company has received annual confirmations of independence from Mr. Zhou Feida, Mr Chan Chun Hong, Thomas and Mr. Liu Huangsong and as at the date of this report, the Company still considers them to be independent.

Directors', supervisors' and senior management's biographies

Biographical details of the directors, supervisors and senior management of the Company are set out on pages 18 to 20 of the annual report.

Directors' service contracts

Each of the executive directors of the Company has entered into a service contract with the Company on 28th, September 2005. According to the terms of the service contracts, each of the executive directors agreed to be appointed as the Company's executive director until 28th, September 2008. These contracts are renewable in accordance with the Company's articles of association and related listing rules and terminable at the option of the Company and the executive directors by giving three months' notice in writing or according to the terms of the contract prior to the expiry of the contract.

Apart from the foregoing, no director has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Directors' remuneration

The directors' fees are determined and resolved by the Remuneration Committee subject to shareholders' approval at general meetings. Other emoluments are determined by the Remuneration Committee of the Company with reference to directors' duties, responsibilities and performance and the results of the Group.

Directors' and supervisors' interests in contracts

No director and supervisor had a material interest, either directly or indirectly, in any contract of significance to the business of the Group to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party during the year.

Directors' interests and short positions in shares and underlying shares

As at 31 December 2006, none of the directors had registered an interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations that was required to be recorded pursuant to Section 352 of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers.

Directors' rights to acquire shares or debentures

At no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures



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tures of the Company granted to any director or their respective spouse or minor children, or were any such rights exercised by them; or was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

Contract of significance

The Company has entered into various contracts of significance with its ultimate holding company, Shanghai Electric (Group) Corporation ("Shanghai Electric Corporation"), and the subsidiaries of Shanghai Electric Corporation. Further details of the transactions are set out in the section "Connected transactions and continuing connected transactions" below.

Substantial shareholders' and other persons' interests in shares and underlying shares

At 31 December 2006, the following interests of 5% or more of the issued share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Long positions

Save as disclosed above, as at 31 December 2006, no person had registered an interest or short position in the shares or underlying shares of the Company that was required to be recorded pursuant to Section 336 of the SFO.

Connected transactions and continuing connected transactions

During the year, the Company and the Group had the following connected and continuing connected transactions, certain details of which are disclosed in compliance with the requirements of Chapter 14A of the Listing Rules.

During the year, the Company and the Group did not enter into any connected transaction as defined under Chapter 14A of the Listing Rules that is not exempt under Rule 14A.31 of the Listing Rules.

Continuing connected transactions

Wuxi Land Lease Agreement

On 31 March 2006, Wuxi Turbine Blade Company Limited ("Wuxi Turbine Blades") entered into a land lease agreement with Shanghai Electric Corporation. As Shanghai Electric Corporation is

Name	Capacity and nature of interest	Number of ordinary shares held	Percentage of the Company's issued share capital	Category of ordinary shares
Shanghai Electric Corporation	Directly beneficially owned	678,576,184	47.18	Domestic
JP Morgan Chase & Co.	Directly beneficially owned	105,800,000	7.36	H
The Capital Group Companies, Inc.	Directly beneficially owned	75,198,000	5.23	H



one of the promoters and the substantial shareholder of the Company, Shanghai Electric Corporation and its associates as defined under the Listing Rules are connected persons of the Group pursuant to Chapter 14A of the Listing Rules. Under the Wuxi land lease agreement, Shanghai Electric Corporation agrees to sub-lease a parcel of land that it leases from the Wuxi government with a total area of approximately 106,121.6 square meters to Wuxi Turbine Blades for industrial use. The term of the sub-lease is 10 years which is the same as the term of the lease between the Wuxi government and Shanghai Electric Corporation. The annual cap, representing the agreed rental payment due to Shanghai Electric Corporation is RMB 3.7 million per year for the first three years of the agreement and is to be reviewed every three years, taking into account market conditions, and should not be higher than the rent applicable to a third party tenant. The rental payment term is also the same as the lease between the Wuxi government and Shanghai Electric Corporation.

In 2006, Wuxi Turbine Blades obtained an approval from the Wuxi government for a waiver of the rental for three years starting from November 2005 and a 50% reduction in the rental for two years thereafter (the "Waiver"). Shanghai Electric Corporation has agreed on the Waiver. Accordingly, no rental payment was payable by Wuxi Turbine Blades to Shanghai Electric Corporation for the year ended 31 December 2006. In the financial statements for the year ended 31 December 2006, Wuxi Turbine Blades has recognised rental expense payable to Shanghai Electric Corporation of RMB 2.0 million, which is the apportionment of total rental payable evenly throughout the 10 years lease period.

Framework Property Lease Agreement

On 31 March 2006, the Company entered into a framework property lease agreement with Shanghai Electric Corporation, pursuant to which Shanghai Electric Corporation agrees to lease (either by itself or through its subsidiaries, excluding Shanghai Electric Group Company Limited and its subsidiaries (collectively referred to as "Shanghai Electric Company")) certain properties with total area of approximately 89,115 square meters to the Group. The term of each lease granted under the framework property lease agreement is 20 years. Under the agreement, the Company has the right, at its discretion, to terminate the lease term of any premises at any time prior to its expiry. The rental payable under the framework property lease agreement is to be reviewed every three years, taking into account market conditions, and should not be higher than the rent applicable to a third party tenant.

The proposed annual caps, representing the maximum aggregate rental payable as agreed between the parties for the years of 2006, 2007 and 2008 are RMB 25 million, RMB 30 million and RMB 30 million, respectively. The actual rental payable to Shanghai Electric Corporation for the year ended 31 December 2006 was RMB 19.6 million.

Framework Processing Agreement with Shanghai Electric Corporation

On 31 March 2006, the Company entered into a framework processing agreement with Shanghai Electric Corporation, pursuant to which Shanghai Electric Corporation (either by itself or through its subsidiaries, excluding Shanghai Electric Company) agrees to provide to the Group processing services.



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Pursuant to the framework processing agreement, Shanghai Biaowu High Tensile Fasteners Company Limited will provide the raw materials for certain fasteners to Shanghai Electric Corporation and its subsidiaries, excluding the Group and Shanghai Electric Company (collectively referred to as "Parent Group") for processing and receiving finished fasteners products from the Parent Group.

The fees payable by the Group under the framework processing agreement must be:

- such prices as may be stipulated by the PRC government (if any); and if there are no such stipulated prices,
- prices not exceeding any pricing guidelines or pricing recommendations set by the PRC government (if any); and if there are no such pricing guidelines or recommendations,
- prices not exceeding market price; and if there is no market price for a particular type of service,
- an agreed price consisting of the actual or reasonable cost incurred by the Parent Group in providing that services plus a reasonable profit.

The term of the framework processing agreement is three years, renewable at the option of the Company for another term of three years by giving at least three months' notice prior to its expiry of the initial term. Either party may terminate the framework processing agreement at any time by giving at least three months' notice.

The proposed annual caps, representing the maximum aggregate processing fees payable as agreed between the parties for the years of 2006, 2007

and 2008 are RMB 8.5 million, RMB 9.3 million and RMB 10.1 million, respectively. The actual processing fees payable to the Parent Group for the year ended 31 December 2006 were RMB 3.5 million.

Framework Sales Agreement with Shanghai Electric Corporation

The Company entered into a framework sales agreement dated 31 March 2006 with Shanghai Electric Corporation, pursuant to which the Group has agreed to sell, on a non-exclusive basis, products from its bearing and cutting tool businesses, both finished and semi-finished, to the Parent Group.

The prices of the products sold to Shanghai Electric Corporation under the framework sales agreement shall be:

- such prices as may be stipulated by the PRC government (if any); and if there are no such stipulated prices,
- prices not exceeding any pricing guidelines or pricing recommendations set by the PRC government (if any); and if there are no such pricing guidelines or recommendations,
- prices not exceeding market price; and if there is no market price for a particular product,
- an agreed price consisting of the actual or reasonable cost incurred by the Group in supplying the product plus a reasonable profit.

The term of the framework sales agreement is three years, renewable at the option of the Company for another term of three years by giving at least three months' notice prior to its expiry of the initial term. The framework sales agreement



may be terminated by either party by giving at least three months' notice.

The proposed annual caps, representing the maximum amount of sale as agreed between the parties for the years of 2006, 2007 and 2008 are RMB 12.1 million, RMB 14.5 million and RMB 17.4 million, respectively. The Group's actual sale to Shanghai Electric Corporation for the year ended 31 December 2006 amounted to RMB10.0 million.

Framework Purchase Agreement with Shanghai Electric Corporation

The Company entered into a framework purchase agreement dated 31 March 2006 with Shanghai Electric Corporation, pursuant to which the Group has agreed to purchase (on a non-exclusive basis) raw materials and component parts from the Parent Group, and the Parent Group has agreed to supply (on a non-exclusive basis) such raw materials and component parts to the Group.

The prices of raw materials and components supplied under the framework purchase agreement shall be:

- such prices as may be stipulated by the PRC government (if any); and if there are no such stipulated prices,
- prices not exceeding any pricing guidelines or pricing recommendations set by the PRC government (if any); and if there are no such pricing guidelines or recommendations,
- prices not exceeding market price; and if there is no market price for a particular product,
- an agreed price consisting of the actual or reasonable cost incurred by the Parent Group in supplying the product plus a reasonable profit.

The term of the framework purchase agreement is three years, renewable at the option of the Company for another term of three years by giving at least three months' notice prior to its expiry of the initial term. The framework purchase agreement may be terminated by either party by giving at least three months' notice.

The proposed annual caps, representing the maximum aggregate purchase price as agreed between the parties for the years of 2006, 2007 and 2008 are RMB 45.2 million, RMB 53.9 million and RMB 64.4 million, respectively. The Group's actual purchases from the Parent Group for the year ended 31 December 2006 amounted to RMB 38.1 million.

Framework Sales Agreement with Shanghai Electric Company

The Company entered into a framework sales agreement dated 31 March 2006 with Shanghai Electric Company, pursuant to which the Group has agreed to sell, on a non-exclusive basis, products from its turbine blade and cutting tool businesses, both finished and semi-finished, to Shanghai Electric Company.

Shanghai Electric Company is a subsidiary and therefore an associate of Shanghai Electric Corporation as defined under the Listing Rules. As such, any transaction entered or to be entered into between the Group and Shanghai Electric Company would constitute connected transactions pursuant to Chapter 14A of the Listing Rules.

The prices of the products sold to Shanghai Electric Company under the framework sales agreement shall be:

- such prices as may be stipulated by the PRC government (if any); and if there are no such stipulated prices,

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- prices not exceeding any pricing guidelines or pricing recommendations set by the PRC government (if any); and if there are no such pricing guidelines or recommendations,
- prices not exceeding market price; and if there is no market price for a particular product,
- an agreed price consisting of the actual or reasonable cost incurred by the Group in supplying the product plus a reasonable profit.

The term of the framework sales agreement is three years, renewable at the option of either party for another term of three years by giving at least three months' notice prior to its expiry of its initial term. The framework sales agreement may be terminated by either party by giving at least three months' notice.

The proposed annual caps, representing the maximum aggregate amount of sales as agreed between the parties for the years of 2006, 2007 and 2008 are RMB 230.0 million, RMB 282.6 million and RMB 345.1 million, respectively. The Group's actual sale to Shanghai Electric Company for the year ended 31 December 2006 amounted to RMB 224.4 million.

Continuing Connected Transaction with Shanghai Ruihua (Group) Company Limited ("Shanghai Ruihua")

Shanghai Ruihua is an associate of Sweden Ruihua Group Corporation, which is a substantial shareholder of Shanghai Nanyang Electric Motor Company Limited, a non-wholly owned subsidiary of the Company. As such Shanghai Ruihua is a connected person of the Group pursuant to Chapter 14A of the Listing Rules. The Company entered into a framework purchase agreement with Shanghai Ruihua, pursuant to which the Group agreed to purchase electric motors and related components from Shanghai Ruihua.

The Group's purchases from Shanghai Ruihua for the year ended 31 December 2006 amounted to RMB 1.7 million.



The independent non-executive directors of the Company have reviewed the continuing connected transactions set out above and in note 41 to the financial statements and have confirmed that these continuing connected transactions were entered into:

- (i) in the ordinary and usual course of business of the Group;
- (ii) on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; and
- (iii) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

Sufficiency of public float

Based on information that is publicly available to the Company and within the knowledge of the directors, at least 25% of the Company's total issued share capital was held by the public as at the date of this report.

Post balance sheet events

Details of the significant post balance sheet events of the Group are set out in note 43 to the financial statements.

Auditors

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the board

Zhou Zhiyan

Chairman
Shanghai, PRC
30 March 2007