Notes to Financial Statements

31 December 2006

1. CORPORATE INFORMATION

Shanghai Prime Machinery Company Limited (the "Company") is a joint stock limited liability company incorporated in the People's Republic of China (the "PRC") on 30 September 2005. The registered office of the Company as at the date of this report is located at Rooms 1401, 1406 to 1410, No. 511 Tianmu Xi Road, Shanghai, the PRC.

During the year, the Company and its subsidiaries (collectively referred to as the "Group") was principally involved in the design and sale of turbine blades, precision bearings, highly durable fasteners, numerical control machine cutting tools, small-to-medium sized electric motors and others, the provision of related technical services, domestic trade, the provision of manpower service, industrial investment, entrepot trade of goods and technical services.

In the opinion of the directors, the holding company and the ultimate holding company of the Company is Shanghai Electric (Group) Corporation ("Shanghai Electric Corporation"), a wholly state-owned enterprise established in the PRC.

In September 2005, Shanghai Electric Corporation underwent a reorganisation (the "Reorganisation"). Pursuant to the Reorganisation, Shanghai Electric Corporation and Shanghai Electric Industrial Corporation ("Shiye") entered into an investment agreement (the "Investment Agreement") with Shanghai Electric Assets Management Company Limited, Shanghai Electric Group Assets Operation Company Limited and Shanghai General Machinery (Group) Corporation (collectively the "Investors") to establish the Company in the PRC. Pursuant to the Investment Agreement, Shanghai Electric Corporation and Shiye contributed their equity interests in eight companies (the "Eight Companies"), including all of their corresponding assets and liabilities, except for certain land and buildings, with an aggregate carrying value of approximately RMB71,789,000 which were originally owned by one of the Eight Companies and transferred to Shanghai Electric Corporation (the "Net Assets"), and cash, in the amount of RMB 443,640,184 and RMB 301,000,000, respectively, as capital contribution. The remaining Investors contributed cash aggregating RMB 3,000,000 to the Company. The Net Assets also included the Eight Companies' then equity interests in their subsidiaries and associates, which, upon the capital contribution to the Company by Shanghai Electric Corporation and Shiye, became indirectly owned by the Company through its equity interests in the Eight Companies. Included in the Eight Companies were four subsidiaries (the "Four Subsidiaries"), a jointly-controlled entity (the "jointly-controlled entity") and three associates (the "Three Associates").

The values of the Net Assets of RMB 443,640,184, contributed by Shanghai Electric Corporation and Shiye were appraised by Shanghai Orient Appraisal Co., Ltd., an independent professionally qualified valuer in the PRC, on 26 September 2005 and 23 September 2005, respectively, by reference to the book values as at 31 August 2005. The capital contributions by the Investors totalling RMB 747,640,184 were certified on 26 September 2005 by Shanghai Certified Public Accountants Co., Ltd., an independent professionally qualified certified public accountant in the PRC. As a result of the above capital contributions by the Investors, Shanghai Electric Corporation, Shiye and the remaining Investors owned 96.132%, 3.466% and 0.402% of the paid-up capital of the Company, respectively.

Following the Reorganisation but prior to the listing of the Company's H Shares, the Company acquired the entire equity interest in Shanghai Biaowu High Tensile Fasteners Company Limited ("Biaowu Fasteners") from Shanghai Electric Corporation and one of its wholly owned subsidiaries by way of cash on 1 December 2005.

On 27 April 2006, the H shares of the Company were listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

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 derivative financial instruments, which have been measured at fair value. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

The consolidated financial statements have been prepared on a continuing basis as if the Reorganisation had been completed as at the beginning of the financial years presented. The consolidated financial statements include the Group's results of operations and cash flows as if the equity interests in the Eight Companies had been transferred to the Group at the beginning of the financial years presented. For the purpose of determining the capital contribution from Shanghai Electric Corporation and Shiye upon the incorporation of the Company, the Net Assets were transferred to the Company on 30 September 2005 (being the effective date of the Investment Agreement among the shareholders of the Company, the Assets Transfer Agreement among Shanghai Electric Corporation, Shiye and the Company, and the Articles of Association of the Company) at revalued amounts of RMB 443,640,184, as required and approved by the relevant PRC authorities. The Net Assets were recorded at their respective book values upon the capital contribution into the Company, with the difference between the revalued amounts of the Net Assets (being the Company's cost of investment in the Net Assets) and the aggregate amount of the paid-up capital of the Four Subsidiaries and the jointly-controlled entity attributable to the Group and the then carrying value of the Group's interests in the Three Associates upon the establishment of the Company recorded as contributed surplus in the consolidated balance sheet.

Except that the results of Biaowu Fasteners, which was acquired by cash on 1 December 2005, and those subsidiaries that were historically acquired or disposed of by the Eight Companies or their subsidiaries are consolidated using purchase method of accounting from or to their effective dates of acquisition or disposal, being the respective dates on which the Group obtained control or ceased to have control over such subsidiaries, the results of the companies comprising the Group were presented on a merger basis as described in the preceding paragraph.

In the opinion of the directors, the financial statements, prepared on the above basis, present fairly the results, cash flows and the state of affairs of the Group as a whole.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2006. Adjustments are made to bring into line any dissimilar accounting policies that may exist. 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 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

The principal changes are as follows:

(a) HKAS 21 The Effects of Changes in Foreign Exchange Rates

Upon the adoption of the HKAS 21 Amendment regarding a net investment in a foreign operation, all exchange differences arising from a monetary item that forms part of the Group's net investment in a foreign operation are recognised in a separate component of equity in the consolidated financial statements irrespective of the currency in which the monetary item is denominated. This change has had no material impact on these financial statements as at 31 December 2006 or 31 December 2005.

(b) HKAS 39 Financial Instruments: Recognition and Measurement

(i) Amendment for financial guarantee contracts

This amendment has revised the scope of HKAS 39 to require financial guarantee contracts issued that are not considered insurance contracts, to be recognised initially at fair value and to be remeasured at the higher of the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*. The adoption of this amendment has had no material impact on these financial statements.

(ii) Amendment for the fair value option

This amendment has changed the definition of a financial instrument classified as fair value through profit or loss and has restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through the income statement. The Group had not previously used this option, and hence the amendment has had no effect on the financial statements.

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (continued)

(b) HKAS 39 Financial Instruments: Recognition and Measurement (continued)

(iii) Amendment for cash flow hedge accounting of forecast intragroup transactions

This amendment has revised HKAS 39 to permit the foreign currency risk of a highly probable intragroup forecast transaction to qualify as a hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the consolidated income statement. As the Group currently has no such transactions, the amendment has had no effect on these financial statements.

(c) HK(IFRIC)-Int 4 Determining whether an Arrangement contains a Lease

The Group has adopted this interpretation as of 1 January 2006, which provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied. The adoption of this interpretation has had no material impact on these financial statements.

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	HKFRS2-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.

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

HKFRS 8 shall be applied for annual periods beginning on or after 1 January 2009. The standard requires an entity to adopt the "management approach" to report on the financial performance of its operating segments. Generally, the information to be reported would be that used internally for the purpose of evaluating segment performance and deciding resources allocation to operating segments. Such information may be different from what is used for preparing the income statement and balance sheet. HKFRS 8 therefore requires explanations of the basis on how the segment information is prepared and reconciled to the income statement and balance sheet.

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 8 and HKFRS 7 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.

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.

Joint venture companies

A joint venture is an entity set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture entity and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Joint venture companies (continued)

A joint venture company is treated as:

(a) a subsidiary, if the Group has unilateral control, directly or indirectly, over the joint venture;

(b) a jointly-controlled entity, if the Group does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;

(c) an associate, if the Group does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or

(d) an equity investment accounted for in accordance with HKAS 39, if the Group holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

Jointly-controlled entities

A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's investment in its jointly-controlled entity is accounted for by proportionate consolidation, which involves recognising its share of the jointly-controlled entity's assets, liabilities, income and expenses with similar items in the consolidated financial statements on a line-by-line basis. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of the jointly-controlled entity are included in the Company's income statement to the extent of dividends received and receivable. The Company's investment in its jointly-controlled entity is treated as non-current asset and is stated at cost less any impairment losses.

Associates

An associate is an entity, not being a subsidiary or a jointly-controlled entity, in which the Group has a long-term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of associates is included in the consolidated income statement and consolidated reserves, respectively. The Group's investments in associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in associates are treated as non-current assets and are stated at cost less any impairment losses.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Excess over the cost of business combinations

Any excess of the Group's interests in the net fair value of the acquirees' identifiable assets, liabilities and contingent liabilities over the cost of the acquisition of subsidiaries, after reassessment, is recognised immediately in the income statement.

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 value 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 and certain financial assets 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) the party, directly, or indirectly through one or more intermediaries, (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).

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. When an item of property, plant and equipment is classified as held for sale or when it is part of a disposal group classified as held for sale, it is not depreciated and is accounted for in accordance with HKFRS 5. 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 for this purpose are as follows:

Leasehold buildings	10 to 40 years
Machinery and equipment	5 to 20 years
Motor vehicles	5 to 10 years
Office and other equipment	3 to 10 years
Leasehold improvements	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.

Included in machinery and equipment is a spire-pressure machine (10KT-clutch mode) which is depreciated on the unit-of-production method to write off its cost to the residual value over its estimated working hours capacity.

Residual values, useful lives and depreciation methods 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 or retirement 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 property, plant and equipment under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment or investment properties when completed and ready for use.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets (other than goodwill)

The useful lives of intangible assets are assessed to be either finite or indefinite. 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.

Patents and licences

Purchased patents and licences are stated at cost less any impairment losses and are amortised on the straight-line basis over their estimated useful lives of 10 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.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products not exceeding 10 years, commencing from the date when the products are put into commercial production.

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 net of any incentives received from the lessor are charged to the income statement on the straight-line basis over the lease terms.

Prepaid land premiums/land lease payments under operating leases are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms. The lease terms of prepaid land premiums range from 20 to 50 years.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivative 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.

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. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on these financial assets are recognised in the income statement.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial asset at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in 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.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

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 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 value is determined 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 other valuation 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 loans and 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.

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.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Assets carried at amortised cost (continued)

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 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 (or, where applicable, a part of a financial asset or part of a group of similar financial assets) 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.

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 that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, 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 loans and borrowings)

Financial liabilities including trade and other payables, an amount due to the ultimate holding company and interest-bearing loans and borrowings 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.

Financial guarantee contracts

Financial guarantee contracts in the scope of HKAS 39 are accounted for as financial liabilities. A financial guarantee contract is recognised initially at its fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial guarantee contract, except when such contract is recognised at fair value through profit or loss. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 Provision, Contingent Liabilities and Contingent Assets; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 Revenue.

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 the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivative financial instruments

The Group uses derivative financial instruments such as forward currency contracts to hedge its risks associated with foreign currency fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the income statement.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

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.

Contracts for services

Contract revenue on the rendering of services comprises the agreed contract amount. Costs of rendering services comprise labour and other costs of personnel directly engaged in providing the services and attributable overheads.

Revenue from the rendering of services is recognised based on the percentage of completion of the transaction, provided that the revenue, the costs incurred and the estimated costs to completion can be measured reliably. The percentage of completion is established by reference to the costs incurred to date as compared to the total costs to be incurred under the transaction.

Provision is made for foreseeable losses as soon as they are anticipated by management.

Where contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is treated as an amount due from contract customers.

Where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is treated as an amount due to contract customers.

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 sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits which are not restricted as to use.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Provisions for product warranties granted by the Group on certain products are recognised based on sales volume and past experience of the level of repairs and returns, discounted to their present values as appropriate.

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 in the same or a different period directly in equity.

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 liabilities 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 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 interests in subsidiaries, investment in jointly-controlled entity and associates, 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 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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

- in respect of deductible temporary differences associated with interests in subsidiaries, investments in jointly-controlled entity and associates, 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.

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 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

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

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) from the rendering of services, on the percentage of completion basis, as further explained in the accounting policy for "Contracts for services" above ;

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

(d) 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; and

(e) dividend income, when the shareholders' right to receive payment has been established.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Retirement benefits

The Group, jointly-controlled entity and associates participate in a government-regulated defined contribution pension scheme, under which the Group, jointly-controlled entity and associates pay contributions to a government-regulated pension scheme at a fixed percentage of wages and salaries of the existing full-time employees in the PRC and have no further legal or constructive obligations to pay additional contributions. The contributions are charged as an expense to the income statement as incurred. Details of the government-regulated pension scheme are set out in note 6(i) below.

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.

Foreign currencies

The financial records of the Group, jointly-controlled entity and associates are maintained and these financial statements are presented in RMB, which is the functional and presentation currency of the Group, jointly-controlled entity and associates.

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. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

3. SIGNIFICANT ACCOUNTING ESTIMATES

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 disclosed below.

(i) Deferred tax assets

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. Where the actual or expected tax positions of the relevant companies of the Group in future are different from the original estimate, such differences will impact the recognition of deferred tax assets and income tax charge in the period in which such estimate has been changed.

(ii) Write-down of inventories to net realisable value

Write-down of inventories to net realisable value is made based on the ageing and estimated net realisable value of inventories. The assessment of the write-down amount required involves management's 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 write-down charge/reversal in the period in which such estimate has been changed.

(iii) Impairment of trade receivables

Impairment of trade receivables is made based on assessment of the recoverability of trade receivables and other receivables. The identification of impairment of trade receivables requires management's 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 impairment loss/reversal of impairment in the period in which such estimate has been changed.

(iv) Impairment of property, plant and equipment

The carrying value of property, plant and equipment is reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable in accordance with the accounting policy as disclosed in the relevant part of these consolidated financial statements. The recoverable amount of property, plant and equipment is calculated as the higher of its fair value less costs to sell and value in use, the calculations of which involve the use of estimates.

4. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provided. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments.

Summary details of the business segments are as follows:

(i) the bearing segment is engaged in the production and sale of bearings;

(ii) the turbine blade segment is engaged in the production and sale of turbine blades;

(iii) the cutting tool segment is engaged in the production and sale of cutting tools;

(iv) the fastener segment is engaged in the production and sale of fasteners;

(v) the electric motor segment is engaged in the production and sale of electric motors; and

(vi) "others" refers to investment in an associate, which is engaged in the production and sales of carbolic products, and trading activities carried out by the Company.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers. No further geographical segments based on the location of the assets are presented as the Group's operations and assets are solely located in the PRC.

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.

4. SEGMENT INFORMATION (continued)

Business segments

The following tables present revenue, profit and certain asset, liability and expenditure information on the Group 's business segments for the years ended 31 December 2006 and 2005:

Year ended 31 December 2006	Bearing *RMB'000*	Turbine blade *RMB'000*	Cutting tool *RMB'000*	Fastener *RMB'000*	Electric motor *RMB'000*	Others *RMB'000*	Elimination *RMB'000*	Total *RMB'000*
Segment revenue:								
Sales to external customers	248,364	575,454	362,151	1,268,051	390,424	22,827	-	2,867,271
Inter-segment sales	-	-	-	-	-	23,988	(23,988)	-
Other revenue	1,513	13,502	27,075	3,186	8,868	-	-	54,144
Total	249,877	588,956	389,226	1,271,237	399,292	46,815	(23,988)	2,921,415
Segment results	29,364	137,463	67,476	65,396	20,524	907	-	321,130
Interest and dividend income and unallocated gains								46,736
Corporate and other unallocated expenses								(24,826)
Finance costs								(18,826)
Share of profits and losses of associates	8,569	-	(1,710)	-	-	5,072		11,931
Profit before tax								336,145
Tax								(97,899)
Profit for the year								238,246
Assets and liabilities								
Segment assets	288,496	650,788	436,113	496,946	446,941	143,940	(290,939)	2,172,285
Investments in associates	46,759	-	5,889	-	-	17,754	-	70,402
Corporate and other unallocated assets								1,023,404
Total assets								3,266,091
Segment liabilities	125,945	109,995	115,799	253,909	193,537	218,927	(290,939)	727,173
Corporate and other unallocated liabilities								110,030
Total liabilities								837,203
Other segment information:								
Depreciation and amortisation	5,726	28,437	15,401	11,752	13,781	276	-	75,373
Capital expenditure	20,420	132,451	8,936	23,498	38,393	5,837	-	229,535
Impairment losses recognised in the income statement	93	-	-	-	-	-	-	93
Other non-cash expenses	2,049	1,781	(6,208)	483	1,860	-	-	(35)

4. SEGMENT INFORMATION (continued)

Business segments (continued)

Year ended 31 December 2005	Bearing *RMB'000*	Turbine blade *RMB'000*	Cutting tool *RMB'000*	Fastener *RMB'000*	Electric motor *RMB'000*	Other *RMB'000*	Elimination *RMB'000*	Total *RMB'000*
Segment revenue:								
Sales to external customers	220,024	500,992	316,058	67,818	318,870	1,586	-	1,425,348
Inter-segment sales	-	-	-	-	-	1,586	(1,586)	-
Other revenue	2,580	6,852	17,300	-	2,873	-	-	29,605
Total	222,604	507,844	333,358	67,818	321,743	3,172	(1,586)	1,454,953
Segment results	13,487	114,669	47,400	6,216	24,930	32	-	206,734
Interest and dividend income and unallocated gains								5,260
Corporate and other unallocated expenses								(2,372)
Finance costs								(17,202)
Share of profits and losses of associates	5,228	-	(302)	-	-	3,599		8,525
Profit before tax								200,945
Tax								(55,481)
Profit for the year								145,464
Assets and liabilities								
Segment assets	214,127	497,915	319,111	305,077	350,758	5,017	(1,856)	1,690,149
Investments in associates	38,191	-	7,247	-	-	20,342	-	65,780
Corporate and other unallocated assets								43,351
Total assets								1,799,280
Segment liabilities	88,158	297,787	215,732	105,351	174,814	-	(1,856)	879,986
Corporate and other unallocated liabilities								104,515
Total liabilities								984,501
Other segment information:								
Depreciation and amortisation	5,751	24,768	17,990	889	11,538	-	-	60,936
Capital expenditure	27,296	54,360	5,469	131,290	77,537	-	-	295,952
Impairment losses recognised in the income statement	548	-	267	-	-	-	-	815
Impairment losses reversed in the income statement	(20)	-	-	-	-	-	-	(20)
Other non-cash expenses	1,291	1,224	(2,756)	210	1,042	-	-	1,011

4. SEGMENT INFORMATION (continued)

Geographical segments

The following table presents revenue information on the Group's geographical segments for the years ended 31 December 2006 and 2005:

	2006	2005
	RMB'000	*RMB'000*
Sales to external customers:		
PRC	1,518,588	1,261,315
Outside PRC	1,348,683	164,033
Total	2,867,271	1,425,348

5. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Group's turnover, represents the net invoiced value of goods sold, after allowances for returns and trade discounts, and the value of services rendered during the year, net of sales taxes and surcharges.

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

	Note	2006	2005
		RMB'000	*RMB'000*
Revenue			
Sales of goods		2,856,028	1,407,943
Rendering of services		11,243	17,405
		2,867,271	1,425,348
Other income			
Dividend income from available-for-sale investments		1,269	35
Interest income from over-subscription funds		36,772	-
Interest income from bank balances and deposits		33,703	1,581
Interest income for loans receivable		717	114
Gross rental income		2,058	1,969
Profit on sales of raw materials, spare parts and semi -finished goods		10,832	10,102
Subsidy income		4,257	6,429
Compensation income		1,675	373
Others		4,729	2,080
		96,012	22,683
Gains			
Gain/(loss) on disposal of items of property, plant and equipment, net		3,106	(806)
Gain on disposal of a subsidiary	36	-	4,477
Gain on disposal of an associate		-	265
Gain on disposal of available-for-sale investments		-	2,062
Gain on assets contributed to an associate		-	2,599
Gain from debt restructuring		28,381	55
Excess over the cost of a business combination	35	-	3,530
Gain on disposal of financial investments *		1,715	-
Fair value gains, net: derivatives financial instruments		1,615	-
Foreign exchange differences, net **		(29,949)	-
		4,868	12,182
		100,880	34,865

* Included in the total amount of gain on disposal of financial investments, RMB 1,179,000 related to overseas investment. The overseas investment represented an assets management agreement with a total amount of HK$ 100 million entered into with a 40%-owned associate of a company, which is 49% indirectly owned by Shanghai Electric Corporation, during the year. The overseas investment had a return rate of 10% per annum and the Group has received the investment income and the principal thereof as of 31 December 2006.

** The exchange losses have been included in the same item disclosed in note 6.

6. PROFIT BEFORE TAX

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

	2006	2005
	RMB'000	*RMB'000*
Cost of inventories sold	2,334,079	1,043,619
Cost of services provided	11,077	16,189
Depreciation	71,669	58,482
Recognition of prepaid land premiums/land lease payments	943	194
Amortisation of patents and licences *	2,218	2,114
Amortisation of other intangible assets *	543	146
Write-down/(reversal of write-down) of inventories to net realisable value	799	(164)
Research and development costs: *		
Current year expenditure	16,937	2,752
Minimum lease payments under operating leases:		
Land and buildings	17,014	5,233
Plant and machinery	1,981	3,081
Vehicles	2,377	2,341
Auditors' remuneration:		
Audit services	4,869	1,209
Non-audit services	1,370	-
Employee benefits expenses (including directors' and supervisors' remuneration - note 8):		
Wages and salaries	205,590	151,512
Defined contribution pension scheme (note i)	26,722	22,301
Early retirement benefits (note ii)	-	121
Medical benefits (note iii)	7,968	7,758
Housing fund (note iv)	8,440	6,733
Cash housing subsidies costs	41	113
	248,761	188,538
Foreign exchange differences, net	37,860	1,295
Impairment/(reversal of impairment) of trade receivables*	(834)	1,175
Impairment of property, plant and equipment *	93	528
Impairment of investments in associates *	-	267
Loss from debt restructuring *	106	215

*These items are included in "Other expenses" on the face of the consolidated income statement of the Group.

6. PROFIT BEFORE TAX (continued)

Notes:

(i) Defined contribution pension scheme

All of the Group's full-time employees in the PRC are covered by a government-regulated pension scheme and are entitled to an annual pension determined by their basic salaries upon their retirement. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated pension scheme at 22% of the employees' basic salaries subject to a cap. The related pension costs are expensed as incurred.

(ii) Early retirement benefits

The Group implemented an early retirement plan for certain employees in addition to the benefits under the government regulated defined contribution pension scheme described above. The benefits of the early retirement plan are calculated based on factors including the remaining number of years of services from date of early retirement to normal retirement date and the salary amount on the date of early retirement of the employees.

Wuxi Turbine Blade Company Limited ("Wuxi Turbine Blades") and Shanghai Electric Corporation have agreed that the costs of early retirement benefits for those employees who early retired before 1 September 2005 will be borne by Shanghai Electric Corporation from 1 September 2005 onwards, being the following day of the reference date for valuation of the Net Assets contributed by Shanghai Electric Corporation and Shiye to the Company as mentioned in note 1. Beginning from that date the related costs paid by Wuxi Turbine Blades will be fully reimbursed by Shanghai Electric Corporation. The total costs of early retirement benefits so borne by Shanghai Electric Corporation were approximately RMB 14 million, of which RMB 3,357,000 was related to the year ended 31 December 2006.

Taking into consideration of the above, the costs of early retirement benefits have been recognised in the period when employees opted for early retirement.

(iii) Medical benefits

The Group contributes on a monthly basis to defined contribution medical benefit plans administrated by the PRC government. The PRC government undertakes to assume the medical benefit obligations of all existing and retired employees under these plans. Contributions to these plans by the Group are expensed as incurred. The Group has no further obligations for medical benefits for their qualified employees under these plans.

(iv) Housing fund

The Group contributes on a monthly basis to defined contribution housing fund plans administrated by the PRC government. Contributions to these plans by the Group are expensed as incurred.

7. FINANCE COSTS

	2006	2005
	RMB'000	*RMB'000*
Interest on bank and other loans wholly repayable within five years	18,826	17,202

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	Directors		Supervisors	
	2006	2005	2006	2005
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Fees	457	-	-	-
Other emoluments:				
Salaries, housing benefits, other allowances and benefits in kind	687	631	360	338
Performance related bonuses	1,217	757	130	179
Pension scheme contributions	83	150	34	17
Total	2,444	1,538	524	534

(a) Independent non-executive directors

The fees paid to independent non-executive directors during the year were as follows:

	2006	2005
	RMB'000	*RMB'000*
Chan Chun Hong, Thomas	183	-
Zhou Feida	137	-
Liu Huangsong	137	-
	457	-

There were no other emoluments payable to the independent non-executive directors during the year (2005: Nil).

8. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

(b) Executive directors and supervisors

	Salaries, housing benefits, other allowances and benefits in kind	Performance related bonuses	Pension scheme contributions	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
2006				
Executive directors:				
Zhou Zhiyan	-	-	-	-
Yan Qi	220	269	15	504
Hu Kang	125	308	17	450
Chen Hui	118	171	17	306
Xia Sicheng	85	220	17	322
Huang Wennong	139	249	17	405
	687	1,217	83	1,987
Supervisors:				
Chen Jiaming	-	-	-	-
Hu Peiming	68	130	17	215
Lin Guanhong	292	-	17	309
	360	130	34	524
	1,047	1,347	117	2,511
2005				
Executive directors:				
Zhou Zhiyan	76	135	10	221
Yan Qi	112	84	82	278
Hu Kang	78	148	10	236
Chen Hui	124	91	16	231
Xia Sicheng	95	150	16	261
Huang Wennong	146	149	16	311
	631	757	150	1,538
Supervisors:				
Chen Jiaming	39	78	5	122
Hu Peiming	65	101	6	172
Lin Guanhong	234	-	6	240
	338	179	17	534
	969	936	167	2,072

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

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included two (2005: five) directors or supervisors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining three (2005: Nil) non-director and non-supervisor, highest paid employees for the year are as follows:

	2006	2005
	RMB'000	*RMB'000*
Salaries, housing benefits, other allowances and benefits in kind	1,462	-
Pension scheme contributions	48	-
	1,510	-

The remuneration of each of three non-director and non-supervisor, highest paid employees does not exceed RMB 1,000,000.

10. TAX

Except for the following companies, the Group is subject to a statutory corporate income tax rate of 33% for the year under the income tax rules and regulations of the PRC:

- Shanghai United Bearings Company Limited ("United Bearings") is subject to a corporate income tax rate of 27% as it is located in a coastal economic and technology development area and special economic region with foreign investment in the production business in the old city area;

- Shanghai Tian An Bearing Company Limited ("Tian An Bearings") was subject to a corporate income tax rate of 27% up to 31 August 2005 as it was located in a coastal economic and technology development area and special economic region with foreign investment in the production business in the old city area. From 1 September 2005 onwards, Tian An Bearings ceases to be a foreign investment enterprise and its applicable tax rate is 33%; and

- Shanghai Nanyang Electric Motor Company Limited ("Nanyang Motor") is subject to a corporate income tax rate of 27% as it was established in the Nan Xiang Industrial Zone, Jia Ding District, Shanghai.

In addition, foreign investment manufacturing enterprises are further exempt from PRC State corporate income tax for two years starting from the first year they make assessable profits, after deducting the tax losses carried forward, and are granted a 50% reduction in tax for the three years thereafter. During the year, certain of the companies of the Group were entitled to such tax concessions.

No provision for Hong Kong profits tax has been made as the Group had no assessable profits arising in Hong Kong for the year.

10. TAX (continued)

	2006 RMB'000	2005 RMB'000
Group:		
Current -the PRC		
Charge for the year	89,307	46,955
Under provision/(over provision) in prior years	(1,607)	8
Deferred (note 21)	10,199	8,518
Total tax charge for the year	97,899	55,481

A reconciliation of the tax expense applicable to profit before tax using the statutory rate of 33% to the tax expense at the effective tax rate is as follows:

	2006 RMB'000	2005 RMB'000
Profit before tax	336,145	200,945
Tax at the statutory tax rate of 33%	110,928	66,312
Lower tax rate for specific provinces/districts or concessions	(4,849)	(7,693)
Adjustments in respect of current tax of previous periods	(1,607)	8
Profits and losses attributable to associates	(2,818)	(2,913)
Income not subject to tax	(5,414)	(2,438)
Expenses not deductible for tax	1,659	2,205
Total income tax charge for the year	97,899	55,481
The Group's effective income tax rate	29.1%	27.6%

The share of tax attributable to associates amounting to RMB 2,897,000 (2005: RMB 2,495,000) is included in "Share of profits and losses of associates" on the face of the consolidated income statements.

11. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated profit attributable to equity holders of the Company for the year ended 31 December 2006 includes a profit of RMB 24,335,000 (30 September 2005 (date of incorporation) to 31 December 2005: loss of RMB 693,000) which has been dealt with in the financial statements of the Company (note 34(b)).

12. DIVIDENDS

	2006 RMB'000	2005 RMB'000
Proposed final -RMB 4 cents (2005: Nil) per ordinary share	57,531	-

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

13. EARNINGS PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The calculation of basic earnings per share amounts for the year ended 31 December 2006 is based on the profit for the year attributable to ordinary equity holders of the Company of RMB 231,116,000, and the weighted average number of ordinary shares in issue during the year of 1,217,559,000 shares, as adjusted to reflect the shares issued pursuant to the global offering.

The calculation of basic earnings per share amounts for the year ended 31 December 2005 is based on the profit for that year attributable to equity holders of the Company on the assumption that 747,640,184 shares, representing the number of shares of the Company outstanding immediately before the Global Offering, had been in issue throughout that year.

No diluted earnings per share amounts have been presented for the years ended 31 December 2006 and 2005 as no diluting events occurred during these years.

14. PROPERTY, PLANT AND EQUIPMENT

Group

	Notes	Leasehold buildings RMB'000	Machinery and equipment RMB'000	Motor vehicles RMB'000	Office and other equipment RMB'000	Construction in progress RMB'000	Leasehold improvements RMB'000	Total RMB'000
31 December 2006								
Cost:								
At 1 January 2006		159,540	817,987	22,127	20,063	40,948	3,896	1,064,561
Additions		568	6,235	5,630	2,376	195,772	-	210,581
Disposals		(766)	(30,679)	(3,896)	(4,331)	(2,048)	-	(41,720)
Transfers		10,223	113,003	3,456	871	(127,553)	-	-
At 31 December 2006		169,565	906,546	27,317	18,979	107,119	3,896	1,233,422
Accumulated depreciation and impairment:								
At 1 January 2006		32,649	372,324	10,556	9,499	1,589	1,491	428,108
Depreciation		6,122	59,472	3,081	2,248	-	746	71,669
Impairment recognised		-	-	3	-	90	-	93
Disposals		(273)	(30,656)	(1,634)	(3,732)	(1,385)	-	(37,680)
At 31 December 2006		38,498	401,140	12,006	8,015	294	2,237	462,190
Net book value:								
At 31 December 2006		131,067	505,406	15,311	10,964	106,825	1,659	771,232
31 December 2005								
Cost:								
At 1 January 2005		273,769	626,868	12,825	14,555	11,056	3,896	942,969
Additions		2,505	63,902	4,333	3,681	78,890	-	153,311
Acquisition of a subsidiary	35	15,075	107,465	4,360	2,196	3,164	-	132,260
Disposals		(132,608)	(19,062)	(1,242)	(1,857)	(441)	-	(155,210)
Disposal of a subsidiary	36	-	(8,278)	(291)	(200)	-	-	(8,769)
Transfers		799	47,092	2,142	1,688	(51,721)	-	-
At 31 December 2005		159,540	817,987	22,127	20,063	40,948	3,896	1,064,561

14. PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

	Notes	Leasehold buildings RMB'000	Machinery and equipment RMB'000	Motor vehicles RMB'000	Office and other equipment RMB'000	Construction in progress RMB'000	Leasehold improvements RMB'000	Total RMB'000
Accumulated depreciation and impairment:								
At 1 January 2005		55,524	326,073	7,789	8,724	1,609	691	400,410
Depreciation		9,364	44,682	1,864	1,772	-	800	58,482
Acquisition of a subsidiary	35	-	20,706	1,624	162	-	-	22,492
Impairment recognised/(reversed)		-	-	548	-	(20)	-	528
Disposals		(32,239)	(13,632)	(989)	(1,020)	-	-	(47,880)
Disposal of a subsidiary	36	-	(5,505)	(280)	(139)	-	-	(5,924)
At 31 December 2005		32,649	372,324	10,556	9,499	1,589	1,491	428,108
Net book value:								
At 31 December 2005		126,891	445,663	11,571	10,564	39,359	2,405	636,453

Company

	Motor vehicles RMB'000	Office and other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
31 December 2006				
Cost:				
At 1 January 2006	-	-	-	-
Additions	1,285	2,897	1,961	6,143
At 31 December 2006	1,285	2,897	1,961	6,143
Accumulated depreciation and impairment:				
At 1 January 2006	-	-	-	-
Depreciation provided	28	281	-	309
At 31 December 2006	28	281	-	309
Net book value:				
At 31 December 2006	1,257	2,616	1,961	5,834

The details of the Group's property, plant and equipment pledged for interest-bearing loans and borrowings granted to the Group are set out in note 32.

As at 31 December 2006, the Group had not obtained real estate certificates or building ownership certificates for certain buildings with net book value of approximately RMB 5,638,000 (2005: RMB 84,983,000).

15. PREPAID LAND PREMIUMS/LAND LEASE PAYMENTS

Group

	Note	2006	2005
		RMB'000	*RMB'000*
At cost:			
At beginning of year		30,037	8,712
Additions		17,784	15,150
Acquisition of a subsidiary	35	-	14,887
Disposals		-	(8,712)
At end of year		47,821	30,037
Accumulated amortisation:			
At beginning of year		50	1,565
Recognised		943	194
Disposals		-	(1,709)
At end of year		993	50
Net book value:			
At end of year		46,828	29,987
Of which:			
Current portion included in prepayments, deposits and other receivables (note 25)		968	613
Non-current portion		45,860	29,374
		46,828	29,987

The Group's leasehold lands are all situated in the PRC and are held under the following lease terms:

	2006	2005
	RMB'000	*RMB'000*
At cost:		
Medium-term leases	32,514	30,037
Long-term leases	15,307	-

16. INTANGIBLE ASSETS

Group

	Note	Patents and licences	Others	Total
		RMB'000	*RMB'000*	*RMB'000*
31 December 2006				
At cost:				
At 1 January 2006		22,181	1,741	23,922
Additions		-	1,170	1,170
At 31 December 2006		22,181	2,911	25,092
Accumulated amortisation:				
At 1 January 2006		3,157	172	3,329
Amortisation provided		2,218	543	2,761
At 31 December 2006		5,375	715	6,090
Net book value:				
At 31 December 2006		16,806	2,196	19,002
31 December 2005				
At cost:				
At 1 January 2005		20,861	225	21,086
Additions		-	1,516	1,516
Acquisition of a subsidiary	35	1,320	-	1,320
At 31 December 2005		22,181	1,741	23,922
Accumulated amortisation:				
At 1 January 2005		1,043	26	1,069
Amortisation provided		2,114	146	2,260
At 31 December 2005		3,157	172	3,329
Net book value:				
At 31 December 2005		19,024	1,569	20,593

17. INTERESTS IN SUBSIDIARIES

Company

	2006 *RMB'000*	2005 *RMB'000*
Unlisted investments, at cost	1,064,963	564,963
Due from a subsidiary	53,111	150,275
	1,118,074	715,238

The Company's trades payable and other payables and accruals with subsidiaries are disclosed in notes 29 and 31. The amount due from a subsidiary included in the interests in subsidiaries above aggregating RMB 53,111,000 (2005: RMB 150,275,000) are in respect of non-trade balance, which is unsecured, non-interest-bearing and has no fixed terms of repayment and is therefore classified as non-current. In the opinion of the Company's directors, these advances are considered as quasi-equity loans to the subsidiary. The carrying amount of the balance approximates its fair value.

Particulars of the subsidiaries of the Group are as follows:

Name	Place of incorporation/ registration and operations	Registered capital (in '000)	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Shanghai Tian An Bearing Company Limited * 上海天安軸承有限公司	PRC	USD12,616	99%	-	Production and sale of precision and other bearings and ancillary appliances
Wuxi Turbine Blade Company Limited 無錫透平葉片有限公司	PRC	RMB355,460	99.49%	0.51%	Production and sale of turbine blades
Shanghai Tool Works Company Limited 上海工具廠有限公司	PRC	RMB265,113	99.74%	0.26%	Production and sale of cutting tools and accesories
Shanghai Biaowu High Tensile Fasteners Company Limited 上海標五高強度緊固件有限公司	PRC	RMB233,100	98.93%	1.07%	Production and sale of high tensile fasteners and related equipment
Shanghai Nanyang Electric Motor Company Limited * 上海南洋電機有限公司	PRC	USD19,000	60%	-	Production and sale of electric motors and accesories
Shanghai Tool Works Sales Company Limited 上海工具廠銷售有限公司	PRC	RMB8,140	-	92.81%	Sale of tools, measures and hardware

*Sino-foreign equity joint venture.

18. INVESTMENT IN A JOINTLY-CONTROLLED ENTITY

Group

The Group's balances of trade receivables, prepayments, deposits and other receivables and entrusted loan with its jointly-controlled entity are disclosed in notes 23, 25 and 26, respectively.

Particulars of the jointly-controlled entity of the Group are as follows:

Name	Place of incorporation/ registration and operations	Registered capital (in '000)	Percentage of Ownership interest	Percentage of Voting power	Percentage of Profit sharing	Principal activities
Shanghai United Bearings Company Limited * 上海聯合滾動軸承有限公司	PRC	USD7,800	50%	50%	50%	Production and sale of bearings and related specific equipment

*United Bearings is a Sino-foreign equity joint venture and its equity interests are directly owned by the Company.

The following table illustrates the summarised financial information of the Group's jointly-controlled entity:

	2006 *RMB'000*	2005 *RMB'000*
Share of the jointly-controlled entity's assets and liabilities:		
Current assets	64,563	44,232
Non-current assets	35,909	20,637
Current liabilities	(77,539)	(48,780)
Net assets	22,933	16,089
Share of the jointly-controlled entity's results:		
Revenue	110,476	88,051
Other income	1,209	970
Total revenue	111,685	89,021
Total expenses	(103,471)	(88,252)
Tax	(1,370)	(214)
Profit after tax	6,844	555

Company

	2006 *RMB'000*	2005 *RMB'000*
Unlisted investment, at cost	16,260	16,260

The Company's balance of trade receivables, prepayments, deposits and other receivables and entrusted loan with its jointly-controlled entity are disclosed in notes 23, 25 and 26, respectively.

19. INVESTMENTS IN ASSOCIATES

Group

	2006	2005
	RMB'000	*RMB'000*
Share of net assets	70,402	65,780

The Group's balances of trade receivables, prepayments, deposits and other receivables and trade payables with its associates are disclosed in notes 23, 25 and 29.

Particulars of the associates of the Group are as follows:

Name	Place of incorporation/ registration and operations	Registered capital (in '000)	Percentage of ownership interest attributable to the Group	Principal activities
Shanghai General Bearing Company Limited i, ii 上海通用軸承有限公司	PRC	USD8,750	40%	Production and sale of bearings and spare parts
Shanghai Bearing Import & Export Company Limited ii 上海軸承進出口有限公司	PRC	RMB3,000	30%	Import and export of commodities and technology
Shanghai Morgan Carbon Crucible Company Limited i, ii 上海摩根碳製品有限公司	PRC	USD7,972	30%	Production and sale of carbolic products
S.U. Machine Tool (Shanghai) Company Limited i 上優機床工具（上海）有限公司	PRC	EUR2,500	40%	Design, production and sale of numerical control machine tools with three dimensions and above, and related tools

i. Sino-foreign equity joint venture
ii. The equity interests of these companies are directly owned by the Company.

The following table illustrates the summarised financial information of the Group's associates:

	2006	2005
	RMB'000	*RMB'000*
Assets	406,023	309,067
Liabilities	(197,195)	(124,753)
Revenue	648,932	573,095
Profit	36,105	22,535

Company

	2006	2005
	RMB'000	*RMB'000*
Unlisted investments, at cost	68,321	68,321

20. AVAILABLE-FOR-SALE INVESTMENTS

	2006 RMB'000	2005 RMB'000
Unlisted investments, at cost	6,263	6,263

All the available-for-sale investments are in the PRC. Unlisted equity investments are stated at cost because the range of reasonable fair value estimates is so significant that the directors are of the opinion that their fair value cannot be measured reliably.

21. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

Group

Deferred Tax Assets

	Losses available for offset against future taxable profit RMB'000	Impairment of assets RMB'000	Depreciation in excess of related depreciation allowance RMB'000	Others RMB'000	Total RMB'000
At 1 January 2006	391	39,380	2,758	3,756	46,285
Credited/(charged) to the income statement during the year (note 10)	142	(1,543)	1,238	1,447	1,284
At 31 December 2006	533	37,837	3,996	5,203	47,569
Offset by deferred tax liabilities					(533)
Net deferred tax assets at 31 December 2006					47,036

Deferred Tax Liabilities

	Fair value adjustments arising from				
	Derivative financial instruments RMB'000	Acquisition of a subsidiary RMB'000	Interest income from oversubscription funds RMB'000	Unremitted earnings RMB'000	Total RMB'000
At 1 January 2006	-	1,603	-	869	2,472
Charged/(credited) to the income statement during the year (note 10)	533	(163)	9,708	1,405	11,483
At 31 December 2006	533	1,440	9,708	2,274	13,955
Offset by deferred tax assets					(533)
Net deferred tax liabilities at 31 December 2006					13,422

	Losses available for offset against future taxable profit	Impairment of assets	Tax credits	Early retirement benefits	Depreciation in excess of related depreciation	Others	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
At 1 January 2005	98	36,792	8,066	430	-	3,016	48,402
Credited/(charged) to the income statement during the year (note 10)	293	(158)	(8,066)	(430)	(28)	740	(7,649)
Acquisition of a subsidiary (note 35)	-	2,746	-	-	2,786	-	5,532
At 31 December 2005	391	39,380	-	-	2,758	3,756	46,285
Offset by deferred tax liabilities							(341)
Net deferred tax assets at 31 December 2005							45,944

	Fair value adjustments arising from acquisition of a subsidiary	Unremitted earnings	Total
	RMB'000	*RMB'000*	*RMB'000*
At 1 January 2005	-	-	-
Business combination (note 35)	1,603	-	1,603
Charged to the income statement during the year (note10)	-	869	869
Gross deferred tax liabilities at 31 December 2005	1,603	869	2,472
Offset by deferred tax assets			(341)
Net deferred tax liabilities at 31 December 2005			2,131

22. INVENTORIES

Group

	2006	2005
	RMB'000	*RMB'000*
Raw materials	140,963	108,250
Work in progress	139,588	142,757
Finished goods	249,140	201,320
	529,691	452,327

Company

	2006	2005
	RMB'000	*RMB'000*
Raw materials	4,832	-

23. TRADE RECEIVABLES

The Group's trading terms with customers are mainly on credit, except for new customers, where payment in advance or cash on delivery is normally required. The credit period is generally for a period of less than three months. In view of the aforementioned and that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. Trade receivables are non-interest-bearing.

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

Group

	2006	2005
	RMB'000	*RMB'000*
Within 3 months	307,106	207,687
Over 3 months but within 6 months	15,800	11,587
Over 6 months but within 1 year	10,258	9,843
Over 1 year but within 2 years	3,278	903
Over 2 years	45	86
	336,487	230,106

23. TRADE RECEIVABLES (continued)

The amounts due from a jointly-controlled entity, associates, the related companies over which Shanghai Electric Corporation is able to exert control or significant influence ("SEC group companies") and other related companies included in the above can be analysed as follows:

	2006 *RMB'000*	2005 *RMB'000*
Due from a jointly-controlled entity	8,627	1,856
Due from associates	115	300
Due from SEC group companies	2,548	23,174
Due from other related companies	596	-
	11,886	25,330

Company

	2006 *RMB'000*	2005 *RMB'000*
Within 3 months	142,886	28,111
Over 3 months but within 6 months	4,212	-
	147,098	28,111

The amount due from a jointly-controlled entity of RMB 17,254,000 (2005: RMB 3,712,000) is included in the Company's trade receivables.

The Group's and Company's balances with related parties are unsecured, non-interest-bearing and are repayable on similar credit terms to those offered to the major customers of the Group.

24. BILLS RECEIVABLE

The maturity profiles of the bills receivable of the Group are as follows:

	2006 *RMB'000*	2005 *RMB'000*
Within 3 months	31,153	11,094
Over 3 months but within 6 months	40,830	4,421
	71,983	15,515

Included in the above balances were bills of RMB 7,375,000 (2005: RMB 100,000) issued by SEC group companies.

The balances are unsecured, non-interest-bearing and are repayable as the bills fall due.

25. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

Group

	2006	2005
	RMB'000	*RMB'000*
Prepayments as purchase deposits	32,008	30,165
Receivables for sales of non-trade assets	755	241
Utility deposits	3,996	4,513
Prepaid land premiums/land lease payments	968	613
Value-added tax refundables and prepaid value-added tax	29,126	8,311
Other receivables	17,236	12,448
Due from a jointly-controlled entity	10,308	130
Due from associates	1,183	2,205
Due from ultimate holding company	3,357	1,040
Due from SEC group companies	3,374	3,307
Due from other related companies	5,477	-
	107,788	62,973

Company

	2006	2005
	RMB'000	*RMB'000*
Prepayments as purchase deposits	3,763	1,306
Other receivables	40,166	4,870
Due from a jointly-controlled entity	20,615	-
Due from subsidiaries	407	-
	64,951	6,176

The Group's and Company's balances with related parties are unsecured, non-interest-bearing and are repayable on demand or within one year.

26. LOAN RECEIVABLE

The balance represents an entrusted loan provided by the Company to United Bearings through China Construction Bank. The loan is unsecured, bearing an interest rate of 5.58% per annum and for a period of six months beginning from 27 October 2006. The carrying amount of the loan approximates to its fair value.

27. DERIVATIVE FINANCIAL INSTRUMENTS

The balances represent various forward currency contracts entered into by the Company to manage its exchange rate exposures which did not meet the criteria for hedge accounting. Changes in the fair value of non-hedging currency derivatives amounting to RMB 1,615,000 were credited to the income statement during the year (2005: Nil).

28. CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS

Group

	2006	2005
	RMB'000	*RMB'000*
Cash and bank balances	260,974	165,616
Time deposits	926,149	13,790
	1,187,123	179,406
Less: Restricted deposits	659,805	14,341
Cash and cash equivalents	527,318	165,065

The restricted deposits can be analysed as follows:

	2006	2005
	RMB'000	*RMB'000*
Pledged bank balances and time deposits secured for:		
Bank loans	2,941	2,941
Trade finance facilities	3,829	4,400
Restricted bank balances and time deposits not allowed to be withdrawn before maturity	653,035	7,000
	659,805	14,341

The Group's cash and bank balances are denominated in RMB at each balance sheet date, except for the followings:

	2006		2005	
	Original Currency	RMB equivalent	Original Currency	RMB equivalent
	in'000	*in'000*	*in'000*	*in'000*
Cash and bank balances:				
USD	525	4,097	783	6,320
JPY	683	45	6,035	415
HKD	696,744	699,998	-	-

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.

28. CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS (continued)

Company

	2006	2005
	RMB'000	*RMB'000*
Cash and bank balances	1,037,220	43,741
Less: Restricted deposits	653,035	-
Cash and cash equivalents	384,185	43,741

The restricted deposits can be analysed as follows:

	2006	2005
	RMB'000	*RMB'000*
Restricted bank balances and time deposits not allowed to be withdrawn before maturity	653,035	-

The Company's cash and bank balances are denominated in RMB at each balance sheet date, except for an amount of RMB 699,998,000 (2005: Nil) which is denominated in HKD 696,744,000 (2005: Nil).

Cash at bank earns interest at floating rates based on daily bank deposits rates. Short-term time deposits are made for varying periods within six months depending on the immediate cash requirements of the Group, and earn interest at the respective short term time deposit rates. The carrying amounts of the cash and cash equivalents and the pledged deposits approximates to their fair values.

29. TRADE PAYABLE

The trade payables are non-interest-bearing and are normally settled on 60-day terms. An ageing analysis of trade payables, based on the invoice date, is as follows:

Group

	2006	2005
	RMB'000	*RMB'000*
Within 3 months	332,930	217,091
Over 3 months but within 6 months	55,656	15,618
Over 6 months but within 1 year	14,710	24,925
Over 1 year but within 2 years	2,371	2,080
Over 2 years	7,006	5,540
	412,673	265,254

29. TRADE PAYABLES (continued)

The amounts due to associates and SEC group companies included in the above can be analysed as follows:

	2006	2005
	RMB'000	*RMB'000*
Due to associates	39	-
Due to SEC group companies	6,045	23,342
	6,084	23,342

Company

	2006	2005
	RMB'000	*RMB'000*
Within 3 months	109,512	24,771

The amount due to a subsidiary of RMB 99,201,000 (2005: RMB 21,768,000) is included in the Company's trade payables.

The Group's and Company's balances with related parties are unsecured, non-interest-bearing and payable on similar credit terms to those offered to the Group by its major suppliers.

30. BILLS PAYABLE

The maturity profiles of the bills payable are as follows:

	Group		Company	
	2006	2005	2006	2005
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Within 3 months	11,800	4,422	10,000	-

31. OTHER PAYABLES AND ACCRUALS

Other payables are non-interest-bearing.

Group

	2006	2005
	RMB'000	*RMB'000*
Advance from customers	54,821	58,248
Other tax payables	21,348	11,935
Staff cost payables	40,993	43,034
Interest payables	4,768	5,973
Payables for purchases of non-trade assets	6,057	8,153
Accruals	13,151	7,060
Other payables	5,522	8,291
Due to ultimate holding company	2,536	62,189
Due to SEC group companies	39,526	89,282
Due to other related companies	-	232
	188,722	294,397

Company

	2006	2005
	RMB'000	*RMB'000*
Advance from customers	8,375	4,061
Other payables	1,992	1,290
Accruals	5,658	-
Due to ultimate holding company	-	1,119
Due to subsidiaries	194,093	-
	210,118	6,470

Other payables are non-interest-bearing and have average terms of one to three months. The Group's and Company's balances with related parties are unsecured and are repayable on demand or within one year.

32. BANK AND OTHER BORROWINGS

Group

	Effective interest rate (%)	Maturity	2006 RMB'000	2005 RMB'000
Current				
Bank loans				
- secured	5.0-5.3	2007	75,000	6,850
- unsecured	5.4-6.1	2007	15,000	282,710
			90,000	289,560
Other loans				
- unsecured	-	-	-	17,300
			-	17,300
			90,000	306,860
Non-current				
Other loans				
- unsecured	-	Not fixed	17,000	17,880
			17,000	17,880
			107,000	324,740
Analysed into:				
Bank loans repayable:				
Within one year or on demand			90,000	289,560
Other loans repayable:				
Within one year or on demand			-	17,300
In the second year			-	17,139
In the third to fifth years, inclusive			-	67
Beyond five years			17,000	674
			17,000	35,180
			107,000	324,740

32.BANK AND OTHER BORROWINGS (continued)

Group (continued)

Certain of the Group's bank loans are secured by:

(i) mortgages over certain of the Group's buildings, land use right and machineries with aggregate net book values of approximately RMB 120,318,000 (2005: RMB 18,716,000); and

(ii) pledge of certain of the Group's bank balances and time deposits as set out in note 28.

The Group's bank and other borrowings are all denominated in RMB as at 31 December 2006 (2005: RMB 880,000 denominated in JPY 12,801,000).

The Group's other loans represented loans borrowed from non-banking financial institutions as follows:

	2006	2005
	RMB'000	*RMB'000*
Other loans - unsecured:		
Other non-banking financial institutions	17,000	21,800
Ultimate holding company	-	12,500
Others	-	880
	17,000	35,180

Company

The Company has an unsecured bank loan of RMB 100,000,000 repayable within one year which bore interest at a rate of 4.7% per annum at 31 December 2005.

The carrying amounts of the Group's and the Company's bank and other borrowings approximate their fair values.

33. ISSUED CAPITAL

	2006		2005	
	Number of Shares	Amount	Number of Shares	Amount
	'000	*RMB'000*	*'000*	*RMB'000*
Registered, issued and fully paid:				
Domestic Shares of RMB1.00 each, currently not listed				
-State-owned Shares	678,576	678,576	747,640	747,640
H Shares of RMB1.00 each	759,710	759,710	-	-
	1,438,286	1,438,286	747,640	747,640

The Domestic Shares are currently not listed on any stock exchange.

33. ISSUED CAPITAL (continued)

The holders of ordinary shares are entitled to receive dividends as and when declared by the Company. All ordinary shares carry one vote per share without restriction.

600,562,000 new H shares of the Company were listed on the Stock Exchange on 27 April 2006. On 2 May 2006, the Company exercised its over-allotment option to offer 90,084,000 new H shares of the Company on the Stock Exchange. Pursuant to the "Provisional Administrative Measures for the Reduction of State-owned Shares in Raising the Social Security Fund", 69,064,000 State-owned shares of the Company should be converted into 69,064,000 H shares and transferred to the Chinese National Social Security Fund (the "CNSSF") upon completion of the global offering. Accordingly, 69,064,000 State-owned shares of the Company were converted into 69,064,000 H shares and transferred to the CNSSF.

As a result of the exercise of the over-allotment option and the transfer of H shares to CNSSF, 759,710,000 H shares of the Company, comprising 690,646,000 new H shares and 69,064,000 transferred H shares, were listed on the Stock Exchange starting as at 2 May 2006. These H shares with a nominal value of RMB1.00 each, other than the 69,064,000 H shares transferred to CNSSF, were issued to the public by way of the global offering at a price of HKD 2.10 per share. After deducting the share issue expenses totalling approximately RMB 118,617,000, the Company raised net proceeds of approximately RMB 1,381,863,000, of which issued capital amounted to RMB 690,646,000 and capital reserve amounted to RMB 691,217,000.

A summary of the transactions during the year with reference to the above movements in the Company's issued share capital is as follows:

	Number of shares in issue *'000*	Issued share capital *RMB'000*	Share premium account *RMB'000*	Total *RMB'000*
Capital contribution to the Company upon its establishment	747,640	747,640	-	747,640
At 31 December 2005 and 1 January 2006	747,640	747,640	-	747,640
Shares issued on 27 April 2006	690,646	690,646	809,834	1,500,480
	1,438,286	1,438,286	809,834	2,248,120
Share issue expenses	-	-	(118,617)	(118,617)
At 31 December 2006	1,438,286	1,438,286	691,217	2,129,503

34. 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 page 42 to 43 of the financial statements.

Surplus reserves

In accordance with the PRC Company Law and the articles of association of the relevant companies, the Company, its subsidiaries and jointly-controlled entity are required to appropriate certain percentage of their net profits after tax to the surplus reserves comprising statutory common reserve and discretionary common reserve. Subject to certain restrictions set out in the relevant PRC regulations and in the Group companies' articles of association, the statutory common reserve may be used either to offset losses, or to be converted to increase share capital; and the discretionary common reserve is set aside to cover unexpected losses. These reserves cannot be used for purposes other than those for which they are created.

Contributed surplus

The contributed surplus of the Group arises from the preparation of the Group's consolidated financial statements on the basis of preparation set out in note 2.1 to the financial statements. It represents the difference between the Company's cost of investment in the Net Assets acquired from Shanghai Electric Corporation and Shiye as part of the Reorganisation and the aggregate amount of the paid-up capital of the Four Subsidiaries and the jointly-controlled entity attributable to the Group and the then carrying value of the Group's interests in the Three Associates upon the establishment of the Company.

Capital reserve

The capital reserve of the Group includes the Company's share premium of RMB 691,217,000 and the non-distributable reserves of the Company and its subsidiaries created in accordance with accounting and financial regulations in the PRC.

Distributable reserves

For dividend purpose, the amount for which the Company can legally distribute by way of a dividend is determined by reference to its profit as reflected in its PRC statutory financial statements prepared in accordance with the PRC GAAP. These profits differ from those that are reflected in these financial statements, which are prepared in accordance with HKFRSs.

The Company may not distribute dividends exceeding the lower of the Group's distributable reserves as determined under PRC GAAP and those under HKFRSs.

In accordance with the Company Law of the PRC, profit after tax can be distributed as dividends after appropriation to the statutory common reserve as set out above.

The Company's maximum distributable reserves as at 31 December 2006, which represent the Group's reserves as determined in accordance with the PRC GAAP after deduction of capital reserves and the minimum transfers to the statutory common reserve as set out above, amounted to approximately RMB 169,810,000.

34. RESERVES (continued)

(b) Company

	Capital reserves *RMB'000*	Surplus reserves *RMB'000*	Accumulated losses *RMB'000*	Total *RMB'000*
Losses for the period from 30 September 2005 (date of incorporation) to 31 December 2005	-	-	(693)	(693)
Appropriation to surplus reserves	-	5,623	(5,623)	-
At 31 December 2005 and 1 January 2006	-	5,623	(6,316)	(693)
Issue of shares	809,834	-	-	809,834
Share issue expenses	(118,617)	-	-	(118,617)
Profits for the year	-	-	24,335	24,335
Transfer to capital reserve	28,604	-	(28,604)	-
Appropriation to surplus reverses	-	16,995	(16,995)	-
Proposed final 2006 dividend	-	-	(57,531)	(57,531)
At 31 December 2006	719,821	22,618	(85,111)	657,328

Included in the Company's capital reserve account above is the share premium account of RMB 691,217,000 as at 31 December 2006.

35. BUSINESS COMBINATION

Acquisition in 2005

On 1 December 2005, the Group acquired the entire equity interest in Biaowu Fasteners, a subsidiary of Shanghai Electric Corporation. Biaowu Fasteners is engaged in the production and sales of high tensile fastener and the related specific equipment. The purchase consideration of RMB 40,951,000 for the acquisition was in the form of cash and was paid on 31 October 2005.

The fair values of the identifiable assets and liabilities of Biaowu Fasteners as at the date of acquisition and the corresponding carrying amounts immediately before the acquisition were as follows:

35. BUSINESS COMBINATION (continued)

Acquisition in 2005 (continued)

	Notes	Fair value recognised on acquisition *RMB'000*	Carrying amount *RMB'000*
Net assets acquired:			
Property, plant and equipment	14	109,768	108,686
Prepaid land premiums/land lease payments	15	14,887	14,887
Intangible assets	16	1,320	-
Available-for-sale investments		6,290	3,837
Deferred tax assets	21	5,532	5,532
Inventories		45,626	45,626
Trade receivables		18,745	18,745
Bills receivable		860	860
Prepayments, deposits and other receivables		9,121	9,121
Cash and cash equivalents		9,503	9,503
Trade payables		(60,226)	(60,226)
Tax payable		(6,313)	(6,313)
Other payables and accruals		(109,029)	(109,029)
Deferred tax in relation to fair value adjustments	21	(1,603)	-
		44,481	41,229
Excess over the cost of a business combination recognised in the consolidated income statement	5	(3,530)	
		40,951	
Satisfied by:			
Cash		40,951	
Offset by:			
Available-for-sale investments		(1,000)	
Paid-up capital of a subsidiary of the Group		683	
Capital reserve of a subsidiary of the Group		317	
		40,951	

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition of a subsidiary was as follows:

	RMB'000
Cash consideration	(40,951)
Cash and cash equivalents acquired	9,503
Net outflow of cash and cash equivalents in respect of the acquisition of a subsidiary	(31,448)

36. DISPOSAL OF A SUBSIDIARY

Disposal in 2005

On 31 August 2005, Shanghai Tool Works Company Limited ("Shanghai Tools") and Shanghai Tool Works Sales Company Limited disposed of their equity interests of 85% and 15% in Shanghai Shang Gong International Precision Tool Works Company Limited to two subsidiaries of Shanghai Electric Corporation, respectively. The consideration for the disposal was satisfied by cash with amount of RMB 17,240,000.

	Notes	2005
		RMB'000
Net assets disposed of:		
Property, plant and equipment	14	2,845
Investments in associates		2,369
Available-for-sale investments		3,620
Inventories		18,533
Trade receivables		9,192
Prepayments, deposits and other receivables		338
Cash and cash equivalents		5,022
Trade payables		(2,605)
Tax payable		(256)
Other payables and accruals		(25,295)
Bank and other borrowings		(1,000)
		12,763
Gain on disposal of a subsidiary	5	4,477
		17,240
Satisfied by:		
Cash		17,240

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of a subsidiary is as follows:

	2005
	RMB'000
Cash consideration	17,240
Cash and cash equivalents disposed of	(5,022)
Net inflow of cash and cash equivalents in respect of the disposal of a subsidiary	12,218

37. NOTE TO THE CONSOLIDATED CASH FLOW STATEMENT

Major non-cash transactions

During the year, the Group entered into various debt restructuring agreements to settle its certain bank loans and trade payables and recognised net gains from debt restructuring of RMB 28,275,000.

38. OPERATING LEASE COMMITMENTS

(a) The Group

(i) As lessor

The Group leases out certain of its building and plant and machinery under operating lease arrangements, with leases negotiated for terms ranging from 2 to 5 years. The terms of the leases generally also require tenants to pay security deposits and provide for periodic rent adjustments according to the prevailing market conditions.

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

	2006	2005
	RMB'000	*RMB'000*
Within one year	308	739
In the second to fifth years, inclusive	480	1,243
After five years	-	160
Total	788	2,142

(ii) As lessee

The Group leases certain land, buildings and motor vehicles under operating lease arrangements, with leases negotiated for terms ranging from 1 to 20 years.

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

	2006	2005
	RMB'000	*RMB'000*
Within one year	23,690	7,269
In the second to fifth years, inclusive	25,465	17,627
After five years	8,543	18,991
Total	57,698	43,887

38. OPERATING LEASE COMMITMENTS (continued)

(a) The Group (continued)

(ii) As lessee (continued)

In addition, the Group's share of the jointly-controlled entity's own total future minimum lease payments under non-cancellable operating leases is as follows:

	2006 *RMB'000*	2005 *RMB'000*
Within one year	1,665	1,590
In the second to fifth years, inclusive	6,621	6,387
After five years	1,983	3,583
Total	10,269	11,560

(b) The Company

As lessee

The Company leases certain offices under operating lease arrangements with a lease term of one year. As at 31 December 2006, the Company had future minimum lease payments under non-cancellable operating leases of RMB 2,070,000 (2005: RMB 360,000).

39. COMMITMENTS

(a) The Group

In addition to the operating lease commitments detailed in note 38(a)(ii) above, the Group had the following commitments as at 31 December 2006:

	2006 *RMB'000*	2005 *RMB'000*
Contracted, but not provided for:		
Land and buildings	24,569	14,058
Plant and machinery	163,945	70,729
Intangible assets	1,891	-
Others	21,000	1,000
	211,405	85,787
Authorised, but not contracted for:		
Plant and machinery	279,350	268,000
Land and buildings	26,512	-
	305,862	268,000
Total	517,267	353,787

39. COMMITMENTS (continued)

(a) The Group (continued)

In addition, the Group's share of the jointly-controlled entity's own capital commitments is as follows:

	2006 *RMB'000*	2005 *RMB'000*
Contracted, but not provided for:		
Plant and machinery	10,999	1,122
Authorised, but not contracted for:		
Plant and machinery	-	19,000
Total	10,999	20,122

(b) The Company

In addition to the operating lease commitments detailed in note 38(b) above, the Company had the following commitments as at 31 December 2006:

	2006 *RMB'000*	2005 *RMB'000*
Contracted, but not provided for:		
Intangible assets	1,891	-
Others	21,000	-
Total	22,891	-

40. CONTINGENT LIABILITIES

(a) The Group

	2006 *RMB'000*	2005 *RMB'000*
Bills discounted with recourse	-	491
Guarantees given to banks in connection with banking facilities granted to and utilised by:		
- Jointly-controlled entity	30,000	24,700
- Associates	25,500	-
- SEC group companies	-	17,637
- Third parties	-	22,000
	55,500	64,828

40. CONTINGENT LIABILITIES (continued)

(a) The Group (continued)

In respect of the bank guarantee given by the Group for the jointly-controlled entity as disclosed above, the Group's share of bank loan balances of RMB 15,000,000 (2005: RMB 12,350,000) have been recognised in the consolidated balance sheet.

(b) The Company

	2006	2005
	RMB'000	*RMB'000*
Guarantees given to banks in connection with banking facilities granted to and utilised by:		
- Jointly-controlled entity	3,000	-
- Associates	24,000	-
	27,000	-

41. RELATED PARTY TRANSACTIONS

(a) In addition to the transactions 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*
Purchase of materials from:	(i)		
Associates		-	4,972
SEC group companies		31,481	28,141
Other related companies		1,679	6,776
		33,160	39,889
Sales of goods to:	(i)		
Jointly-controlled entity *		23,407	1,586
Associates		-	1,677
SEC group companies		223,438	186,339
		246,845	189,602
Sales of scraps and spare parts to:	(i)		
Associates		-	2
SEC group companies		2,807	9,358
		2,807	9,360

41. RELATED PARTY TRANSACTIONS (continued)

(a) (continued)

	Notes	2006 RMB'000	2005 RMB'000
Receiving of manpower services from:	(i)		
SEC group companies		3,494	37
Other related companies		-	150
		3,494	187
Rendering of manpower services to:	(i)		
SEC group companies		6	-
Other related companies		16	-
		22	-
Purchase of property, plant and equipment from:	(i)		
SEC group companies		2,206	574
Other related companies		687	-
		2,893	574
Rental fee payable to:	(ii)		
Ultimate holding company		2,805	619
SEC group companies		20,132	1,940
		22,937	2,559
Interest expense payable to:	(iii)		
Ultimate holding company		-	531
SEC group companies		-	121
Other related companies		-	953
		-	1,605
Interest income from:	(iii)		
Jointly-controlled entity *		717	114
SEC group companies		-	2
		717	116

Notes:
i. The sales and purchases were conducted in accordance with mutually agreed terms with reference to the market conditions.
ii. The rental fee was based on mutually agreed terms with reference to market rates.

41. RELATED PARTY TRANSACTIONS (continued)

(a) (continued)

Notes (continued):

iii. The interest income and interest expenses were based on mutually agreed terms with reference to market rates.

*The amounts of transactions with jointly-controlled entity disclosed in the tables above are arrived at after deducting the Group's share portion, which has been eliminated in the proportionate consolidation of the Group's investment in the jointly-controlled entity.

(b) Other transactions with related parties

(i) In October 2005, Shanghai Tools , Shanghai General Machinery (Group) Corporation (" General Machinery") which is one of the SEC group companies, and a commercial bank (the "Bank") entered into an agreement pursuant to which General Machinery agreed to repay, by certain property (the "Property"), a bank loan of RMB 66,300,000 due by Shanghai Tools to the Bank. The bank loan became a payable (the "Payable") due by Shanghai Tools to General Machinery.

In April 2006, the Property was sold via an auction at RMB 46,400,000. It was agreed between Shanghai Tools, General Machinery and the Bank that (i) the bank loan was settled in full by the auction proceeds, and (ii) Shanghai Tools was to pay General Machinery the same amount of RMB 46,400,000 to settle the Payable in full. As at 31 December 2006, the Payable balance has been settled by Shanghai Tools. A net gain on debt restructuring of RMB 18,972,000 was recognised in the consolidated income statement for the year.

(ii) During the year, the ultimate holding company leased certain properties to United Bearings with no consideration. The Directors are of the opinion that the prevailing rental on these properties with reference to market rate is RMB 1,004,000 per annum.

(iii) During the year, one of the SEC group companies leased certain properties to Shanghai Tools with no consideration. The Directors are of the opinion that the prevailing rental on these properties with reference to market rate is RMB 1,724,000 per annum.

(iv) During the year, two subsidiaries of Sweden Ruihua Group Corporation ("Ruihua"), who owns 40% equity interest in Nanyang Motor, leased certain properties to Nanyang Motor with no consideration. The Directors are of the opinion that the prevailing rental on these properties with reference to market rate is RMB 3,476,000 per annum.

(c) Guarantees provided by/to related companies of the Group

(i) Guarantees provided to related companies of the Group
As disclosed in note 37, the Group provided corporate guarantees totalling RMB 55,500,000 (2005: RMB 42,337,000) to related companies. The expiry dates of such guarantees fall between 23 January 2007 to 19 June 2007.

41. RELATED PARTY TRANSACTIONS (continued)

(c) Guarantees provided by/to related companies of the Group (continued)

(ii) Guarantees provided by related companies of the Group

The Group's related companies have not provided corporate guarantees in connection with bank and other borrowings to the Group (2005: RMB 102,660,000) or the jointly-controlled entity (2005: RMB 3,000,000).

(d) Balances due from/to related parties

The balances due from/to related parties during the year are mainly resulted from trading transactions, bills receivable, loan receivable, deposits, borrowings, and miscellaneous amounts reimbursable by/to the related parties. Further details are set out in notes 23, 24, 25, 26, 29, 31 and 32.

(e) Compensation of the key management personnel of the Group

	2006	2005
	RMB'000	*RMB'000*
Fees	457	-
Short term employee benefits	2,394	1,905
Post-employment benefits	117	167
	2,968	2,072

Further details of Directors' and supervisors' emoluments are included in note 8.

The related party transactions with the ultimate holding company, SEC group companies and subsidiaries of Ruihua also constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules.

42. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise bank loans, other interest-bearing loans and cash and short term 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.

The Group also enters into derivative transactions, including principally forward currency contracts. The purpose is to manage the currency risks arising from the Group's operations and its sources of finance.

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 risk. Generally, the Group employs a conservative strategy regarding its risk management.

42. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Cash flow interest rate risk

The interest rates and the terms of repayment of the Group's bank and other borrowings are disclosed in note 32 above. 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.

(iii) Credit risk

The carrying amount of trade receivables included in the consolidated balance sheet represents the Group's maximum exposure to credit risk in relation to the Group's trade receivables. The Group does not have a significant concentration of credit risk in relation to trade receivables as the trade receivables due from the five largest customers accounted for only 19% of the Group's total trade receivables as at 31 December 2006.

The Group performs ongoing credit evaluations of its customers' financial conditions. The impairment of trade receivables is based upon a review of the expected collectibility of all trade receivables.

With respect to credit risk arising from the other financial assets of the Group, comprising cash and cash equivalents and other receivables, the Group's exposure to credit risk arises from default of the other party, with a maximum exposure being 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.

(iv) Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans. In addition, banking facilities have been put in place for contingency purposes.

43. POST BALANCE SHEET EVENTS

(a) On 9 August 2006, the Company entered into an equity purchase agreement with the other shareholder of United Bearings, pursuant to which the Company agreed to acquire, subject to satisfaction of certain conditions, a 40% interest in United Bearings (the "Equity Purchase Agreement") at the cash consideration of RMB 30,000,000. Subsequent to the balance sheet date, the Company obtained approvals from the relevant PRC Government Authorities which signified completion of the transaction under the Equity Purchase Agreement.

(b) 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.

44. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 30 March 2007.