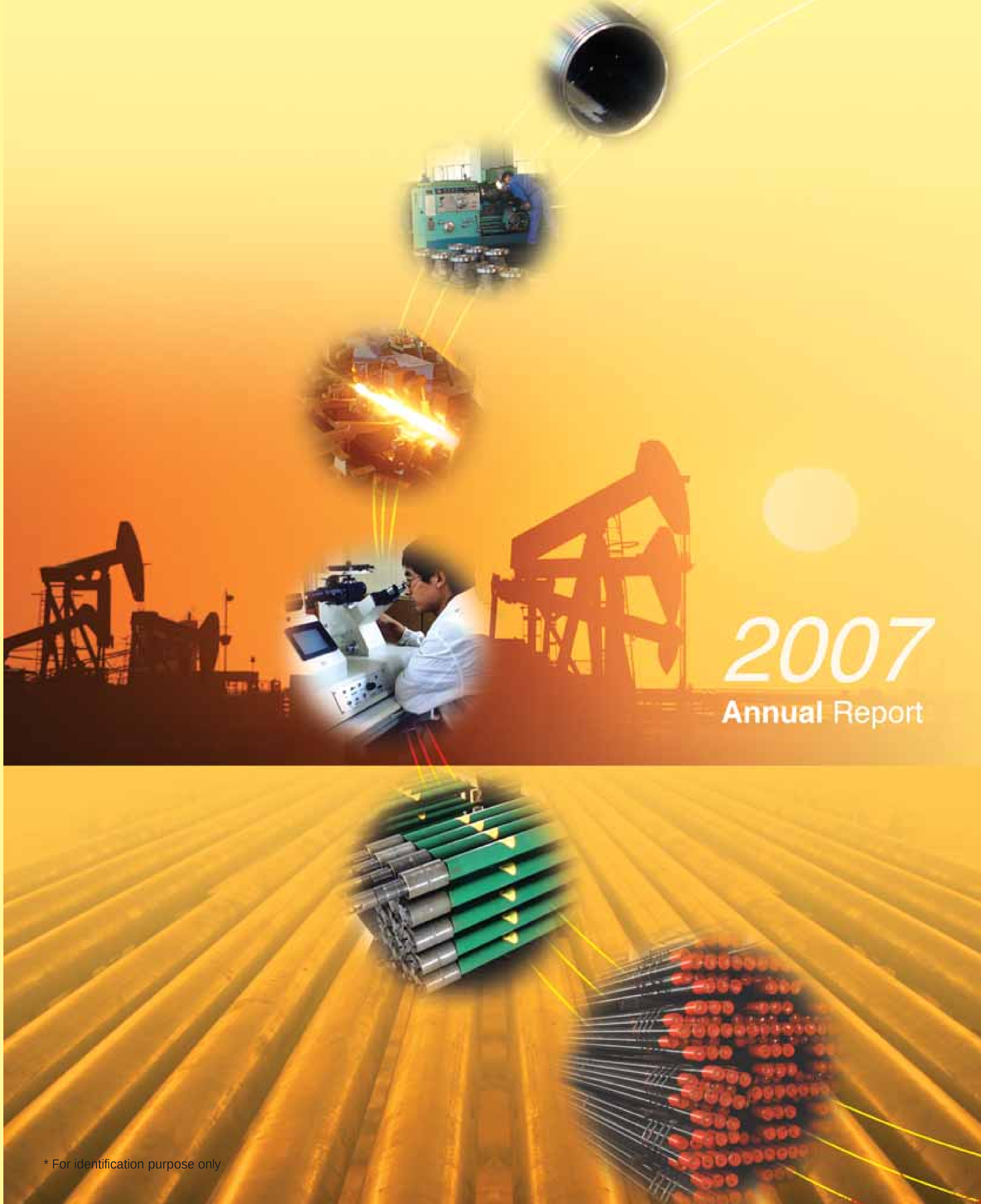
山東墨龍石油機械股份有限公司
Shandong Molong Petroleum Machinery Company Limited*

(a Sino-foreign joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 568)



2007
Annual Report

* For identification purpose only

Contents

Directors

Executive Directors

Mr. Zhang En Rong *(Chairman)*
Mr. Zhang Yun San *(Deputy Chairman)*
Mr. Lin Fu Long
Mr. Xie Xin Cang

Non-executive Directors

Mr. Chen Jian Xiong
Mr. Wang Ping

Independent Non-executive Directors

Mr. Qin Xue Chang
Mr. Yan Yi Zhuang
Mr. Loke Yu alias Loke Hoi Lam

Supervisors

Ms. Li Bao Hui *(Chairman of the Supervisory Committee)*
Mr. Liu Wan Fu
Mr. Fan Ren Yi

Members of Nomination Committee

Mr. Yan Yi Zhuang *(Chairman of the Nomination Committee)*
Mr. Zhang Yun San
Mr. Qin Xue Chang
Mr. Loke Yu alias Loke Hoi Lam

Members of Remuneration and Evaluation Committee

Mr. Loke Yu alias Loke Hoi Lam *(Chairman of the Remuneration and Evaluation Committee)*
Mr. Zhang Yun San
Mr. Qin Xue Chang
Mr. Yan Yi Zhuang

Members of Audit Committee

Mr. Qin Xue Chang *(Chairman of the Audit Committee)*
Mr. Yan Yi Zhuang
Mr. Loke Yu alias Loke Hoi Lam

Qualified Accountant

Mr. Chan Wing Nang, Billy

Company Secretary

Mr. Chan Wing Nang, Billy

Authorised Representatives

Mr. Xie Xin Cang
Mr. Chan Wing Nang, Billy

Authorised Person to Accept Service of Process and Notices

Mr. Chan Wing Nang, Billy

Auditors

Ernst & Young

Compliance Adviser

Guotai Junan Capital Limited (up to 6 February 2008)

Legal Advisers

Coudert Brothers in association with Orrick, Herrington & Sutcliffe LLP. (as to Hong Kong Law)
Kingfield Law Firm (as to PRC law)

Principal Bankers

Agricultural Bank of China
China Bank Co., Ltd
Weifang Commercial Bank
China Industrial and Commercial Bank Co., Ltd
China Merchants Bank Co.,Ltd
China Everbright Bank Co.,Ltd

H Share Registrar and Transfer Office in Hong Kong

Tricor Investor Services Limited
26/F., Tesbury Centre
No. 28 Queen's Road East
Hong Kong

Investor and Media Relations Consultant

Porda International (Finance) P.R. Co., Ltd.
Units 2009-2018, 20th Floor,
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Tel: (852) 31506788
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Registered Address

No. 99 Beihai Road, Shouguang City,
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Suite A, 11/F, Ho Lee Commercial Building,
38-44 D'Aguilar Street,
Central,
Hong Kong

Website

www.molonggroup.com

Stock Code

568

Results

	Year ended 31 December				
	2007	2006	2005	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	**1,700,405**	1,014,037	776,522	487,688	302,274
Profit from operating activities	**264,885**	173,863	118,963	70,148	64,085
Profit before tax	**238,239**	161,774	115,519	65,576	59,347
Profit for the year	**201,029**	142,674	88,248	64,091	46,150
Minority interests	**(699)**	(3,270)	(3,021)	(2,725)	(2,173)
Net profit from ordinary activities attributable to ordinary equity holders of the parent	**200,330**	139,404	85,227	61,366	43,977
Earnings per share - basic (RMB)	**0.062**	0.043	0.028	0.024	0.022

Assets and Liabilities

	As at 31 December				
	2007	2006	2005	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Total assets	**2,290,323**	1,454,216	959,129	467,059	383,356
Total liabilities	**1,450,295**	917,451	544,063	220,415	264,457
Net assets	**840,028**	536,765	415,066	246,644	118,899

On behalf of the Board of Directors (the "**Board**"or "**Directors**") of the Company, I am pleased to present the annual report and the audited financial statements of the Company together with its subsidiaries (collectively the "**Group**") for the financial year ended 31 December 2007 ("**2007**" or the "**current year**" or "**Reporting Period**") to the shareholders of the Company (the "**Shareholders**").

Outstanding Achievements of the Year

The Group recorded impressive business growth during the year. For the year ended 31 December 2007, the Group achieved revenue approximately RMB1,700,405,000, representing an increase of approximately 67.7% as compared with last year. Over the same period, the profit attributable to equity holders of the parent and earnings per share were approximately RMB200,330,000 and RMB0.062, representing an increase of approximately 43.7% and 44.2%, respectively, as compared with last year. All of these achievements clearly demonstrated the persistent effort made by the management and employees of the Group in developing its business.

The Group's acquisition of Maolong Machinery was completed at the end of December 2007. The Group's revenue and net profit above did not include the revenue and net profit of the Shouguang Maolong Machinery Company Limited ("**Maolong Machinery**") and its subsidiaries (collectively the "**Maolong Group**") at the same period. Maolong Group had a sales revenue of approximately RMB597,541,000 (unaudited) and a net profit of approximately RMB55,055,000 (unaudited) in 2007.

Business Review

After the 250,000-tonne oil casing production line was successfully put into trial production in the fourth quarter of 2006, it has achieved approximately 60% of its designed production capacity in 2007 . The commissioning and potential of the production capacity of such production line are beneficial to the substantial growth in oil casing output of the Group and enable the Group to grasp the development opportunities arising from the continuing increase in the demand of petroleum drilling and extraction machinery and related accessories , which is in turn beneficial to the future development of the business and the competitiveness of the Group.

As first H share company which successfully migrated from the Growth Enterprise Market (the "**GEM**") of The Stock Exchange of Hong Kong Limited (the "**Stock Exchange**") to the Main Board of the Stock Exchange (the "**Main Board**"), dealings in the H Shares on the Main Board commenced on 7 February 2007;

As a return to our investors, the Company has granted the Bonus Share Issue by capitalising the capital reserve fund into capital increase and undistributed profits (the "**Bonus Share Issue**") on 25 July 2007;

In order to complement the working capital for the 250,000-tonne oil casing, the Company placed 49,252,000 new H Shares for listing on the Stock Exchange on 19 September 2007;

In order to improve the Group's industrial chain, to ensure stable supply of raw materials, to enhance the Group's new product trial production ability and to reduce connected transactions, the Company completed the acquisition of Maolong Group on 27 December 2007;

Subject to the approval and authorization of the general meeting of shareholders, the Company had submitted to the China Securities Regulatory Commission (the "**CSRC**") the application for A shares issue with the aim at increasing the variety and the scale of production of high grade oil pipes for the enhancement of competitive strengths.

In terms of domestic market expansion, the Group's main customers are major oil fields in China, including Xinjiang Oil Field (新疆油田), Daqing Oil Field (大慶油田), Changqing Oil Field (長慶油田), Liaohe Oil Field (遼河油田), Qinghai Oil Field (青海油田), Huabei Oil Field (華北油田) and Jilin Oil Field (吉林油田), all of which branch oil fields of PetroChina Company Limited and its subsidiaries (collectively, "**PetroChina Group**"), as well as Shengli Oil Field (勝利油田), Zhongyuan Oil Field (中原油田) and Jianghan Oil Field (江漢油田) all of which branch oil fields of China Petroleum & Chemical Corporation (collectively, "**Sinopec Group**"). Sales to the above oil fields under PetroChina Group and Sinopec Group accounted for approximately 46.0% of the Group's sales revenue. In 2007, the Group's products have been successfully introduced to the CNOOC Limited and its subsidiaries (collectively "**CNOOC Group**"), and the Group has become the eligible supplier of CNOOC; meanwhile, the Group's cooperation with Shanxi Yanchang Petroleum (Group) Co., Ltd. ("**Yanchang Petroleum**") is going well. In terms of market expansion of coal-bed gas, the Group's products such as oil well pumps machines, oil well pipes, casings, oil well pumps and extraction machinery accessories have successfully entered the domestic regional markets.

Due to the long-term sound performance and reputation of supply, the Group was selected by the E-Commerce Department of PetroChina Company Limited as one of the Top Four Suppliers of Special Purpose Oil Pipes. Since its listing, the Group has been a member of the first-class online procurement of the e-commerce network of Sinopec Group. During 2007, the oil well pipes and casings of the Group officially entered the offshore exploitation market of CNOOC Group. CNOOC Group has a stringent assessment system for the acceptance of suppliers, including the investigation of reputation, production capability, market scale, cooperation duration and cooperative partners of the suppliers. In addition, experts in related fields are appointed internally by CNOOC Group as the assessors during the assessment of the procurement tender. These experts maintain absolute independence, which increases the difficulty for the suppliers to be included. During the year,the Group became a qualified supplier of CNOOC Group, which symbolized the further improvement of the Group's overall competitive strength.

In terms of overseas market, with the Group's continued effort to further expand such market, there was a rapid increase in both the number of and the business with overseas customers in 2007, while high-end products such as high-grade steel and non-API series occupied a leading position in the overseas business. At present, the Group has established good and long-term cooperative relationships with over 30 overseas agencies and oil field service companies. There has been a significant increase in the exports of the Group's products to overseas regions, such as North America, Europe, Russia and Southeast Asia. Apart from the above, the Group has developed new client bases in the Middle East, Africa and South America. For the financial year ended 31 December 2007, the Group's revenue generated from exports increased significantly, which accounted for approximately 47.8% of the Group's total sales revenue. Such increase formed a solid foundation for the Group to further expand the overseas market in the future.

In the development of new products, with increasing demand for high-end products both in China and overseas, the Group increases investment in product development on the whole. The supersonic non-destructive test equipment, which is leading in the industry, introduced from Unicorn Automation (NDT) Ltd. in the U.K. were installed and commenced operation in 2007. The grasp of application skills of such equipment provides advantageous technical guarantee for the research and development of high-end products of the Company. Meanwhile, during the year, through strengthening technological cooperation with research institutes such as Xi'an Jiaotong University, Xi'an Pipe Material Research Institute of PetroChina Group, and Xi'an Maurer Petroleum Engineering Material Lab, the Group developed over 10 types of API series and non-API series high-end products, which have passed the verification and testing of the domestic authorities. As regards development of high-grade products, during the year, the Group developed a variety of products, such as high collapse-resistance casings, H_2S corrosion resistant series oil well pipes and casings, special drift diameter casings, drill pipes and pipeline pipes. The pipeline pipes were licensed by the American Petroleum Institute under its API-5L Monogram Standards, thus laying a foundation for the Group's products entering into the field of oil transportation. Meanwhile, trial use of some products has been conducted by customers, leading mass production and sales. At present, the revenue of high-grade oil well pipes accounted for approximately 27% of total revenue from oil well pipes, laying a solid foundation for enhancing of the Group's market competitive strength.

The oil well pipe products of the Group have successfully passed the deep well descending test for passing through wells with a depth of 5,750 meters in the Northern Tarim Oil Field in Xinjiang Autonomous Region. It shows that the oil well pipe products of the Group have the ability of being used in complicated geological conditions and in deep well descending.

For the two consecutive years of 2006 and 2007, due to the continuous growth in its business performance, the Group was listed by Forbes as the Top China 100 Potential Enterprises – Enterprises with the Greatest Development Potential. The Group was awarded a number of accreditations by the PRC governmental authorities, banks and tax bureaux including "Demonstrative Enterprise for Informatization in the Manufacturing Industry in Shangdong Province", "High and New Technology Enterprise in Shandong Province", "Faithful Enterprise in Shandong Province", "Famous Export Brands in Shandong Province Entitling to Priority in Fostering and Development for 2006-2007", "Top 100 Industrial Enterprises in Weifang City", "Grade A Credit Rating Enterprise in Tax Payment", "Top 100 Private Enterprises in Weifang City", "2007 Outstanding Contribution Award for Civil Economy Development in Weifang City", "Civilized Entity in Weifang City in 2006-2007", "Ranking No. 4 in "Top 50 Enterprises in Shouguang City" in three years successively", "Mega Enterprises in Shouguang City", "Shouguang City Foreign Trade Advanced Enterprise" and "Triple A Credit Rating Enterprise" etc., the above accreditations demonstrated the recognition of the Group's outstanding results.

Prospects

The Company was the first H share company which successfully migrated from the GEM to the Main Board of the Stock Exchange on 7 February 2007. The Company applied to the CSRC for A Shares issue in 2007. The aim of the A shares issue is to provide a financing channel for the development of the business of the Company and the enhancement of the competitive advantages in the industry. It will also improve the Company's completing activities in the international and domestic petroleum drilling and extraction machinery markets and is favorable to the Company in terms of its efforts in expanding the marketing channels and facilitating international cooperation, thus promoting the stable development of the Company.

International Energy Agency forecasts the global demand for crude oil in 2008 will increase by 2.5% respectively and the global demand for crude oil is expected to increase continuously. The Energy Information Administration of the US also forecasts that the global oil price will tend to rise continually. Under the increasing global demand for crude oil and the rising in the oil price, the capital cost for oil exploration and exploitation will continually increase and will bring more space to the development in the petroleum drilling and extraction machinery industry.

Based on the above information, the Directors believe that, as the global demand for crude oil increases, there will be a corresponding increase in the capital invested by oil explorers for oil drilling which will directly promote the development in the petroleum drilling and extraction machinery industry.

Looking forward, the Group will continue to input more resources into the research and development of petroleum drilling and extraction machineries, increase product technical content, enhance production capacity and product quality, so as to increase its products value-added and further develop the domestic and international markets.

With regard to product research and development, the Group plans to continue to strengthen the development of high grade steel oil well pipes, casings, and oil well pipe products of various specifications, as well as the API series and non API series oil well pipes, so as to meet different demands from different kinds of clients both in the PRC and overseas for the products of the Group, to increase the proportion of high-grade products and enhance the profitability and competitiveness of the Group's products.

With respect to the development of new products, in order to secure business opportunities and explore more resources to increase the Group's revenue, the Group will continue to actively conduct research in the development of production techniques of natural gas and coal-bed gas drilling and extraction machinery based on its existing oil extraction machinery techniques, in light of the trend for consumption demand and development for natural gas and coal-bed gas in the market.

In terms of production capacity, it is expected that the production line of 250,000 tonne of oil casings will reach 80% of its designed production capacity in 2008 and the full designed production capacity in 2009; in combination with A share issue, the Group plans to invest over RMB 700 million in the technical improvement of oil well pipes production lines. Upon the completion of the technical improvement, the company's oil well pipe production capacity will increase to 300,000 tonne the quality of the product and production efficiency will be significantly improved, energy consumption will be greatly reduced and cost will be reduced further. Such technical improvement project has been approved by the Shandong Provincial Economic and Trade Commission.

In terms of the expansion of the domestic market, apart from maintaining and consolidating relationships with the existing customers, the Group will further develop potential new customers. The Company will make use of the advantage of the continual increase oil casing output in 2008 to increase the sales volume of casing in the domestic market. Owing to the good reputation and good cooperation relationship established after the Company having become one of the top four outstanding suppliers of PetroChina Company Limited and the increase of sales of oil casing products in the domestic market, the Group is confident that promotion of high end products in the domestic market can be enhanced simultaneously with the stabilization of the overseas market. At the same time, the Group will on the basis of consolidating and developing relationship with the existing customers, actively promote good cooperative relationships with CNOOC Group and Yanchang Petroluem so as to gain more market share.

For overseas markets, the Company will continue to increase the development in the markets such as the South America and the Middle East to eliminate the risks arising from over-concentration of the Company's products in the overseas markets, according to the different situations in every oil production country, such as the economic and politics situations and the development demands of overseas markets. Meanwhile, the Company will keep long-term cooperation with overseas stock companies who have market resources, dominant services and good reputations. With the Group's expansion into new markets such as Russia, the Middle East, the South America and so on, the Group is confident that it can actively carry out new products promotions through the strengthening of marking activities so as to expand the Group's market coverage continuously.

Facing the uncertainties such as the possible increase in the price of raw materials, the appreciation in RMB and the adjustment of export tax refund policy in the future, the Group will take various measures to mitigate the possible adverse impact brought by the aforementioned factors;

With regard to production capacity: with the further release of the production capacity of the production line of 250,000 tonne of special oil casings, it is expected that the production line will reach 80% of its designed production capacity in 2008, which will further drive down manufacturing expense and cost. Meanwhile, as the operating skills of the Group's staff and gradually improves the production and technical staff becomes more experienced, the production capacity of the other production lines will be increased correspondingly;

With regard to industrial chain: with the completion of the acquisition by the Group of Maolong Group, the industrial chain of the Company will be strengthened. The research and development strength of Maolong Group will ensure the Group's research and development in products and raw materials, whereby enabling cost control and reducing the impact of uncertainties caused by the rise in the price of raw materials;

With regard to business strategy: the Group will continue to increase loans denominated in US$ and adopt a policy of relatively fixed rate of exchange with some customers for the purpose of mutual benefit and reducing the risks of uncertainties associated with the appreciation in RMB; the Group will also enhance its technical improvement , adjust the structure of product sales and increase the sales volume of high-end products and high value-added products to neutralize the impact resulting from the changes in tax refund policies on some products to the maximum degree.

Through the aforementioned strategies and measures, the Group considers that, with the price hiking of crude oil in the international market and increased demand of energy, the demand for oil machinery will also display a rising trend. The Group will seize the opportunities to provide the oil explorers around the world with high quality oil machinery equipment and related components, thus ensuring the profitability of the company and achieving the best return for the shareholders.

Acknowledgement

Lastly, I would like to express my gratitude to the Shareholders and business partners of the Group for their support and encouragement for the past year, and at the same time, my most sincere thanks to the Directors and all the staff of the Group for their dedication and contribution.

Zhang En Rong
Chairman

Shandong, the PRC
16 March 2008

The following discussion and analysis of the Group's financial condition and results of operation should be read in conjunction with the consolidated financial statements and the accompanying notes.

Revenue

For the current year, sales of the Group's oil well pipes, casing, oil well sucker rods oil well pumps and other products increased as a result of substantial increase of market demand in petroleum drilling and the extraction machinery industry and increased production capacity of the Group. There was also a substantial growth of revenue from overseas market. The Group's revenue was approximately RMB1,014.0 million for the year ended 31 December 2006 and surged to approximately RMB1,700.4 million for the current year, representing an increase of approximately 67.7%, while sales of casing has increased by four times when compared with previous year. Revenue from overseas market was increased by approximately 104.4% to RMB808.2 million.

For the two years ended 31 December 2007, the Group's revenue breakdown by products are as follows:

	2007 RMB'000	%	2006 RMB'000	%	Percentage of increase %
Oil well pipes	**673,875**	**39.6**	584,618	57.6	15.3
Casing	**717,236**	**42.2**	137,825	13.6	420.4
Oil well sucker rods	**102,704**	**6.0**	100,316	9.9	2.4
Oil well pumps	**25,627**	**1.5**	23,008	2.3	11.4
Oil well pumping machines	**21,824**	**1.3**	12,056	1.2	81.0
Other petroleum drilling and extraction machinery and accessories	**159,139**	**9.4**	156,214	15.4	1.9
Total	**1,700,405**	**100**	1,014,037	100	67.7

For the two years ended 31 December 2007, the Group's revenue breakdown by countries are as follows:

	2007 RMB'000	%	2006 RMB'000	%	Percentage of increase %
China	**892,161**	**52.5**	618,613	61.0	44.2
USA	**286,701**	**16.9**	163,547	16.1	75.3
Europe	**344,814**	**20.3**	118,288	11.7	191.5
Others	**176,729**	**10.3**	113,589	11.2	55.6
Total	**1,700,405**	**100**	1,014,037	100	67.7

Gross Profit

The Group's gross profit increased from approximately RMB235.5 million for the year ended 31 December 2006 to approximately RMB319.7 million for the current year, representing an increase of approximately 35.7%.

Consolidated Gross Profit Margin

The consolidated gross profit margin of the Group is approximately 18.8% for the current year and the consolidated gross profit margin for the year ended 31 December 2006 was approximately 23.2%.

During the period under review, there was a decrease in the consolidated gross profit margin of the Group, which was mainly due to the increase in the percentage of revenue from casings to 42.2% in the current year and the relatively low gross profit margin of casing products as the production capacity was not fully released.

Net Profit from Ordinary Activities Attributable to Equity Holders of the Parent

The Group's net profit from ordinary activities attributable to equity holders of the parent excluding data of the Maolong Group for the same period increased from approximately RMB139.4 million for the year ended 31 December 2006 to approximately RMB200.3 million for the current year, representing an increase of approximately 43.7%. The substantial increase was mainly due to the rapid increase in the Group's revenue.

Cost of Sales

The Group's cost of sales increased from approximately RMB778.5 million for the year ended 31 December 2006 to approximately RMB1,380.7 million for the current year, representing an increase of approximately 77.4%. The significant increase in cost of sales was mainly attributable to the growth of the Group's revenue.

Distribution Cost

The distribution cost rose from approximately RMB28.3 million for the year ended 31 December 2006 to approximately RMB39.8 million for the year ended 31 December 2007. The increase of distribution cost is mainly due to the increase of the Group's transportation costs by approximately RMB8.0 million in the current year. Distribution cost was approximately 2.8% of the Group's total revenue in 2006 and decreased to approximately 2.3% in 2007.

Administrative Expenses

The Group's administrative expenses increased from approximately RMB33.8 million for the year ended 31 December 2006 to approximately RMB36.5 million for the current year, representing an increase of approximately 8.0%. Administrative cost has decreased from approximately 3.3% of the Group's revenue for the year ended 31 December 2006 to approximately 2.1% of the Group's revenue for the year ended 31 December 2007, which represents a decrease of 1.2%.

Finance Cost

The finance cost of the Group for the current year was approximately RMB26.6 million, representing approximately 1.6% of the Group's total revenue representing an increase of RMB14.6 million when compared to the finance cost of the Group for the year ended 31 December 2006 over the same period. The increase in finance costs was principally due to the increase of loan for business expansion.

Research and Development Cost

The research and development cost of the Group for the current year was approximately RMB19.8 million, representing approximately 1.2% of the Group's total revenue and an increase of approximately RMB8.1 million when compared to the research and development cost for the year ended 31 December 2006. The rise was mainly due to the Group's increasing efforts in the research and development of new products, such as high-pressure survivable and corrosion-resistant steel casing as well as oil pipes.

Liquidity and Financial Resources

As at 31 December 2007, the total current assets of the Group amounted to approximately RMB1,195.8 million (2006: approximately RMB912.4 million) which comprises: (1) cash and bank balances for the total amount of approximately RMB113.0 million (2006: approximately RMB34.1 million) and pledged time deposit to RMB160.6 million (2006: approximately RMB219.3 million). The Company was still mainly using the Bank Acceptance Bill and pledged approximately 30% to 50% fixed deposits, which did not only reduce the rate of bank loan, but also obtained interest from fixed deposit as a result of increasing earnings of the Company. (2) Trade receivable and notes receivable amounted to approximately RMB261.0 million (2006: approximately RMB173.7 million). The increase was mainly attributable to increased market demand for oil drilling and extraction machinery and related accessories, which further boosted sales of products. (3) Inventories amounted to approximately RMB599.2 million (2006: approximately RMB447.6 million) and down payment, deposits and other receivables amounted to approximately RMB60.6 million (2006: approximately RMB37.8 million). The increase was mainly attributable to the improvement of production capacity and increase of sales volume which made it essential to keep inventories and deposit for purchase of raw material.

As at 31 December 2007, the total current liability of the Group amounted to approximately RMB1,056.7 million (2006: RMB847.5 million) which comprises: (1) trade and bills payables approximately RMB575.0 million (2006: RMB611.7 million). The decrease was mainly attributable to a reduction in bank acceptance bill payments as a result of an adjustment made to the model for the procurement of materials; (2) bank loan amounted to approximately RMB157.1 million (2006: approximately RMB135.0 million), this is due to the increased short-term bank loans for the expansion of the scale of the Company. According to the planned arrangement of the present current asset condition and future cash flow, the Company anticipates that it will have sufficient repayment ability to support the Group's operation.

Banking Facilities

For the current year, the Group had interest-bearing bank credit loans amounting to approximately RMB537.1 million (2006: approximately RMB205.0 million). In addition, eleven banks, including the Agricultural Bank of China has granted credit facilities to the Group amounting to approximately RMB700.0 million (2006: approximately RMB352.0 million) that have not been utilised.

Cash Flow

As at 31 December 2007, the cash and cash equivalents of the Company increased by approximately RMB78.3 million as compared with that of the year ended 31 December 2006 (2006: a decrease by approximately RMB150.2 million). The net cash flow from operations of the year amounted to approximately RMB55.0 million (2006: RMB61.8 million). Such decrease is primarily attributable to the increase of project funds such as inventory and trade receivables as a result of the increased sales. Other cash flow items include approximately RMB57.6 million as the additional pledged time deposits, approximately RMB267.1 million as capital expenditures for the purchase of certain fixed assets, approximately RMB13.0 million for distribution of dividends for 2007, and approximately RMB619.2 million as proceeds of new bank loan facilities.

Capital Structure

As at 31 December 2007, the liability ratio of the Company was approximately 172.6% (2006: approximately 170.9%). The increase was mainly attributable to the increase in bills payable, bank loans and reserves over those of last year, all these reflected the favorable conditions of market demand of the Company; the improvement of the Company's operation management and the emphasis on financial management by way of using bills payable in the purchase of raw materials in the operation to enhance the returns on assets, which led to better control on the increase of bank loans. At present, the Company has strong debt repayment ability and has a better fund raising ability in the future.

Gearing Ratio

The Group's gearing ratio was approximately 63.3% (2006: approximately 63.1%) which is calculated based on the Group's total liabilities of approximately RMB1,450.3 million (2006: approximately RMB917.5 million) and total assets of approximately RMB2,290.3 million (2006: approximately RMB1,454.2 million).

Pledge of Assets

The pledged deposits of the Group are as security for bills payable of approximately RMB345.3 million (2006: approximately RMB485.5 million).

Foreign Exchange Exposure

The Group's foreign exchange exposure mainly comes from certain receivables, cash and cash equivalents dominated in a currency other than the functional curreney.

Segment Information

An analysis of the Group's revenue and segment results by geographical segments for the current year is set out in note 4 to the financial statements.

Capital Commitment

For the current year, the Group had capital commitments of approximately RMB128.3 million (2006: approximately RMB52.4 million) in respect of fixed assets.

Employees

For the year ended 31 December 2007, the Group had a total of 2,247 employees (31 December 2006: 1,987 employees). Staff costs including Directors' remuneration were approximately RMB50.0 million (2006: approximately RMB36.7 million). The salaries and benefits of employees of the Group are kept at competitive levels. Employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system which is reviewed annually. A wide range of benefits are also provided to the employees by the Group.

For the year ended 31 December 2007, the breakdown of the number of employees of the Group is set out as below:

	As at 31 December	
	2007	2006
Research and development	**60**	57
Production	**1,863**	1,609
Quality control	**98**	95
Sales and marketing	**65**	58
Administration	**161**	168
Total	**2,247**	1,987

The Group keeps a close watch on the level of employees' remuneration and benefits, and rewards staff according to the results of the Group's operating achievement. Furthermore, the Group offers training and development opportunities to its employees.

Significant Investments

In the year ended 31 December 2007, the Group did not have any significant investment plans.

Acquisitions and Disposals during the Year and Future Investment Plans

The Company entered into the equity transfer agreement (the "**Equity Transfer Agreement**") with all of the shareholders of Maolong Machinery on 25 September 2007, whereby the Company will acquire 100% equity interest of Maolong Machinery held by shareholders of Maolong Machinery at a total consideration of RMB305,000,000. This connected transaction had been approved at the EGM held on 20 December 2007. The circular and EGM resolution about this major and connected transaction were published at the website of the Stock Exchange of Hong Kong Limited and the Company on 2 November 2007 and 21 December 2007 respectively.

By the end of this report period, the Company has paid an amount RMB183,000,000, which accounts for 60% of the total price under the Equity Transfer Agreement, financed by bank borrowing and its own funds. The Company plans to pay the remaining RMB122,000,000, which accounts for 40% of the total consideration with its own funds within 360 days after finishing the relevant registration with the Administrative Bureau for Industry and Commerce. By the end of this report period, the relevant alteration registrations with the Administrative Bureau for Industry and Commerce were finished, and the transaction has was completed.

In the year ended 31 December 2007, the Group did not have other relevant disposals and significant investment plan.

Directors

Executive Directors

Mr. Zhang En Rong (張恩榮先生), aged 68, is the chairman of the Company and an executive Director. Mr. Zhang is a founder of the Company and is responsible for the overall strategic planning, management and business development of the Group. Since the establishment of the Company, Mr. Zhang has held various positions in the Group including the general manager. Mr. Zhang was also a member of the 12th session, 13th session and 14th session of the Weifang City People's Congress of the PRC, a member of the 5th session and the 6th session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr. Zhang was the legal representative and factory manager of Shandong Shouguang Petroleum Machinery Parts Factory ("**Petroleum Machinery Parts Factory**"), Shandong Shouguang Petroleum Machinery Factory ("**Petroleum Machinery Factory**") and Weifang Molong Industrial Company ("**Weifang Molong**") from 1987 to 1993 and the general manager of Shandong Molong Holdings Company ("**Molong Holdings**") from 1994 to 2001. Mr. Zhang was granted the "Good Enterprise Management Personnel" certificate in 1988, the "Modern Industrial Manufacturing Producer" in 1991 and the "Wealth Attainment and Development of Shandong medal of Shandong Province ("山東省「富民興魯」勞動獎章") in 2004. Mr. Zhang is the father of Mr. Zhang Yun San, an executive Director.

Mr. Zhang Yun San (張雲三先生), aged 46, is a founder, the deputy chairman, an executive Director and the general manager of the Company. He is responsible for assisting the chairman of the Board in the overall strategic planning and management and business development of the Group. Mr. Zhang has served in Molong Holdings since 15 November 2007 as general manager. Since 1993, Mr. Zhang has held various positions in Molong Holdings and the Group, including deputy general manager and deputy chairman of the Company. Mr. Zhang graduated from Nanjing University with a bachelor of laws degree and holds an advanced certificate in Training Course of Chinese Communist Party School for Entrepreneurs and was granted the "Excellent Private Enterpriser of Weifang City" in 2004; "Top Ten Young Entrepreneurs of Weifang City" in 2005, "Excellent Chief Information Officer of Weifang City" in 2006 and was appointed as the member of the 10th session of the Weifang City People's Congress of the PRC and the member of the 15th session of the Shouguang City People's Congress of the PRC. Mr. Zhang is currently a member the 15th session of the Standing Committee of Shouguang City People's Congress of the PRC, Deputy Chairman of Shouguang City Association of Entrepreneurs and Vice President of Shouguang City Industries and Commerce Association. He has abundant experience in the development, manufacture and sales of petroleum drilling and extraction machinery and the management of the Group. Mr. Zhang is the son of Mr. Zhang En Rong, an executive Director.

Mr. Lin Fu Long (林福龍先生), aged 56, is a founder, and an executive Director and responsible for major project management of the Group. He is responsible for the overall management of the Group. Mr. Lin was deputy factory manager of Petroleum Machinery Parts Factory, Petroleum Machinery Factory and Weifang Molong from 1989 to 1993 and was deputy general manager of Molong Holdings from 1994 to 2001. Mr. Lin was an executive director of Weifang Molong Machinery. Mr. Lin was awarded as an "Capable Sales Person" by the Shouguang City People's Government in 1994.

Mr. Xie Xin Cang (謝新倉先生), aged 46, is a founder, an executive Director, and deputy general manager of the Company. Mr. Xie has served in Molong Holdings since 1995 as deputy general manager. During his employment, Mr. Xie has applied the nickel plating phosphorus alloy technology in the manufacturing of petroleum drilling and extraction machinery and successfully invented the "MB424 steel wire teasel" that possess international advanced level. Mr. Xie graduated from Xian Jiaotong University in mechanical engineering and majored in metal materials and their heat treatment, the degree of Bachelor of Engineering. Mr. Xie was awarded the "Shandong Province Town and Village Enterprise Technology Innovation Leader" certificate by the Shandong Province Town and Village Enterprise Management Bureau in 1998. Mr. Xie was a standing committee member of the seventh session of the Shouguang City committee of the National Committee of the Chinese People's Political Consultative Conference and is a member of the 8th Session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr Xie is the husband of Ms. Li Bao Hui, a supervisor (a "**Supervisor**") of the Company.

Non-executive Directors

Mr. Chen Jian Xiong (*陳建雄先生*), aged 53, is a non-executive Director. Mr. Chen has worked for Rodless Oil Pump Company of the Shengli Petroleum Administration Bureau ("Rodless Oil Pump") for over 20 years. Since 1994, Mr. Chen has been the chairman of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited ("Kaiyuan Oil") and was an assistant manager of Rodless Oil Pump. In 2004, he served as manager of Rodless Oil Pump. Mr. Chen is currently the Chairman of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited and Shengli Pump Industry Co., Ltd., Shengli Oilfield. Mr. Chen was appointed as a non-executive Director on 28 December 2001, and was re-appointed as a non-executive Director on 7 May 2005.

Mr. Wang Ping (王平先生), aged 53, is a non-executive Director. Mr. Wang has over 20 years of experience in metallurgy and received his doctorate degree in engineering from the University of Science and Technology Beijing. Since 2000, Mr. Wang is a professor at the University of Science and Technology of Beijing. Mr. Wang was appointed as a non-executive Director of the Company on 29 March 2003 and was re-appointed as a non-executive Director of the Company on 12 May 2006.

Independent non-executive Directors

Mr. Qin Xue Chang (秦學昌先生), aged 43, is an independent non-executive Director and the Chairman of the Audit Committee. Mr. Qin has 20 years of experience in accounting and auditing industry. He received his bachelor degree in economics from Shanxi University of Finance and Economics and is a practicing certified public accountant in the PRC. Mr. Qin is a deputy chairman of Beijing Yongtuo Certified Public Accountants Co., Ltd., Director of Shandong Branch Office, Beijing Yongtuo Certified Public Accountants Co., Ltd. He is currently a member of the CPPCC Shandong Provincial Committee, a deputy to the Weifang City People's Congress and a member of the Foreign Affairs Committee under the Standing Committee, an executive member of the Shandong Provincial Industry & Commerce Federation, an executive director of the Shandong Provincial Accounting Society and vice-chairman of the Weifang Youth Federation. The deputy chairman of Industrial and Commercial Union of Weifang City, part-time professor of Shandong Economic and Trade Vocational College. He was acclaimed as the "Top Ten Intellectual Models of Shandong Province" and awarded the second-class honour from the Department of Science and Technology of Shandong Province in 2006. In March 2007, he was elected as the member of 10th session of the Weifang City People's Congress of the PRC. Mr. Qin was appointed as an independent non-executive Director of the Company on 29 March 2003 and was re-appointed as an independent non-executive Director of the Company on 12 May 2006.

Mr. Yan Yi Zhuang (閻翊莊先生), aged 51, is an independent non-executive Director and the Chairman of the Nomination Committee of the Company. He is also an operation manager of Shougang Concord Technology Holdings Ltd., a company listed on the Main Board of the Stock Exchange. Mr. Yan has over 10 years of management experience in electronics technology and graduated from the University of Western Sydney, Australia. Mr. Yan was appointed as an independent non-executive Director on 29 March 2003 and was re-appointed as an independent non-executive Director on 12 May 2006.

Mr. Loke Yu alias Loke Hoi Lam (陸海林先生), aged 58, is an independent non-executive Director and a chairman of the Remuneration and Appraisal Committee of the Company. Mr. Loke has over 30 years of experience in accounting and auditing for private and public companies, financial consultancy and corporate management. He holds a Master of Business Administration Degree from Universiti Teknologi Malaysia and a Doctor of Business Administration Degree from University of South Australia. He is a Fellow of The Institute of Chartered Accountants in England and Wales; Hong Kong Institute of Certified Public Accountants and The Hong Kong Institute of Directors. He is also an associate member of The Hong Kong Institute of Chartered Secretaries and a member of Malaysian Institute of Accountants. He is Chairman of MHL Consulting Limited, and serves as an independent non-executive director of several companies, which are listed on the Stock Exchange.

Supervisors

Ms. Li Bao Hui (李寶惠女士), aged 45, is a Supervisor and the chairman of the supervisory committee of the Company (the "**Supervisory Committee**"). She is currently a quality control manager of the Company and has worked in the quality control department of Molong Holdings since 1995. She has over 10 years of experience in quality control and quality management and graduated from Shanxi Radio and Television University. Ms. Li is the wife of Mr. Xie Xin Cang, an executive Director. Ms Li was appointed as a Supervisor on 29 March 2003 and was re-appointed as a Supervisor on 12 May 2006.

Mr. Liu Wan Fu (劉萬賦先生), aged 69, is a Supervisor. Mr. Liu is a consultant of China National Petroleum Corporation. Mr. Liu has over 40 years of experience in the petroleum industry. Mr. Liu was appointed as a Supervisor on 29 March 2003 and was re-appointed as a Supervisor on 12 May 2006.

Mr. Fan Ren Yi (樊仁意先生), aged 42, is a Supervisor. Mr. Fan is the vice general manager and CFO of Shandong Charming Home-Textiles Co., Ltd.. Mr. Fan holds a bachelor degree from Xian Jiaotong University and is a certified public accountant in the PRC. He was appointed as a Supervisor on 29 March 2003 and was re-appointed as a Supervisor on 12 May 2006.

Senior Management

Mr. Guo Huan Ran （國煥然先生）, aged 41, is the deputy general manager of the Company and is responsible for operations and technology research and development of the Group. Mr. Guo joined Molong Holdings in March 1991. Mr. Guo graduated from Weifang College with a major in Machine Manufacturing and Processing Equipment, and held various positions in the Company including technician, workshop supervisor and Production Director. Mr. Guo has extensive experience in areas including production management and technology research and development of petroleum drilling and extraction machinery. Mr. Guo has directed the innovation of various items for export, such as liner for mud pump and valve body. Some of the products, such as "Special Centralizer for Electrical Submersible Pump System", gained the third prize of "Science and Technology Achievements Award from Village & Township Enterprises Administration of Ministry of Agriculture of People's Republic of China". Mr. Guo has been granted the title of "Outstanding Young Entrepreneur of Shouguang City" in November 2007.

Mr. Zhang Yu Zhi (張玉之先生), aged 49, is a deputy general manager of the Company. He is responsible for the sales of the Group. Mr. Zhang has over 10 years of experience in petroleum drilling and extraction machinery industry. Before joining the Group, he was responsible for management of Weifang Transportation Company and Shouguang Shangkou Sales Agency. He joined the Company in October 1994 as a general manager of Xinjiang office, and has participated in the petroleum drilling and extraction machinery industry since then.

Mr. Zhang Shou Kui (張守奎先生), aged 38, is the deputy general manager of the Company and is responsible for organizing the Group's production. Mr. Zhang joined Molong Holdings in 1990. He has been engaging in the production management for over ten years and has extensive related experiences. He held consecutively as the Chief of Inspection Station, General Manager of Branch Plant, and Manager of Production Department in the Group. He is a member of the Communist Party of China. Having been appointed by the 8th meeting of the second session of Board, Mr. Zhang will be the Deputy General Manager of the Company effective from 16 March 2008.

Mr. Cui Huan You (崔煥友先生), aged 59, is in charge of the finance, accounting and tax department of the Company. Mr. Cui has significant experience in finance, accounting and taxation. He joined Molong Holdings as an accounting supervisor in June 1995. He graduated from Shandong Province Financial Zhigong University. Mr. Cui was awarded the "Outstanding Financial Management Personnel" in 1992 and the "Advanced Accountant of Weifang City" in 2004.

Ms. Sheng Qiang (盛強女士), aged 45, is the secretary to the Board. Ms. Sheng has served in Molong Holdings since 2006. Ms. Sheng graduated in the discipline of auto motion and instrumentation from Shandong University of Technology with a bachelor degree in engineering in 1986. Ms. Sheng was issued the certificate of "secretary to the directors' board" by the Shanghai Stock Exchange in 1997. Ms. Sheng was a secretary to the board in a company which are listed on the Stock Exchange before joining the Group. Ms. Sheng has many years of experience in management of securities matters.

Qualified Accountant and Company Secretary

Mr. Chan Wing Nang, Billy (陳永能先生), aged 46, is the qualified accountant and company secretary of the Company. Mr. Chan graduated from the University of Newcastle upon Tyne, United Kingdom with a bachelor degree in Civil Engineering in 1986. He also read a master degree in business administration at the University of Warwick, United Kingdom. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants and The Institute of Chartered Accountants in England and Wales. Mr. Chan has over 10 years of experience in the accounting and consulting field. Prior to joining the Group, Mr. Chan was a director in a consulting company. Mr. Chan joined the Group on 13 December 2004.

The Board is pleased to present the annual report and the audited financial statements for 2007 of the Group.

Principal Activities

The Group is principally engaged in the design, manufacture and sale of oil well pumping machines, oil well sucker rods, oil well pumps, oil well pipes, casing and other petroleum drilling and extraction machinery accessories.

Results

The Group's profit for the current year and the state of financial affairs of the Group and the Company at that date are set out in the financial statements on pages 48 to 112 of the annual report.

Financial Summary

A summary of the results and of the assets and liabilities of the Group for the past five financial years is set out on page 5 of the annual report.

Dividends

The Board has resolved to recommend a final dividend of RMB0.015 per share (inclusive of tax) for the current year. The proposal to declare and pay this final dividend will be submitted to the annual general meeting to be held on 5 May 2008 (the "**AGM**") for the approval of the Shareholders. Final dividend for domestic shares of the Company will be declared and paid in RMB whereas dividend for H shares will be declared in RMB and paid in Hong Kong dollars. The record date for final dividend payment, the final dividend payment procedues and payment date will be notified and announced after the AGM. The H share register of the Company will be closed from 5 April 2008 to 5 May 2008 (both days inclusive) during which no transfer of H shares of the Company will be registered.

There was no arrangement under which the Shareholders waived or agreed to waive any dividends during 2007.

Changes in Share Capital

Pursuant to the resolution and authorization of the 2006 Annual General Meeting held on 25 July 2007 (the "**2006 AGM**"), the Company issued and listed new shares of the Company (the "**Shares**") to all Shareholders by capitalizing the distributable retained profits of 2006 (two Shares for each existing Share) and by converting the capital reserve fund (two Shares for each existing Share) in amount of 2,591,992,000 Shares. The Company completed the placing of 49,252,000 new H Shares to offshore investors and listed the same on 19 September 2007. The changes in share capital of the Company for 2007 from the aforesaid incidents are set out below, the details are set out in note 30 to the financial statements.

Name of shareholder	Beginning of 2007 (RMB'000)	Percentage of total Shares	After bonus issue of Shares in 2007 (RMB'000)	After placing H Shares in 2007 (RMB'000)	Percentage of total Shares	type of Shares
Domestic shares						
Among:						
Zhang En Rong	27,951.7	43.14%	139,758.5	139,758.5	42.49%	natural shares
Lin Fu Long	3,421.6	5.28%	17,108.0	17,108.0	5.20%	natural shares
Zhang Yun San	3,060.8	4.72%	15,304.0	15,304.0	4.65%	natural shares
Xie Xin Cang	2,141.0	3.30%	10,705.0	10,705.0	3.25%	natural shares
Liu Yun Long	1,467.0	2.26%	7,335.0	7,335.0	2.23%	natural shares
Cui Huan You	923.8	1.43%	4,619.0	4,619.0	1.40%	natural shares
Liang Yong Qiang	681.9	1.05%	34,09.5	3,409.5	1.04%	natural shares
Shengli Kaiyuan	524.4	0.81%	2,622.0	2,622.0	0.80%	domestic corporate shares
H Shares	24,627.6	38.01%	123,138.0	128,063.2	38.94%	overseas-listed tradable shares
Total	64,799.8	100%	323,999.0	328,924.2	100%	

Reserves and Distributable Reserves

Details of changes in the reserves of the Group and of the Company for 2007 are set out in note 31 to the financial statements.

Under the PRC laws and regulations, the Company's distributable reserves will be based on the lower of the amount calculated according to the PRC accounting principles and rules and the amount calculated according to the Hong Kong generally accepted accounting principles. At the end of 2007, the Company's distributable profit was approximately RMB248,760,000 (2006: approximately RMB188,647,000).

Property, Plant and Equipment, and Investment Properties

Details of changes in the property, plant and equipment and investment properties of the Group for 2007 are set out in notes 14 and 15 to the financial statements.

Capitalised Interest

For 2007, the Group did not have any capitalised interest.

Directors and Supervisors

The list of Directors and Supervisors during 2007 and up to the date of this report is set out on page 2 in this annual report.

Directors' and Supervisors' Service Contracts or Letters of Appointment

Each of the Directors and Supervisors (including the independent non-executive Directors and the Supervisors) has entered into a service contract or letter of appointment with the Company for a term of three years. None of the Directors or the Supervisors had entered into any service contract or letter of appointment with the Group which is not terminable by the Company within one year without payment of compensation, other than statutory compensation.

Re-election of the Board

With its zealous devotion for approximately 3 years since the listing of the H Shares on the GEM on 15 April 2004, the First Board of the Company accomplished its obligations and successfully arranged the listing of the H shares of the Company on the Main Board. According to "Company Law" of the PRC and the relevant requirements of the articles of association of the Company (the "**Articles of Association**"), the Nomination Committee proposed the "Resolution of Re-election of the Board" in the 22nd board meeting of the First Board on 29 March 2007. This proposition was approved in the 2006 AGM. All the directors of the first session of the Board were appointed the new members of the second session of the Board.

Special Committee

Upon the re-election of certain Directors, the re-election of the Nomination Committee, the Audit Committee and the Remuneration and Evaluation Committee were held.

The Nomination Committee was established on 18 January 2005 and its members are Mr. Zhang Yun San, Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam). On 28 May 2007, the Board of Directors approved that the aforementioned four directors constituted the Second Nomination Committee of the Board. Mr. Yan Yi Zhuang is the chairman of the Nomination Committee.

The Audit Committee was established on 20 March 2004 and its members are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam). On 28 May 2007, the Board of Directors approved that the aforementioned three persons constituted the Second Audit Committee of the Board. Mr. Qin Xue Chang is the chairman of the Audit Committee.

The Remuneration and Evaluation Committee was established on 18 January 2005 and its members are Mr. Zhang Yan San, Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam). On 28 May 2007, the Board of Directors approved that the aforementioned four directors constituted the Second Remuneration and Evaluation Committee of the Board. Mr. Loke Yu (alias Loke Hoi Lam) is the chairman of the Remuneration and Evaluation Committee.

Executive Directors

The appointment of Mr. Zhang En Rong, Mr. Zhang Yun San, Mr. Lin Fu Long and Mr. Xie Xin Cang ended on 24 March 2007. Pursuant to the Articles of Association of the Company, the aforementioned four persons were re-elected as executive directors at the 2006 AGM with terms from 25 May 2007 to 24 May 2010.

Profiles of the aforementioned four persons are set out in pages 18 and 19 of the section headed "Directors, Supervisors and Senior Management" of this annual report.

Non-executive Director

Mr. Wang Ping (王平先生) was appointed as a non-executive Director of the Company from 29 March 2003, and ended on 29 March 2006. Pursuant to the Articles of Association, he was re-elected as a non-executive Director at the meeting held on 12 May 2006 (the "2005 AGM") with terms of office from 12 May 2006 to 11 May 2009.

Mr. Chen Jian Xiong (陳建雄先生) was appointed as a Director on 28 December 2001. Pursuant to the Articles of Association, he was re-elected as a non-executive Director at the annual general meeting held on 7 May 2005 (the "2004 AGM") with terms of office from 7 May 2005 to 6 May 2008. The Nomination Committee of the Board has proposed to reappoint Mr. Chen as an non-executive Director, and submitted the proposal to the AGM for consideration.

Independent Non-executive Director

Mr. Qin Xue Chang (秦學昌先生) and Mr. Yan Yi Zhuang (閻翊莊先生) were appointed as the independent non-executive Directors on 29 May 2003 ended on 28 March 2006. Pursuant to the Articles of Association, they were re-elected as the independent non-executive Directors at the 2005 AGM with terms of office from 12 May 2006 to 11 May 2009.

Mr. Loke Yu alias Loke Hoi Lam (陸海林先生) was appointed as the independent non-executive Director of the Company on 20 March 2004 and the chairman of the Remuneration and Evaluation Committee ended on 20 March 2007. Pursuant to the Articles of Association, Mr. Loke was re-elected as the independent non-executive Director at the 2006 AGM with terms of office from 25 May 2007 to 24 May 2010..

Pursuant to the requirement of Rule 5.09 of the Listing Rules of the GEM, the Company has received the confirmation letter from each independent non-executive Director before transference to the Main board. After the migration to the Main Board, pursuant to Rule 3.13 of the Listing Rules of the Main Board, the Board still regards each independent non-executive Director as an independent person.

Emoluments of Directors and Highest Paid Individuals

Details of the emoluments of the Directors and the 5 highest paid individuals the emoluments are based on their tasks, experience, qualification and/or performance, are set out in notes 8 and 9 to the financial statements.

Connected Transactions

The Company and Shouguang Molong Electro-mechanical Equipment Company Limited （壽光墨龍機電設備有限公司）(“**Molong Equipment**”) entered into a series of agreements in relation to the supply of casting to the Company (“**Casting Supply Agreements**”) on 20 March 2004, 20 December 2005 and 22 September 2006, which took effect upon the listing of the H shares of the Company on GEM on 15 April 2004 and would remain in force up to 31 December 2007 (both dates inclusive). Pursuant to the Casting Supply Agreements, Molong Equipment agreed to sell and the Company agreed to purchase casting. It has been agreed that if the castings are subject to any prescribed rates, the unit price of the casting will adopt the Prescribed Rates. Otherwise, the price will be negotiated and agreed by both parties with reference to the market price. In addition, Molong Equipment has agreed that the purchase price of the Company will not be higher than that of the same products sold by Molong Equipment to independent third parties in its normal course of business over the same period. The principal terms of the Casting Supply Agreements have been disclosed in the Listing Document dated 19 October 2006 (“Introduction Document”) for the listing by way of introduction of the entire issued H share capital on the Main Board.

On 22 September 2005, the Company and Weihai Baolong Special Petroleum Materials Co., Ltd. （威海市寶隆石油專材有限公司）(“**Weihai Baolong**”) entered into an oil well pipe billets and casing billets supply agreement. Weihai Baolong has agreed to supply the oil well pipe billets and casing billets to the Company. The agreement has been effective from 28 November 2005 and remain in force up to 31 December 2007 (both dates inclusive). It has been agreed that the supply price of oil pipe billets and casing billets charged by Weihai Baolong to the Company will be the prevailing market price less an agreed discount of not more than RMB100 per tonne. In addition, Weihai Baolong undertook that the supply price offered to the Company would not be higher than the supply price of the same goods offered to independent third parties over the same period.

On 22 September 2005, the Company and Molong Equipment entered into a metallurgy accessories supply agreement pursuant to which Molong Equipment agreed to supply metallurgy accessories to the Company. The agreement was effective from 28 November 2005 and remain in force up to 31 December 2007 (both dates inclusive). It has been agreed that the supply price of metallurgy accessories charged by Molong Equipment to the Company will adopt the fixed rates prescribed by the relevant authorities of the PRC (if any), or if no fixed rates are prescribed, with reference to the market price with a discount.

On 22 September 2005, the Company and Molong Equipment entered into a scrap and used metal supply agreement. The Company will supply scrap and used metal to Molong Equipment. The agreement has been effective from 28 November 2005 and remain in force up to 31 December 2007 (both inclusive), It has been agreed that the supply price will adopt the fixed rate (if any), or if no fixed rate is prescribed, with reference to the prevailing market price, subject to adjustment.

As at 12 July 2006, Molong Drilling Equipment Limited ("**Molong Drilling**"), a subsidiary of the Company, entered into a co-operative agreement with Karamay Yalong Oil Well Pump Limited ("**Yalong Oil Well Pump**") to sell oil well pumps and related accessories. The agreement is effective from 1 January 2006 to 31 December 2007 (both dates inclusive). The agreed price will be determined based on the prevailing market price.

The aforementioned five non-exempted continuing connected transactions have been approved by independent Shareholders prior to the listing of the Company on the Main Board in compliance with the Listing Rules of the GEM. Since the aforementioned transactions will continue and remain valid upon the listing of the Company on the Main Board, the Directors have obtained a waiver from strict compliance with the announcement and/or independent shareholders' approval as requirements under Chapter 14A of Listing Rules from the Stock Exchange. If the historical figures of relevant transactions exceeds relevant annual cap or there is any material change to the terms of the relevant agreements upon renewal, the Company will act in full compliance with the relevant requirements of the Listing Rules of the Main Board by performing the relevant review and approval procedures. During the year ended on 31 December 2007, none of the historical figures of the aforementioned five connected transactions exceeded relevant annual cap.

On 25 September, 2007, an Equity Transfer Agreement was executed between the Company and Mr. Zhang Yun Qi, Mr. Lin Fu Long, Mr. Zhang Yun Shan, Mr. Zhang Jin Chuan, Ms. Li Bao Hui, Mr. Guo Huan Ran, Mr. Liu Yun Long, Mr. Zhang Guang He, Mr. Zhang Zhi Jun, Mr. Cui Huan You, Mr. Xie Xin Cang, Mr. Ren Chun Qing and Mr. Zhang Jing Sheng, being all the shareholders of Maolong Machinery, whereby the Company will purchase 100% of the equity interest of Maolong Machinery owned by such shareholders. (See page 17 of the Annual Report: Acquisitions and Disposals during the Year and Future Investment Plans). The product line of Maolong Machinery covers, among others, materials and auxiliaries which may be used by the Group in its own production of petroleum drilling machinery and relevant components. Upon completion of the transaction as to purchase of 100% equity interest of Maolong Machinery by 27 December, 2007, the forgoing five continuing connected transactions will not constitute a continuing connected transaction.

Mr. Zhang En Rong, Mr. Zhang Yun San, Mr.Lin Fu Long, Mr. Xie Xin Cang, Mr.Liu Yun Long and Mr. Cui Huan You were promoters of the Company. According to the Listing Rules, they are connected persons of the Company. Ms Li Bao Hui is a Supervisor. According to the Listing Rules, 14A.11(3) , Ms Li is also a connected person of the Company. Mr. Zhang Yun Qi, the son of Mr. Zhang En Rong and the brother of Mr. Zhang Yun San, is regarded as an associate of Directors and is therefore regarded as a connected person of the Company under the Listing Rules. As Mr. Zhang Yun Qi is interested in approximately 53.15% of the equity interest in Maolong Machinery, Maolong Machinery is deemed to be a connected person of the Company.

Maolong Machinery and the MPM are interested in 75.0% and 25.0% of the registered capital of Molong Equipment respectively. Given that Maolong Machinery is deemed to be a connected person of the Company by the Stock Exchange and Molong Equipment is a subsidiary of Maolong Machinery, Molong Equipment is also deemed to be a connected person of the Company.

Maolong Machinery and Molong Equipment are interested in 95% and 5% of the registered capital of Weihai Baolong respectively. Given that Maolong Machinery is deemed to be a connected person of the Company and that Weihai Baolong is a non wholly-owned subsidiary of Maolong Machinery, Weihai Baolong is also deemed to be a connected person of the Company.

Maolong Machinery is interested in 30% of the equity interest of Yalong Pump, and Mr. Zhang Yun Qi indirectly interested so as to exercise or control the exercise of 30% of the voting power at the general meeting, so Yalong Pump is deemed to be a connected person of the Company.

Accompanying the completion of the acquisition of 100% equity interests for Maolong Machinery on 27 December 2007, Maolong Mechinery and its affiliated companies such as Molong Equipment, Weihai Baolong and Yalong Pump are not the connected persons of the Company.

The independent non-executive Directors have reviewed the above connected transactions in 2007 and confirmed that, in their opinions:

1. The transactions have been entered into by the Group in the ordinary and usual course of its businesses;

2. The transactions have been entered into on normal commercial terms, or where there are no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favorable to the Company than those available to or from independent third parties; and

3. The transactions are entered into in accordance with the terms of the agreement governing such transaction and on terms that are fair and reasonable and in the interests of the Company and shareholders of the Company as a whole.

The auditors of the Company have reviewed the transactions, and have provided a letter to the Company stating that:

1. The transactions have been approved by the Board of directors;

2. The transactions have been entered into in accordance with the pricing policies of the Company which are referenced to the prevailing market prices. Certain goods purchased by or sold to the Group do not have readily prevailing market price information, the prices of these transactions were determined by the parties;

3. The transactions have been entered into in accordance with the relevant agreements governing such transactions; and

4. The transactions have not exceeded the caps disclosed in the Introduction Document of the Company dated 19 October 2006.

In respect of the connected transactions and the continuing connected transactions, the Company has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

Retirement/Pension Scheme Benefits

Staff welfare (salaries):	**2007 RMB'000**	2006 RMB'000
Wages and salaries	**45,412**	33,184
Contributions to retirement benefit schemes	**4,575**	3,531
Total	**49,987**	36,715

As stipulated by the laws, orders and regulations of the PRC, the Group participated in various defined contribution retirement plans organised by municipal governments for its staff. Currently, the Group is required to make contributions to the retirement plans at a rate of 18% (2006: 18.0%) of the salaries, bonuses and certain allowances of its staff. A member of the plan is entitled to a pension, to be paid by the municipal governments, equal to a fixed proportion of the salary prevailing at his retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. When the staff leave the positions, the Group is not entitled to recover the contributions paid in respect of their pension scheme benefits.

Disclosure of Directors', Supervisors' and Chief Executive's Interests in Shares, Underlying Shares and Debentures

As at 31 December 2007, interests and short positions of the Directors, Supervisors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "**SFO**")), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to the Model Code for Securities Transactions by Directors of Listed Company as set out in Appendix 10 of the Listing Rules, to be notified to the Group and to the Stock Exchange, were as follows:

Long positions in the Shares

Name	Type of interest	Number of domestic shares *(Note1)*	Percentage of domestic shares	Percentage of total registered share capital
Zhang En Rong	Beneficial	1,397,585,000	69.58%	42.49%
Lin Fu Long	Beneficial	171,080,000	8.52%	5.20%
Zhang Yun San	Beneficial	153,040,000	7.62%	4.65%
Xie Xin Cang	Beneficial	107,050,000	5.33%	3.25%
Li Bao Hui (Supervisor) *(Note2)*	Interests of spouse	107,050,000	5.33%	3.25%

Note1 *Unlisted shares*

Note2 Ms. Li Bao Hui is the wife of Mr. Xie Xin Cang and is taken to be interested in the 107,050,000 domestic shares held by Mr.Xie Xin Cang under the SFO.

Save as disclosed above, to the best knowledge of the Directors, Supervisors and chief executive, none of the Directors, the Supervisors or chief executive had any interests or short position in shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), which will have to be notified to the Company and the Stock Exchange under Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under the SFO) or will be required pursuant to section 352 of the SFO to be entered in the register referred to therein, or which will be required pursuant to the Model Code for Securities Transactions by Directors of Listed Company as set out in Appendix 10 of the Listing Rules, to be notified to the Group and to the Stock Exchange.

Directors' and Supervisors' Rights to Acquire Shares or Debentures

None of the Directors or Supervisors or their respective associates (as defined under the Rule 1.01 of the Listing Rules of the Main Board) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights for 2007.

Share Option Scheme

The Company does not have any share option scheme.

Substantial Shareholders

As at 31 December 2007, so far as known to the Directors, Supervisors or chief executive of the Company, the following persons (other than a Director, Supervisor or chief executive) had, or were deemed or taken to have interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO:

Long positions in the H Shares

Name	Type of interests	Number of H Share	Percentage of H shares	Percentage of total registered capital
Paul G. Desmarais *(Note 1)*	Interest of controlled corporation	244,052,000 *(Note 1)*	19.82%	7.53%
Nordex Inc. *(Note 1)*	Interest of controlled corporation	244,052,000 *(Note 1)*	19.82%	7.53%
Gelco Enterprises Ltd. *(Note 1)*	Interest of controlled corporation	244,052,000 *(Note 1)*	19.82%	7.53%
Power Corporation of Canada *(Note 1)*	Interest of controlled corporation	244,052,000 *(Note 1)*	19.82%	7.53%
Power Financial Corporation *(Note 1)*	Interest of controlled corporation	244,052,000 *(Note 1)*	19.82%	7.53%
IGM Financial Incorporation *(Note 1)*	Interest of controlled corporation	244,052,000 *(Note 1)*	19.82%	7.53%
Martin Currie (Holdings) Limited *(Note 2)*	Interest of controlled corporation	116,780,000	9.48%	3.61%
Commonwealth Bank of Australia *(Note 3)*	Interest of controlled corporation	72,906,000	5.92%	2.25%

Notes:

1. According to the disclosure of interest notices filed by Desmarais Paul G., Gelco Enterprises Ltd., IGM Financial Inc., Nordex Inc., Power Corporation of Canada and Power Financial Corporation, each of these companies is interested in 244,052,000 H Shares as at 31 Dec 2007, this figure has taken into Among these 244,052,000 H Shares in which these companies are deemed to have interest, 228,676,000 H Shares were directly held by Mackenzie Cundill Investment Management Ltd. and 15,376,000 H Shares were directly held by Mackenzie Cundill Investment MGMT (Bermuda) Ltd.

Mackenzie Cundill Investment Management Ltd. is a wholly-owned subsidiary of Mackenzie Financial Corporation, which in turn is a wholly-owned subsidiary of Mackenzie Inc. Mackenzie Inc. is a wholly-owned subsidiary of IGM Financial Inc., which in turn is owned as to 55.99% by Power Financial Corporation, Power Financial Corporation is owned as to 66.40% by 171263 Canada Inc, which in turn is a wholly-owned subsidiary of 2795957 Canada Inc. 2795957 Canada Inc is a wholly-owned subsidiary of Power Corporation of Canada, which in turn is owned as to 54.18% by Gelco Enterprise Ltd., Gelco Enterprise Ltd. is owned as to 94.95% by Nordex Inc., which in turn is owned as to 68% by Paul G. Desmarais.

Mackenzie Cundill Investment MGMT (Bermuda) Ltd, is a wholly-owned subsidiary of Mackenzie (Rockies) Corp. which in turn is a wholly-owned subsidiary of Mackenzie Financial Corporation.

2. According to the disclosure of interest notices filed by Martin Currie (Holdings) Limited and Martin Currie Ltd., each of these companies is interested in 116,780,000 H Shares of the Company as at 31 Dec 2007, this figure has taken into among these 116,780,000 H Shares in which these companies are deemed to have interest, 50,220,000 H Shares were directly held by Martin Currie Inc and 66,560,000 H Shares were directly held by Martin Currie Investment Management.

   Martin Currie Inc and Matin Currie Investment Management are wholly-owned subsidiaries of Martin Currie Ltd., which in turn is a wholly-owned subsidiary of Martin Currie (Holdings) Limited.

3. The H Shares in which Commonwealth Bank of Australia was deemed interested in under SFO were held by a corporation it controlled indirectly. The 72,906,000 H Shares are directly held by First State Investments (Hong Kong) Ltd, which was a wholly-owned subsidiary of First State (Hong Kong) LLC, which was in turn wholly-owned by First State Investments (Bermuda) Ltd., First State Investments (Bermuda) Ltd. was wholly owned by First State Investment Managers (Asia) Ltd. which was wholly owned by Colonial First State Group Ltd. Colonial First State Group Ltd. was wholly owned by Commonwealth Insurance Holdings Ltd. which was wholly owned by Colonial Holding Company Pty. Ltd. Commonwealth Bank of Australia wholly and directly owns the interests in Colonial Holding Company Pty. Ltd..

Save as disclosed above, so far as known to the Directors Supervisors or chief executive of the Company, there are no other persons not being a Director, Supervisor or chief executive of the Company who had, or were deemed or take to have interests or short positions in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register required to be kept under section 336 of the SFO.

Directors' Interests in Contracts

Saved as set out in Note 34 to "Related Party Transactions" and in the section headed "Connected Transactions" above, there were no contracts of significance to which the Company or any of its subsidiaries was a party and in which any of the Directors had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Contracts of Significance

Saved as the transactions set out in Note 36 to "Related Party Transactions" and in the section headed "Connected Transactions", none of the Company (or any of its subsidiaries) and the controlling shareholders of the Company (or any of its subsidiaries) has entered into any material contracts, and none of the controlling shareholders of the Company (or any of its subsidiaries) has provided any material service contract to the Company (or any of its subsidiaries).

Major Customers and Suppliers

During 2007, 52.2% of the Group's products are sold to domestic oilfields within the PRC. In addition, 47.8% of the Group's products are sold to customers in countries and regions such as the North America, Europe, Middle East, Southeast Asia, Africa, and Latin America, etc. The five largest customers accounted for approximately 69.3% of the Group's total revenue. The largest customer of the Group accounted for approximately 38.5% of the Group's total revenue.

During 2007, the Group's major suppliers are reputable material producers in the PRC, with whom the Group has established good relationships. With oil well pipe being one of our main products, continuous casting pipe billet is the Group's principal raw materials. The largest supplier was 威海市寶隆石油專材有限公司, which the Group has signed strategic co-operation agreement with. The five largest suppliers accounted for approximately 62.4% of the Group's total procurement. The largest supplier accounted for approximately 27.7% of the Group's total procurement.

Save as disclosed above, none of the Directors, Supervisors, their associates or any shareholders of the Company (who or which to the knowledge of the Directors own more than 5.0% of the share capital of the Company) has any beneficial interest in any of the Group's five largest customers and suppliers.

Purchase, Sale or Redemption of Securities

Neither the Company nor its subsidiary has purchased, sold or redeemed any listed securities of the Company during 2007.

Pre-emptive Rights

There is no provision for pre-emptive rights under the Articles of Association of the Company or the laws of the PRC which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Corporate Governance

The principal Code on Corporate Governance adopted by the Company is set out in the Corporate Governance Report on pages 38 to 44 of the annual report.

Sufficiency of Public Float

According to information of the Company available to the public and to the knowledge of the Directors, the Directors confirm that the Company has maintained a sufficient public float throughout the year under review.

Auditors

For the five years ended 31 December 2007, the Company has not changed its auditors.

The accounts have been audited by Ernst & Young who will retire and, being eligible, will offer themselves for re-appointment as the auditors of the Company. A resolution for their re-appointment as the auditors of the Company will be proposed at the forthcoming AGM.

By order of the Board of Directors
Zhang En Rong
Chairman

Shandong, the PRC
16 March 2008

To the Shareholders:

The supervisory committee (the "**Supervisory Committee**") of Shandong Molong Petroleum Machinery Company Limited, in compliance with the provisions of the Company Law of the People's Republic of China (the "**PRC Company Law**"), the relevant laws and regulations of Hong Kong and the Articles of Association of the Company, has conducted its work in accordance with the fiduciary principle, and has taken up an active role to work faithfully and diligently to protect the interests of the Company and the Shareholders.

During 2007, the Supervisory Committee has convened two meetings. Three members of the supervisory committee attended the meetings and reviewed cautiously the development plans of the Company and provided reasonable suggestions and opinions to the board of Directors whilst attending board meetings. It also strictly and effectively monitored and supervised the Company's management in making significant policies and decisions to ensure that they are in compliance with the laws and regulations of the PRC and the Articles of Association of the Company, and that they are in the interests of the Shareholders.

During 2007, we canvassed all documents about the internal control system for the company making by the Board, including the "Independent Directors' Rules", "Internal Control System", the "Guarantee to Any Other Party Administrative Measures", the "Related Party Transactions Administration Measures", the "Proceeds Administration Measures", the "General Manager Detailed Rules and the Article of Association", the "Rules and Procedures of the Meeting of the Shareholders", the "Rules and Procedures of the Board", the "Rules and Procedures of the Supervisory Committee", which are revised for the A shares. Meanwhile we also reviewed Board documents for the acquisition Maolong Machinery major and connected transactions. We believe that the capital operations during the year is in compliance with the requirement of the Regulatory Authorities and Hong Kong main board Listing Rules; the company strictly follows the essential information disclosure procedures that perfect the company governance structure, and have achieved great progress in standard operation.

We have carefully reviewed and agreed to the report of the Directors, audited financial statements, the report of the use of proceeds of the Company's previous secondary placing during the year and the plan of the declaration of a final dividend to be proposed by the Board for presentation at the annual general meeting. The Supervisors believe that during 2007, the operating results of the Company adequately reflects its state of affairs; all expenses and costs incurred were reasonable; the plan for distribution of dividends accommodated the Shareholders' interests and the long-term benefits of the Group, and the statutory surplus reserve and welfare fund provided from net profits for the year were made in compliance with applicable laws, regulations and the Articles of Association.

Throughout 2007, to the best knowledge of the Supervisory Committee, none of the Directors or other officers of the Group had been found to have abused their authority, damaged the interests of the Company or infringed upon the interest of the Shareholders and the Company's employees. To the best knowledge of the Supervisory Committee, none of the Directors or other officers of the Company was found to be in breach of any applicable laws and regulations, the Articles of Association of the Company or relevant regulations of China Securities Regulatory Commission. We are of the opinion that the Directors and other officers of the Company were able to strictly observe their respective duties, to act diligently and to exercise their authority faithfully in the best interests of the Company.

The Supervisory Committee is satisfied with the achievement and cost-effectiveness of the Company for 2007 and has great confidence in the future of the Company and would like to take this opportunity to express its appreciation to all Shareholders, Directors and staff of the Company for the strong support of our work.

By order of the Supervisory Committee
Li Bao Hui
Chairman of the Supervisory Committee

Shandong, the PRC
16 March 2008

The Company strives to attain a higher standard of corporate governance. The principles of corporate governance adopted by the Group emphasize a quality Board, sound internal control, and transparency and accountability to all stakeholders.

(a) Corporate Governance Practices

The Company put strong emphasis on the superiority, steadiness and rationality of corporate governance. In order to enhance the management level, the Company has set up a committee to review its internal management structure. During the current year, the Company has complied with the requirements with respect to "Code on Corporate Governance Practices", of Appendix 15 to the Listing Rules on the GEM before the migration of the listing of the Company to the Main Board and "Code on Corporate Governance Report", Appendix 14 of the Listing Rules of the Main Board, after the migration of the listing of the Company to the Main Board.

(b) Directors' Securities Transactions

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 of the Listing Rules, which requires the securities transactions of the Directors of the Company to be conducted in accordance with the Model Code. The Model Code is also applicable to the senior management of the Company. After making specific enquiries, all Directors have confirmed that they have fully complied with the Model Code throughout 2007.

(c) The Board

The Board is responsible for planning and overseeing the overall development and management of the Group with the objective of enhancing shareholders' value. The Board, led by the Chairman, is responsible for the approval and monitoring of the overall strategies and policies of the Group, approval of annual budgets and business plans, evaluation of the Company's performance and oversight of the management. In 2007, the Board comprised nine Directors, including four executive Directors, two non-executive Directors and three independent non-executive Directors. Biographical details of the Directors are set out under the "Directors, Supervisors and Senior Management" section from pages 18 to 20 in this annual report. The independence of an Independent Non-executive Director may only be established upon confirmation by the Board that such Director does not have any other direct or indirect relationship with the Group. The Chairman of the Board, Mr. Zhang En Rong, is the father of Mr. Zhang Yun San, an executive Director. Aside from this, there is no financial, business and relatives relationship among members of the Board.

During 2007, the Board has convened nine meetings.

Attendence record of the directors:

Members of Directors	Position	Number of meetings attended
Zhang En Rong	Chairman and Executive Director	9/9
Zhang Yun San	Deputy Chairman and Executive Director	9/9
Lin Fu Long	Executive Director	9/9
Xie Xin Cang	Executive Director	9/9
Chen Jian Xiong	Non-executive Director	9/9
Wang Ping	Non-executive Director	9/9
Qin Xue Chang	Independent non-executive Director	9/9
Yan Yi Zhuang	Independent non-executive Director	9/9
Loke Hoi Lam	Independent non-executive Director	9/9

(d) Chairman and General Manager

The Chairman provides leadership for the Board. He is responsible for approving and monitoring the overall strategies and policies of the Group, reviewing annual budget and business plan, assessing the performance of the Company and overseeing the duties of the management. The General Manager is responsible for daily operations of the Group. The roles of Chairman and General Manager are separate and not are performed by the same individual. During the current year, Mr. Zhang En Rong was the Chairman and Mr. Lin Fu Long was the General Manager.

Mr. Zhang Yun San was appointed as General Manager, for a term beginning 15 November 2007 to 31 December 2010 , by the Directors on the 7th Session of the Second Board on 15 November 2007. Mr. Lin Fu Long has no longer served as the General Manager of the Company since 15 November 2007.

(e) Non-executive Director

The appointment of non-executive Director, Mr. Chen Jian Xiong, is valid from 7 May 2005 to 6 May 2008. The appointment of non-executive Director, Mr. Wang Ping, is valid from 12 May 2006 to 11 May 2009.

(f) Nomination Committee

The Nomination Committee was established on 18 January 2005 and its members are Mr. Yan Yi Zhuang, Mr. Zhang Yun San, Mr. Qin Xue Chang and Mr. Loke Yu (alias Loke Hoi Lam), with Mr. Yan Yi Zhuang as the Chairman of the Nomination Committee.

Summary of Tasks of the Nomination Committee

The Nomination Committee submitted to the Board with related motion on the 22nd Session of the First Board on 29 March 2007 and nominate the new Director candidate list to the Board following the process below:

1. Candidate acquisition: any person can recommend Director candidate to Nomination Committee as well as recommend oneself to be Director candidate.

2. Qualification examination: as regards to the persons above, the Nomination Committee should strictly examine the qualifications of Director candidate in accordance with Director choice standard.

3. Written survey: Nomination Committee should examine and verify the aptitude of the Director candidate who conforms to the requirement and provide a written report.

4. Official recommendation: Nomination Committee is in charge of choosing the excellent from the qualified candidates and give official nomination during general meeting.

Members of Nomination Committee	Position	Number of meetings attended
Yan Yi Zhuang	Committee Chairman and Independent non-executive Director	1/1
Zhang Yun San	Deputy Chairman and Executive Director	1/1
Qin Xue Chang	Independent non-executive Director	1/1
Loke Hoi Lam	Independent non-executive Director	1/1

The Nomination Committee identifies Directors or manager candidates with appropriate qualifications and advises the Board accordingly.

(g) Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee was established on 18 January 2005 and its members are Mr. Loke Yu (alias Loke Hoi Lam), Mr. Zhang Yan San, Mr. Qin Xue Chang, Mr. Yan Yi Zhuang, Mr. Loke Yu (alias Loke Hoi Lam) is the chairman of the Remuneration and Evaluation Committee.

Summary of Tasks of the Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee submitted to the Board with remuneration solution on the 22nd Session of the first Board on 29 March 2007 and follow the basic principles below to formulate senior management remuneration:

1. ensuring that the level emolument corresponds with Director's, Supervisor's and Senior management's work experience, ability, obligation and responsibility taken.

2. ensuring that no Director, Supervisor or senior management determines one's own remuneration.

3. any increase of remuneration should be in line with the change of the Company's profit and the development status of the Company.

Formulation of the remuneration

1. Formulation of the remuneration for Executive Directors

   Executive Directors' remuneration is formulated by the Remuneration Committee and is consisted of basic salary and incentives. The Company and each executive Director should enter into an "executive Director service agreement".

2. Formulation of the remuneration for non-executive Director and independent non-executive Director

   Non-executive Directors and independent non-executive Directors' remuneration advised by the Remuneration and Evaluation Committee and reported to the Board for permission. The Company and each non-executive Director or independent non-executive Director should sign "Non-executive Director Service Agreement" or "Independent Non-executive Director Service Agreement", respectively.

Summary of tasks of Remuneration and Evaluation Committee

Members of Remuneration and Evaluation Committee	Position	Number of meetings attended
Loke Hoi Lam	Committee Chairman and Independent non-executive Director	1/1
Zhang Yun San	Deputy Chairman and Executive Director	1/1
Qin Xue Chang	Independent non-executive Director	1/1
Yan Yi Zhuang	Independent non-executive Director	1/1

The Remuneration and Evaluation Committee has determined the remuneration of the Directors according to their expertise, knowledge and commitment to the Company with reference to the Company's profitability and the prevailing market conditions.

3. Formulation of the remuneration for Senior management

   Senior management's remuneration is formulated by Remuneration Committee and is consisted of basic salary and incentive.

(h) Audit Committee

The Audit Committee was established on 20 March 2004 and its members are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam), with Mr. Qin Xue Chang as the Chairman of the Committee. Mr. Qin Xue Chang and Mr. Yan Yi Zhuang were assigned to be a member of Audit Committee from 12 May 2006 to 11 May 2009. Mr. Loke Yu (Loke Hoi Lam) continues to serve as member of the Audit Committee after re-elected as Independent Non-executive Director in 25 May 2007.

Summary of tasks of Audit Committee

The Audit Committee has held three meetings this year to discuss matters relating to the accounting standards and practices adopted by the Group, and internal control and financial reporting matters, etc., including reviewing the audited results. The Audit Committee has reviewed the major and connected transactions Acquisition of Mao long Machinery, and was elected to the Board as an independent committee to the shareholders on independent advice.

The Audit Committee had held meetings with the external auditors of the Company to discuss the interim report, the annual financial statements and the internal control system of the Company. The Directors and Chief Financial Officer of the Company also attended the meetings to answer questions in respect of the financial results of the Company.

The management of the Company shall provide all ledgers, analyses and supporting documents as required by the Audit Committee to facilitate their review on the financial statements and control system of the Company to their satisfaction so that they may submit appropriate advice to the Board.

Members of the Audit Committee	Duties	Number of meetings attended
Qin Xue Chang	Committee Chairman and Independent non-executive Director	3/3
Yan Yi Zhuang	Independent non-executive Director	3/3
Loke Hoi Lam	Independent non-executive Director	3/3

(i) Auditors' Remuneration

For 2007, auditing service less payable to the Company's auditors ("Ernst & Young") amounted to approximately RMB0.9 million. The Company confirms that other professional fee payable to Ernst & Young amounted to approximately RMB3.7 million by the Company during the year.

(j) The Directors confirmed their responsibilities in preparing the Group's financial statements

The Directors have confirmed that the preparation of the Group's financial statement is in compliance with the relative regulations and applicable accounting standards. The Directors also warrant that the Group's financial statement will be distributed in due course.

(k) Internal Control

The Board places great importance on internal control and risk management and is responsible for establishing and maintaining adequate internal control over financial reporting for the Company and assessing the overall effectiveness of those internal controls.

The Company has taken many steps to enhance the internal control of the Company, such as having internal control inspection, setting up a receipt mechanism and strengthening the management of the contracts.

The Company has an Internal Audit Department which plays a major role in monitoring the internal governance of the Company. The major tasks of the Internal Audit Department are reviewing the financial condition and management of the Company and conducting comprehensive audits of the practices, procedures, expenditure and internal controls of all branches and subsidiaries of the Company on a regular basis. During the year of 2007, the Internal Audit Department issued reports to the senior management covering various operational and financial units of the Company and also conducted reviewed of major projects and contracts as well as area of concern identified by the Company's management.

(l) Going Concern

For 2007, there was no uncertainty or conditions of a material nature that would affect the Company's ability as to continue as a going concern.

(m) Investor Relations

The Board Office of the Company is responsible for preparing responses to written and telephone enquiries from shareholders/investors. The Company maintains a hotline (86 536 5101565-8106) and email addresses: dsh@molonggroup.com and pyj@molonggroup.com for such enquiries.

The Company has appointed a company engaged in financial public relations and adopted its advice from time to time. We also seek professional opinions from overseas investors recommended by this Company to ensure good communication with investors.

According to the proposal for issuing A share, the Company referenced to the "Guidelines for Articles of Association of listed companies" (as amended in 2006) issued by CSRC and the " Company Law of PRC " (the "Company Law") which took effect in 1 January 2006 , the Articles of Associations of the Companies was amended systematically. In addition, amendments were made to the " Rules and Procedures of the Meeting of the Shareholders", the "Rules and Procedures of the Board " and " the Rules and Procedures of the Supervisory Committee" in accordance with the domestic relevant requirements, and the " Independent Directors Rules" was adopted as an appendix to the Articles of Associations. The above amendments and adoption were approved by the EGM. They have contained the requirements of domestic regulatory authorities to the external security, the connected transaction, the administration of the use of proceeds. This further upgrade the corporate governance structure, and regulated the operation of the Company. At the same time, the Company cordially invites shareholders to express their opinions by filling out the feedback form enclosed with the annual report. Visits to our facilities in the PRC will also be arranged for shareholders. Opinions from our shareholders will be forwarded to senior management and the Directors of the Company.

(n) Sincere Communication

The Board knows that it is essential establishing a good relationship with investors. The company has established a good channel of communication with institutional investors and analysts, and made introduction to them of the Company's performance timely. The migration from the GEM to the Main Board of the Stock Exchange and placing of H Share in 2007 attracted more attention of the foreign investors. We also held demonstrations, meetings with investors, and telephone conference to communicate with investors widely. The executives participated in these meetings more than 20 performances, and effectively enhanced the corporate transparency.

The Company has a policy of open communication and fair disclosure. Disclosure is a key means to enhance our corporate governance standards. The Company provides its Shareholders and other stakeholders with the information necessary for them to form their own judgement and to provide feedback. The Company understands that full and frank disclosure does not only increase transparency of the Company, but is also essential for building market confidence.

The Company understands that not all Shareholders and stakeholders have ready access to information online. If this is the case, please feel free to send a written request to our Board Office at No. 99 Beihai Road, Shouguang City, Shandong Province,(ZIP :262703) the PRC or email to dsh@molonggroup.com for a copy of the above information.

Proposed A Share Issue

For the purpose of promoting the OTGC production scale and the competitiveness of the Company, the Board had passed a resolution on 9 September 2007 for the issue of not more than 700 million A Shares of RMB0.10 each (or 70 million A Shares of RMB1.00 each). The proceeds from the A Share Issue shall be used to facilitate the 180 millimeters special petroleum pipes reconstruction project. The proposed A Share issue had been approved with a special resolution at the EGM and separated Class Meetings on 17 November 2007. The proposed A Share issue shall be completed after the approved by CSRC.

ERNST & YOUNG
安永會計師事務所

■ Certified Public Accountants
18/F Two International Finance Centre,
8 Finance Street, Central, Hong Kong
■ Phone: 852 2846 9888
Fax: 852 2868 4432

To the shareholders of
Shandong Molong Petroleum Machinery Company Limited
(Registered in the People's Republic of China with limited liability)

We have audited the financial statements of Shandong Molong Petroleum Machinery Company Limited set out on pages 48 to 112, which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2007 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Ernst & Young
Certified Public Accountants
Hong Kong
16 March 2008

Year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
REVENUE	5	**1,700,405**	1,014,037
Cost of sales		**(1,380,747)**	(778,488)
Gross profit		**319,658**	235,549
Other income and gains	5	**44,610**	14,946
Selling and distribution costs		**(39,846)**	(28,254)
Administrative expenses		**(36,486)**	(33,790)
Other expenses		**(27,247)**	(14,588)
Finance costs	6	**(26,646)**	(12,089)
Share of profit of an associate		**4,196**	—
PROFIT BEFORE TAX	7	**238,239**	161,774
Tax	10	**(37,210)**	(19,100)
PROFIT FOR THE YEAR		**201,029**	142,674
Attributable to:			
Equity holders of the parent	11	**200,330**	139,404
Minority interests		**699**	3,270
		201,029	142,674
DIVIDENDS	12		
Interim		**—**	9,708
Proposed final		**49,339**	12,960
		49,339	22,668
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT – Basic (RMB)	13	**0.062**	0.043

31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	14	**820,313**	505,155
Investment properties	15	**3,574**	7,664
Prepaid land lease payments	16	**88,584**	19,709
Intangible asset	17	**377**	253
Goodwill	18	**147,115**	—
Investment in an associate	20	**2,142**	—
Available-for-sale investment	21	**10,000**	50
Long term prepayment		**6,704**	—
Deferred tax assets	29	**15,705**	8,942
Total non-current assets		**1,094,514**	541,773
CURRENT ASSETS			
Inventories	22	**599,168**	447,579
Trade receivables	23	**232,957**	169,878
Bills receivable		**28,080**	3,786
Prepayments, deposits and other receivables	24	**60,618**	37,808
Due from related party	36(c)(i)	**1,449**	—
Pledged deposits	25	**160,557**	219,254
Cash and bank balances	25	**112,980**	34,138
Total current assets		**1,195,809**	912,443
CURRENT LIABILITIES			
Trade and bills payables	26	**575,039**	611,721
Other payables and accruals	27	**259,117**	59,024
Interest-bearing bank and other borrowings	28	**157,120**	135,000
Due to related parties	36(c)(ii)	**18,132**	22,966
Tax payable		**47,256**	18,740
Total current liabilities		**1,056,664**	847,451
NET CURRENT ASSETS		**139,145**	64,992
TOTAL ASSETS LESS CURRENT LIABILITIES		**1,233,659**	606,765
NON-CURRENT LIABILITIES			
Interest-bearing bank loans	28	**380,000**	70,000
Deferred tax liabilities	29	**13,631**	—
Total non-current liabilities		**393,631**	70,000
NET ASSETS		**840,028**	536,765

31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
EQUITY			
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT			
Issued capital	30	**328,924**	64,800
Reserves	31(a)	**414,850**	450,844
Proposed final dividend	12	**49,339**	12,960
		793,113	528,604
MINORITY INTERESTS		**46,915**	8,161
TOTAL EQUITY		**840,028**	536,765

Zhang Yun San
Director

Xie Xin Cang
Director

Year ended 31 December 2007

		Attributable to equity holders of the parent										
	Note	Issued share capital RMB'000	Capital reserve RMB'000	Statutory reserve fund* RMB'000	Statutory welfare fund# RMB'000	Retained profits RMB'000	Exchange fluctuation reserve RMB'000	Subtotal of reserves RMB'000 (note 31(a))	Proposed final dividend RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2006		64,800	177,712	23,965	11,982	120,700	—	334,359	11,016	410,175	4,891	415,066
Final 2005 dividend declared		—	—	—	—	—	—	—	(11,016)	(11,016)	—	(11,016)
Exchange realignment		—	—	—	—	—	(251)	(251)	—	(251)	—	(251)
Profit for the year		—	—	—	—	139,404	—	139,404	—	139,404	3,270	142,674
Transfer from retained profits to statutory reserve fund		—	—	17,167	—	(17,167)	—	—	—	—	—	—
Interim 2006 dividend	12	—	—	—	—	(9,708)	—	(9,708)	—	(9,708)	—	(9,708)
Proposed final 2006 dividend	12	—	—	—	—	(12,960)	—	(12,960)	12,960	—	—	—
At 31 December 2006		64,800	177,712	41,132	11,982	220,269	(251)	450,844	12,960	528,604	8,161	536,765

Year ended 31 December 2007

		Attributable to equity holders of the parent										
	Note	Issued share capital RMB'000	Capital reserve RMB'000	Statutory reserve fund* RMB'000	Statutory welfare fund# RMB'000	Retained profits RMB'000	Exchange fluctuation reserve RMB'000	Subtotal of reserves RMB'000 (note 31(a))	Proposed final dividend RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2007		64,800	177,712	41,132	11,982	220,269	(251)	450,844	12,960	528,604	8,161	536,765
Final 2006 dividend declared		—	—	—	—	—	—	—	(12,960)	(12,960)	—	(12,960)
Exchange realignment, income and expense charged directly to equity		—	—	—	—	—	(691)	(691)	—	(691)	(228)	(919)
Profit for the year		—	—	—	—	200,330	—	200,330	—	200,330	699	201,029
Paid-in capital		4,924	72,906	—	—	—	—	72,906	—	77,830	—	77,830
Transfer from capital reserve and retained profits to issued share capital		259,200	(129,600)	—	—	(129,600)	—	(259,200)	—	—	—	—
Transfer from retained profits to statuary reserve fund		—	—	17,111	—	(17,111)	—	—	—	—	—	—
Transfer from statutory welfare fund to statutory reserve fund		—	—	11,982	(11,982)	—	—	—	—	—	—	—
Establishment and incorporation of subsidiaries		—	—	—	—	—	—	—	—	—	45,625	45,625
Acquisition of minority interests		—	—	—	—	—	—	—	—	—	(7,342)	(7,342)
Proposed final 2007 dividend	12	—	—	—	—	(49,339)	—	(49,339)	49,339	—	—	—
At 31 December 2007		328,924	121,018	70,225	—	224,549	(942)	414,850	49,339	793,113	46,915	840,028

* The Company and its subsidiaries in Mainland China are required to comply with the laws and regulations of the People's Republic of China (the "PRC") and their articles of association to provide for the statutory reserve fund, which is appropriated from the profit for the year, but before dividend distribution, at the discretion of their board of directors on at least 10% of the profit for the year. The statutory reserve fund is provided for each entity until the balance of the fund has reached 50% of the entity's registered capital. The statutory reserve fund may only be used, upon approval of the relevant authority, to offset accumulated losses or to increase capital.

\# During the year, the whole balance of the Group's statutory welfare fund as at 31 December 2007 has been transferred to the Group's statutory reserve fund which is in compliance with the current legal requirements.

Year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		**238,239**	161,774
Adjustments for:			
Finance costs	6	**26,646**	12,089
Bank interest income	5	**(6,970)**	(3,887)
Gain on disposal of items of property, plant and equipment	5	**(6,005)**	(181)
Gain on disposal of prepaid land lease payments		**(2,394)**	—
Amortisation of an intangible asset	7	**314**	284
Depreciation	7	**39,917**	26,339
Recognition of prepaid land lease payments	7	**929**	492
Share of profit of an associate		**(4,196)**	—
		286,480	196,910
(Increase)/decrease in inventories		**5,546**	(233,725)
(Increase)/decrease in trade receivables		**(40,384)**	(94,134)
(Increase)/decrease in bills receivable		**(21,894)**	11,378
(Increase)/decrease in prepayments, deposits and other receivables		**(7,607)**	(23,950)
(Increase)/decrease in amounts due from a related party		**(772)**	21,977
Increase/(decrease) in trade and bills payables		**(114,842)**	190,532
Increase in other payables and accruals		**30,633**	19,979
Increase/(decrease) in amounts due to related parties		**(37,490)**	12,324
Cash generated from operations		**99,670**	101,291
Interest paid		**(26,646)**	(12,089)
Income tax paid – PRC corporate income tax		**(18,012)**	(27,419)
Net cash inflow from operating activities		**55,012**	61,783

Year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Net cash inflow from operating activities		**55,012**	61,783
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest received	5, 7	**6,970**	3,887
Purchases of items of property, plant and equipment		**(267,136)**	(205,401)
Purchases of prepaid land lease payments		**(1,024)**	—
Purchase of an intangible asset		**(438)**	(264)
Proceeds from disposal of property, plant and equipment		**10,824**	575
Proceeds from disposal of prepaid land lease payment		**7,552**	—
Decrease/(increase) in pledged time deposits		**57,620**	(146,075)
Acquisition of a subsidiary		**(148,365)**	—
Purchase of available-for-sale investment		**(10,000)**	—
Acquisition of a minority interest		**(7,342)**	—
Net cash outflow from investing activities		**(351,339)**	(347,278)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares		**77,830**	—
Capital contributed by a minority shareholder		**12,600**	823
New bank loans and other borrowings		**619,244**	333,000
Repayment of bank loans		**(322,124)**	(178,000)
Dividends paid		**(12,960)**	(20,556)
Net cash inflow from financing activities		**374,590**	135,267
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**78,263**	(150,228)
Cash and cash equivalents at beginning of year		**35,215**	185,694
Effect of foreign exchange rate changes, net		**(498)**	(251)
CASH AND CASH EQUIVALENTS AT END OF YEAR		**112,980**	35,215
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	25	**112,980**	34,138
Time deposits with original maturity of less than three months when acquired, pledged as security for bills payable		**—**	1,077
		112,980	35,215

31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	14	**521,918**	490,571
Investment properties	15	**—**	12,194
Prepaid land lease payments	16	**14,307**	19,709
Intangible asset	17	**377**	253
Investments in subsidiaries	19	**425,467**	12,676
Available-for-sale investment	21	**10,000**	50
Deferred tax assets	29	**3,547**	8,942
Total non-current assets		**975,616**	544,395
CURRENT ASSETS			
Inventories	22	**518,719**	420,309
Trade receivables	23	**209,685**	168,083
Bills receivable		**25,680**	3,500
Prepayments, deposits and other receivables	24	**40,440**	35,252
Due from subsidiaries	19	**15,340**	—
Due from a related party	36(d)(i)	**771**	—
Pledged deposits	25	**160,557**	219,254
Cash and bank balances	25	**85,973**	32,459
Total current assets		**1,057,165**	878,857
CURRENT LIABILITIES			
Trade and bills payables	26	**462,833**	607,110
Other payables and accruals	27	**226,113**	61,045
Tax payable		**29,402**	19,210
Interest-bearing bank loans and other borrowings	28	**128,000**	135,000
Due to subsidiaries	19	**142,334**	46,924
Due to related parties	36(d)(ii)	**18,132**	15,881
Total current liabilities		**1,006,814**	885,170
NET CURRENT ASSETS/(LIABILITIES)		**50,351**	(6,313)
TOTAL ASSETS LESS CURRENT LIABILITIES		**1,025,967**	538,082
NON-CURRENT LIABILITIES			
Interest-bearing bank loans	28	**270,000**	70,000
NET ASSETS		**755,967**	468,082
EQUITY			
Issued capital	30	**328,924**	64,800
Reserves	31(b)	**377,704**	390,322
Proposed final dividend	12	**49,339**	12,960
TOTAL EQUITY		**755,967**	468,082

Zhang Yun San
Director

Xie Xin Cang
Director

31 December 2007

1. CORPORATE INFORMATION

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

During the year, the Group was involved in the design, manufacture and sale of petroleum extraction machinery and related accessories, which included oil well pipes, oil well sucker rods, oil well pumps and oil well pumping machines.

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("**HKFRSs**") (which include all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("**HKASs**") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the remeasurement of certain equity investments as further explained below. These financial statements are presented in Renminbi ("RMB").

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2007. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries. An acquisition of minority interests is accounted for using the parent entity extension method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as goodwill.

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 interpretations has had no material effect on these financial statements.

HKFRS 7	*Financial Instruments: Disclosures*
HKAS 1 Amendment	*Capital Disclosures*
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*

The principal effects of adopting these new and revised HKFRSs are as follows:

(a) HKFRS 7 *Financial Instruments: Disclosures*

This 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. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results of operations of the Group, comparative information has been included where appropriate.

(b) Amendment to HKAS 1 *Presentation of Financial Statements - Capital disclosures*

This amendment requires the Group to make disclosures that enable users of the financial statements to evaluate the Group's objectives, policies and processes for managing capital. These new disclosures are shown in note 37 to the financial statements.

(c) HK(IFRIC)-Int 8 *Scope of HKFRS 2*

This interpretation requires HKFRS 2 to be applied to any arrangement in which the Group cannot identify specifically some or all of the goods or services received, for which equity instruments are granted or liabilities (based on a value of the Group's equity instruments) are incurred by the Group for a consideration, and which appears to be less than the fair value of the equity instruments granted or liabilities incurred. As the Company has no issued equity instruments to the Group's employees in accordance with the Group's share option scheme, the interpretation has had no effect on these financial statements.

(d) HK(IFRIC)-Int 9 *Reassessment of Embedded Derivatives*

This interpretation requires that the date to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative is the date that the Group first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Group has no embedded derivative, the interpretation has had no effect on these financial statements.

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

(e) HK(IFRIC)-Int 10 *Interim Financial Reporting and Impairment*

The Group has adopted this interpretation as of 1 January 2007, which requires that an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument classified as available for sale or a financial asset carried at cost is not subsequently reversed. As the Group had no impairment losses previously reversed in respect of such assets, the interpretation has had no impact on the financial position or results of operations of the Group.

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.

HKFRS 8	*Operating Segments*[1]
HKAS 23 (Revised)	*Borrowing Costs* [1]
HK(IFRIC)-Int 11	*HKFRS 2 – Group and Treasury Share Transactions*[2]
HK(IFRIC)-Int 12	*Service Concession Arrangements*[4]
HK(IFRIC)-Int 13	*Customer Loyalty Programmes*[3]
HK(IFRIC)-Int 14	*HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*[4]

1 Effective for annual periods beginning on or after 1 January 2009
2 Effective for annual periods beginning on or after 1 March 2007
3 Effective for annual periods beginning on or after 1 July 2008
4 Effective for annual periods beginning on or after 1 January 2008

HKFRS 8, which will replace HKAS 14 *Segment Reporting*, specifies how an entity should report information about its operating segments, based on information about the components of the entity that is available to the chief operating decision maker for the purposes of allocating resources to the segments and assessing their performance. The standard also requires the disclosure of information about the products and services provided by the segments, the geographical areas in which the Group operates, and revenue from the Group's major customers. The Group expects to adopt HKFRS 8 from 1 January 2009.

HKAS 23 has been revised to require capitalisation of borrowing costs when such costs are directly attributable to the acquisition, construction or production of a qualifying asset. As the Group's current policy for borrowing costs aligns with the requirements of the revised standard, the revised standard is unlikely to have any financial impact on the Group.

HK(IFRIC)-Int 11 requires arrangements whereby an employee is granted rights to the Group's equity instruments, to be accounted for as an equity-settled scheme, even if the Group acquires the instruments from another party, or the shareholders provide the equity instruments needed. HK(IFRIC)-Int 11 also addresses the accounting for share-based payment transactions involving two or more entities within the Group. As the Group currently has no such transactions, the interpretation is unlikely to have any financial impact on the Group.

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

HK(IFRIC)-Int 12 requires an operator under public-to-private service concession arrangements to recognise the consideration received or receivable in exchange for the construction services as a financial asset and/or an intangible asset, based on the terms of the contractual arrangements. HK(IFRIC)-Int 12 also addresses how an operator shall apply existing HKFRSs to account for the obligations and the rights arising from service concession arrangements by which a government or a public sector entity grants a contract for the construction of infrastructure used to provide public services and/or for the supply of public services. As the Group currently has no such arrangements, the interpretation is unlikely to have any financial impact on the Group.

HK(IFRIC)-Int 13 requires that loyalty award credits granted to customers as part of a sales transaction are accounted for as a separate component of the sales transaction. The consideration received in the sales transaction is allocated between the loyalty award credits and the other components of the sale. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed or the liability is otherwise extinguished.

HK(IFRIC)-Int 14 addresses how to assess the limit under HKAS 19 *Employee Benefits*, on the amount of a refund or a reduction in future contributions in relation to a defined benefit scheme that can be recognised as an asset, in particular, when a minimum funding requirement exists.

As the Group currently has no customer loyalty award credits and defined benefit scheme, HK(IFRIC)-Int 13 and HK(IFRIC)-Int 14 are not applicable to the Group and therefore are unlikely to have any financial impact on the Group.

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 HKFRS 8 may result in new or amended disclosures and the adoption of HKAS 23 (Revised) may result in a change in accounting policy, the other 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 investments in subsidiaries are stated at cost less any impairment losses.

Associate

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 investment in an associate is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. The Group's share of the post acquisition results and reserves of an associate is included in the consolidated income statement and consolidated reserves, respectively.

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

Goodwill

Goodwill arising on the acquisition of subsidiaries represents the excess of the cost of the business combination over the Group's interest in the net fair value of the acquirees' identifiable assets acquired, and liabilities and contingent liabilities assumed as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset, initially measured at cost and subsequently at cost less any accumulated impairment losses.

The carrying amount of goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. The Group performs its annual impairment test of goodwill as at 31 December. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Goodwill *(continued)*

Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

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 the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash-generating unit to which the asset belongs.

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

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, but 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 member of the key management personnel of the Group or its parent;

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Related parties *(continued)*

(e) 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 (c) or (d).

Property, plant and equipment and depreciation

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

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

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

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

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

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

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

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investment properties

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

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

For a transfer from investment properties to owner-occupied properties, the cost and carrying amount of the property are transferred to property, plant and equipment at the date of change in use.

Intangible assets (other than goodwill)

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

Software

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

Research and development costs

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

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

Operating leases

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

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets

Financial assets in the scope of HKAS 39 are classified as 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 assesses whether a contract contains an embedded derivative when the Group first becomes a party to it and assesses whether an embedded derivative is required to be separated from the host contract when the analysis shows that the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the 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.

Loans and receivables

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

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified in the above category. 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. Interest and dividends earned are reported as interest income and dividend income, respectively and are recognised in the income statement as “Other income” in accordance with the policies set out for “Revenue recognition” below.

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets *(continued)*

Fair value

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

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 through the use of an allowance account. The amount of the impairment loss is recognised in the income statement. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery.

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 by adjusting the allowance account. 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 and other receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor and significantly changes in the technological, market economic or legal environment that have an adverse effect on 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.

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. A provision for impairment is made for available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or ''prolonged" requires judgement. In addition, the Group evaluates other factors, such as the share price volatility. Impairment losses on equity instruments classified as available for sale are not reversed through the income statement.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Derecognition of financial assets

A financial asset is derecognised where:

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

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

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

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

Financial liabilities including trade and other payables, amount due to related parties and interest-bearing bank loans are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost. The related interest expense is recognised within "finance costs" in the income statement.

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

Derecognition of financial liabilities

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

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Inventories

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

Cash and cash equivalents

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

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

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.

Income tax

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

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

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

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

- where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries and an associate, 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.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Income tax *(continued)*

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

- in respect of deductible temporary differences associated with investments in subsidiaries and an associate, 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 deferred tax liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

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

Government grants and subsidies

Government grants and subsidies from the government are recognised at their fair values where there is reasonable assurance that the grant or subsidy will be received and all attaching conditions will be complied with. When the grant or subsidy relates to an expense item, it is recognised as income over the periods necessary to match the grant or subsidy on a systematic basis to the costs that it is intended to compensate.

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;

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Revenue recognition *(continued)*

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

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

(d) commission income and subcontracting income, on an accrual basis; and

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

Retirement benefits

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

Borrowing costs

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

Dividends

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

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Foreign currencies

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

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

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

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3. SIGNIFICANT ACCOUNTING ESTIMATES

The preparation of the Group's financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

(i) Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating unit to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2007 was RMB147,115,000 (2006: Nil). More details are given in note 18.

(ii) Impairment of non-financial assets (other than goodwill)

The Group assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. Indefinite life intangible assets are tested for impairment annually and at other times when such indicator exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

(iii) Impairment of receivables

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

(iv) Impairment of available-for-sale financial assets

The Group classifies certain assets as available for sale and recognises movements of their fair values in equity. When the fair value declines, management makes assumptions about the decline in value to determine whether there is an impairment that should be recognised in the income statement. At 31 December 2007, no impairment losses have been recognised for the available for sale investment (2006: Nil). The carrying amount of the available for sale investment was RMB10,000,000 (2006: RMB50,000).

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4. SEGMENT INFORMATION

Segment information is presented by way of the Group's primary segment reporting basis, by geographical segment. The Group's operating business is with customers based in the PRC, the United States, Europe and other countries. Each of the Group's geographical segments represents customer destinations to which the Group sells products or provides services which are subject to risks and returns that are different from those of the other geographical segments. No further business segment information is presented as over 90% of the Group's operations relate to the sale of petroleum machinery.

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

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

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4. SEGMENT INFORMATION *(continued)*

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's geographical segments for the years ended 31 December 2007 and 2006:

	PRC		United States		Europe		Other countries		Consolidated	
	2007 RMB'000	2006 RMB'000	**2007 RMB'000**	2006 RMB'000	**2007 RMB'000**	2006 RMB'000	**2007 RMB'000**	2006 RMB'000	**2007 RMB'000**	2006 RMB'000
Segment revenue										
Sales to external customers	**892,161**	618,613	**286,701**	163,547	**344,814**	118,288	**176,729**	113,589	**1,700,405**	1,014,037
Other revenue	**14,887**	5,346	**4,393**	—	**—**	—	**—**	—	**19,280**	5,346
Total revenue	**907,048**	623,959	**291,094**	163,547	**344,814**	118,288	**176,729**	113,589	**1,719,685**	1,019,383
Segment results	**164,753**	125,092	**46,138**	32,894	**73,364**	26,172	**19,033**	28,483	**303,288**	212,641
Unallocated income									**25,331**	9,600
Unallocated expenses									**(63,734)**	(48,378)
Finance costs									**(26,646)**	(12,089)
Profit before tax									**238,239**	161,774
Tax									**(37,210)**	(19,100)
Profit for the year									**201,029**	142,674
Segment assets and liabilities:										
Segment assets	**1,825,555**	1,335,954	**164,863**	72,513	**198,280**	23,034	**101,625**	22,715	**2,290,323**	1,454,216
Total assets									**2,290,323**	1,454,216
Segment liabilities	**1,360,364**	904,501	**671**	2,286	**69,121**	5,867	**20,139**	4,797	**1,450,295**	917,451
Total liabilities									**1,450,295**	917,451
Other segment information:										
Depreciation and amortisation	**41,160**	27,115	**—**	—	**—**	—	**—**	—	**41,160**	27,115
Capital expenditure	**268,598**	205,665	**—**	—	**—**	—	**—**	—	**268,598**	205,665
Provision/(reversal of provision) against inventories	**(4,584)**	9,193	**—**	—	**—**	—	**—**	—	**(4,584)**	9,193
Reversal of impairment of trade receivables	**(2,240)**	(3,278)	**—**	—	**—**	—	**—**	—	**(2,240)**	(3,278)

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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 during the year.

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

	Notes	Group 2007 RMB'000	2006 RMB'000
Revenue			
Sale of petroleum machinery		**1,700,405**	1,014,037
Other income			
Subcontracting income		**1,050**	288
Bank interest income		**6,970**	3,887
Government subsidies		**7,389**	—
VAT refund	(i)	**9,789**	5,376
Gross rental income		**743**	690
Profit from sale of scrap and raw materials	(ii)	**4,695**	4,187
Commission income		**4,393**	—
Others		**1,182**	337
		36,211	14,765
Gains			
Gain on disposal of items of property, plant and equipment		**6,005**	181
Gain on disposal of prepaid land lease payments		**2,394**	—
		8,399	181
		44,610	14,946

Notes:

(i) The VAT refund for the years ended 31 December 2007 and 2006 represented the VAT received by Weifang Molong Drilling Equipment Company Limited, a subsidiary of the Group (濰坊墨龍鑽採設備有限公司) ("Molong Drilling Equipment"), which was approved by the Ministry of Civil Affairs of Shandong Province (山東省民政廳) as a welfare enterprise (民政福利企業). According to the tax document Guo Shui Fa [1994] No.155, "*Notice about the levy of turnover tax of welfare enterprises issued by the State Tax Bureau*" (「國家税務局關於民政福利企業徵收流轉税問題的通知」), the output VAT paid by Molong Drilling Equipment was refundable.

(ii) The profit arising from sale of scrap and raw materials for the years ended 31 December 2007 and 2006 represented the sale of scrap and used metals to related parties and third parties. The selling price was determined at a fixed amount prescribed by the relevant authorities of the PRC. If no fixed price was prescribed by the relevant authorities of the PRC, the selling price was determined by prices agreed by both parties with reference to the prevailing market price.

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6. FINANCE COSTS

	Group	
	2007	2006
	RMB'000	RMB'000
Interest on bank loans wholly repayable within five years	**26,646**	12,089

7. PROFIT BEFORE TAX

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

		Group	
	Notes	**2007**	2006
		RMB'000	RMB'000
Cost of inventories sold		**1,380,747**	778,488
Depreciation	14,15	**39,917**	26,339
Amortisation of an intangible asset	17	**314**	284
Recognition of prepaid land lease payments	16	**929**	492
Research and development costs		**19,778**	11,667
Minimum lease payments under operating leases:			
Plant and machinery		**—**	81
Land and buildings located in Mainland China		**323**	558
		323	639
Auditors' remuneration		**900**	1,020
Employee benefits expense (including directors' remuneration (note 8)):			
Wages and salaries		**45,412**	33,184
Pension scheme contributions (defined contribution scheme)		**4,575**	3,531
		49,987	36,715
Foreign exchange differences, net		**1,453**	2,403
(Write-back of provision)/provision against inventories		**(4,584)**	9,193
Reversal of impairment of trade receivables		**(2,240)**	(3,278)
Rental income		**(743)**	(690)
Bank interest income		**(6,970)**	(3,887)
Gain on disposal of items of property, plant and equipment		**(6,005)**	(181)
Gain on disposal of prepaid land lease payments		**(2,394)**	—

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8. DIRECTORS' REMUNERATION

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

	Group	
	2007	2006
	RMB'000	RMB'000
Fees	**180**	150
Other remuneration:		
Salaries, allowances and benefits in kind	**314**	198
Bonuses	**1,114**	1,180
Pension scheme contributions	**9**	9
	1,617	1,537

(a) Independent non-executive directors

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

	2007	2006
	RMB'000	RMB'000
Mr. Qin Xue Chang（秦學昌）	**30**	30
Mr. Yan Yi Zhuang（閆翊莊）	**60**	60
Mr. Loke Yu, alias Loke Hoi Lam（陸海林）	**90**	60
	180	150

There was no other remuneration payable to the independent non-executive directors during the year (2006: Nil).

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8. DIRECTORS' REMUNERATION *(continued)*

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

(b) Executive directors and non-executive directors

	Salaries, allowances and benefits in kind RMB'000	Bonuses RMB'000	Pension scheme contributions RMB'000	Total RMB'000
2007				
Executive directors:				
Mr. Zhang En Rong（張恩榮）	111	454	—	565
Mr. Zhang Yun San（張雲三）	94	368	3	465
Mr. Lin Fu Long（林福龍）	46	98	3	147
Mr. Xie Xin Cang（謝新倉）	63	194	3	260
	314	1,114	9	1,437
Non-executive directors:				
Mr. Chen Jian Xiong（陳建雄）	—	—	—	—
Mr. Wang Ping（王平）	—	—	—	—
	314	1,114	9	1,437
2006				
Executive directors:				
Mr. Zhang En Rong（張恩榮）	65	500	—	565
Mr. Zhang Yun San（張雲三）	56	320	3	379
Mr. Lin Fu Long（林福龍）	34	150	3	187
Mr. Xie Xin Cang（謝新倉）	43	210	3	256
	198	1,180	9	1,387
Non-executive directors:				
Mr. Chen Jian Xiong（陳建雄）	—	—	—	—
Mr. Wang Ping（王平）	—	—	—	—
	198	1,180	9	1,387

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

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9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included four (2006: four) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining one (2006: one) non-director, highest paid employee for the year are as follows:

	Group	
	2007	2006
	RMB'000	RMB'000
Salaries, allowances and benefits in kind	**58**	44
Bonuses	**162**	200
Pension scheme contributions	**3**	3
	223	247

10. TAX

The Company is located in Mainland China and as a result is subject to the PRC corporate income tax at a rate of 33% on its assessable profits. Hong Kong profits tax has been provided at the rate of 17.5% on the estimated assessable profits arising in Hong Kong during the year. In the prior year, no provision for Hong Kong profits tax had been made as the Group did not generate any assessable profit during that year.

Molong Drilling Equipment, one of the Group's subsidiaries, was approved by the Ministry of Civil Affairs of Shandong Province（山東省民政廳）as a welfare enterprise（民政福利企業）and hence was entitled to a full exemption from PRC corporate income tax for the year ended 31 December 2006 and for the period from 1 January to 30 June 2007 according to the tax document Cai Shui Zi [1994] No.1, "*Notice about the several preferential policies on PRC corporate income tax*"（「關於企業所得和若干優惠政策的通知」）. According to Cai Shui Zi [2007] No. 92（財稅字[2007]92 號文）, with effect from 1 July 2007, Molong Drilling Equipment was entitled to claim twice of salaries paid to its disabled employees when calculating the PRC corporate income tax and to take full exemption of the value added tax ("VAT") or business tax.

In accordance with the relevant income tax rules and regulations of the PRC, Shouguang Molong Electro-mechanical Equipment Company Limited ("Molong Equipment") is entitled to an income tax rate of 24% as it is a Sino-foreign investment enterprise registered in Shouguang, Shandong Province, the PRC.

Other subsidiaries are all located in Mainland China and as a result are subject to the PRC corporate income tax at a rate of 33% on their assessable profits.

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10. TAX *(continued)*

	Group 2007 RMB'000	Group 2006 RMB'000
Current – PRC tax charge for the year	**31,369**	22,804
Current – Hong Kong tax charge for the year	**635**	—
Deferred *(note 29)*	**5,206**	(3,704)
Total tax charge for the year	**37,210**	19,100

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

	2007				2006	
	Mainland China		**Hong Kong**		Mainland China	
	RMB'000	**%**	**RMB'000**	**%**	RMB'000	%
Profit before tax	**230,413**		**7,826**		161,774	
Tax at the statutory tax rate	**76,036**	**33.00**	**1,370**	**17.50**	53,385	33.00
Tax exemption of purchased fixed assets used for qualified technological improvement projects	**(29,819)**	**(12.94)**	**—**	**—**	(22,357)	(13.82)
Tax exemption granted to a welfare enterprise for the year	**(7,248)**	**(3.15)**	**—**	**—**	(10,664)	(6.59)
Additional deductible research and development expenses	**(3,264)**	**(1.42)**	**—**	**—**	—	—
Income not subject to tax	**—**	**—**	**(753)**	**(9.62)**	—	—
Expenses not deductible for tax	**870**	**0.38**	**18**	**0.23**	86	0.05
Temporary differences not recognised	**—**	**—**	**—**	**—**	(1,350)	(0.83)
Tax charge at the Group's effective tax rate	**36,575**	**15.87**	**635**	**8.11**	19,100	11.81

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11. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The consolidated profit attributable to equity holders of the parent for the year ended 31 December 2007 includes a profit of RMB223,015,000 (2006: RMB110,226,000) which has been dealt with in the financial statements of the Company (note 31(b)).

12. DIVIDENDS

	Note	**2007 RMB'000**	2006 RMB'000
Interim – Nil (2006: RMB0.015) per ordinary share		**—**	9,708
Proposed final – RMB0.015 (2006: RMB0.02) per ordinary share	38	**49,339**	12,960
		49,339	22,668

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 ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share is based on the profit for the year attributable to ordinary equity holders of the parent, and the weighted average number of ordinary shares in issue during the year:

	2007	2006
Profit for the year attributable to ordinary equity holders of the parent (RMB'000)	**200,330**	139,404
Weighted average number of ordinary shares ('000)	**3,253,888**	3,239,990
Weighted average earnings per ordinary share (RMB)	**0.062**	0.043

The weighted average number of ordinary shares for the year ended 31 December 2006 has been recomputed after taking into account the number of shares transferred from retained profits and capital reserve into the share capital (see note 30).

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

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14. PROPERTY, PLANT AND EQUIPMENT

Group	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2006	74,814	96,639	2,073	6,850	2,869	183,087	366,332
Additions	13,115	107,788	760	418	968	82,352	205,401
Transferred from construction in progress	16,114	198,512	—	1,163	—	(215,789)	—
Disposals	—	(2,352)	—	(353)	(349)	—	(3,054)
At 31 December 2006	104,043	400,587	2,833	8,078	3,488	49,650	568,679
Additions	6,408	7,665	934	541	577	251,011	267,136
Transferred from construction in progress	13,592	51,910	—	3,180	131	(68,813)	—
Transferred from investment properties *(note 15)*	8,069	—	—	—	—	—	8,069
Acquisition of subsidiaries *(note 32)*	34,823	112,082	551	677	481	381	148,995
Disposals	(9,081)	(528)	—	(348)	—	—	(9,957)
At 31 December 2007	157,854	571,716	4,318	12,128	4,677	232,229	982,922
Accumulated depreciation							
At 1 January 2006	6,584	28,634	915	2,851	1,234	—	40,218
Provided during the year	4,481	19,126	404	1,462	493	—	25,966
Disposals	—	(2,049)	—	(272)	(339)	—	(2,660)
At 31 December 2006	11,065	45,711	1,319	4,041	1,388	—	63,524
Provided during the year	5,574	31,982	461	1,346	554	—	39,917
Transferred from investment properties *(note 15)*	405	—	—	—	—	—	405
Acquisition of subsidiaries *(note 32)*	4,614	13,712	451	507	189	—	19,473
Disposals	(4,585)	(261)	—	(292)	—	—	(5,138)
At 31 December 2007	17,073	91,144	2,231	5,602	2,131	—	118,181
Accumulated impairment							
At 31 December 2006	—	—	—	—	—	—	—
Acquisition of subsidiaries *(note 32)*	6,837	37,591	—	—	—	—	44,428
At 31 December 2007	6,837	37,591	—	—	—	—	44,428
Net carrying amount							
At 31 December 2007	133,944	442,981	2,087	6,526	2,546	232,229	820,313
At 31 December 2006	92,978	354,876	1,514	4,037	2,100	49,650	505,155

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

Company	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2006	70,758	83,259	2,053	6,850	2,858	183,048	348,826
Additions	13,040	105,707	760	418	968	82,200	203,093
Transferred from construction in progress	16,114	198,392	—	1,163	—	(215,669)	—
Transferred to investment properties *(note 15)*	(2,944)	—	—	—	—	—	(2,944)
Disposals	—	(6,231)	(7)	(353)	(349)	—	(6,940)
At 31 December 2006	96,968	381,127	2,806	8,078	3,477	49,579	542,035
Additions	3,814	11,235	813	318	362	45,456	61,998
Transferred from construction in progress	7,706	51,546	—	3,180	131	(62,563)	—
Transferred from investment properties *(note 15)*	10,142	—	—	—	—	—	10,142
Disposals	(4,156)	(957)	—	(348)	(94)	—	(5,555)
At 31 December 2007	114,474	442,951	3,619	11,228	3,876	32,472	608,620
Accumulated depreciation							
At 1 January 2006	4,795	22,519	906	2,851	1,232	—	32,303
Provided during the year	4,164	17,758	400	1,462	491	—	24,275
Transferred to investment properties *(note 15)*	(365)	—	—	—	—	—	(365)
Disposals	—	(4,135)	(3)	(272)	(339)	—	(4,749)
At 31 December 2006	8,594	36,142	1,303	4,041	1,384	—	51,464
Provided during the year	4,994	29,980	452	1,343	546	—	37,315
Transferred from investment properties *(note 15)*	1,297	—	—	—	—	—	1,297
Disposals	(2,456)	(568)	—	(292)	(58)	—	(3,374)
At 31 December 2007	12,429	65,554	1,755	5,092	1,872	—	86,702
Net carrying amount							
At 31 December 2007	102,045	377,397	1,864	6,136	2,004	32,472	521,918
At 31 December 2006	88,374	344,985	1,503	4,037	2,093	49,579	490,571

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

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15. INVESTMENT PROPERTIES

	Note	Group 2007 RMB'000	Group 2006 RMB'000	Company 2007 RMB'000	Company 2006 RMB'000
Cost:					
At 1 January		**8,069**	8,069	**15,067**	12,123
Addition from acquisition *(note 32)*		**3,682**	—	**—**	—
Transferred from/(to) owner-occupied properties	14	**(8,069)**	—	**(10,142)**	2,944
Disposals		**—**	—	**(4,925)**	—
At 31 December		**3,682**	8,069	**—**	15,067
Accumulated depreciation:					
At 1 January		**405**	32	**2,873**	1,821
Transferred from owner-occupied properties	14	**—**	—	**—**	365
Recognised depreciation during the year		**—**	373	**553**	687
Addition from acquisition *(note 32)*		**108**	—	**—**	—
Transferred to owner-occupied properties	14	**(405)**	—	**(1,297)**	—
Disposals		**—**	—	**(2,129)**	—
At 31 December		**108**	405	**—**	2,873
Carrying amount at 31 December		**3,574**	7,664	**—**	12,194

The investment properties of the Group at 31 December 2007 were the land use rights held for sale or for lease which are under a medium lease term.

The investment properties of the Group and the Company at 31 December 2006 were leased to related parties under operating leases (note 34(a)). Such properties have been transferred to owner-occupied properties following the acquisition of the equity interest in such related parties pursuant to the acquisition as detailed in note 32.

The investment properties of the Group and the Company are all situated in Shouguang City, Shandong Province, the PRC.

16. PREPAID LAND LEASE PAYMENTS

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Carrying amount at 1 January	**20,198**	20,690	**20,198**	20,690
Additions	**33,424**	—	**—**	—
Acquisition of subsidiaries	**42,962**	—	**—**	—
Recognised during the year	**(929)**	(492)	**(475)**	(492)
Disposals	**(5,158)**	—	**(5,158)**	—
Carrying amount at 31 December	**90,497**	20,198	**14,565**	20,198
Current portion included in prepayments, deposits and other receivables	**(1,913)**	(489)	**(258)**	(489)
Non-current portion	**88,584**	19,709	**14,307**	19,709

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

Included in the balance at 31 December 2007 were the prepaid land lease payments invested by Weifang Shengcheng Investment Management Company Limited ("Shengcheng Investment"), the minority shareholder of Shouguang Baolong Petroleum Material Company Limited ("Shouguang Baolong"), one of the Group's subsidiaries, with a carrying value of RMB32,400,000 on 31 December 2007 (note 19(c)). Such prepaid land lease payments were previously owned by Maolong Machinery, a related party which became the Group's subsidiary on 27 December 2007. Before the acquisition of Maolong Machinery in January 2007, such prepaid land premiums were disposed of to Shengcheng Investment at a consideration of RMB9,000,000.

The land certificate of the prepaid land lease payments with a carrying value of RMB1,648,000 (area of 9,022 square metres) which is situated in Shangkou Town, Shouguang City, Shandong Province, the PRC, has not been obtained.

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17. INTANGIBLE ASSET

Software	Group and Company 2007 RMB'000	2006 RMB'000
Cost at 1 January, net of accumulated amortisation	**253**	273
Additions	**438**	264
Amortisation provided during the year	**(314)**	(284)
At 31 December	**377**	253
At 31 December		
Cost	**1,022**	584
Accumulated amortisation	**(645)**	(331)
Net carrying amount	**377**	253

18. GOODWILL

	Group RMB'000
Acquisition of subsidiaries (note 32) and at 31 December 2007	147,115

Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to the cash-generating unit (the "CGU") for impairment testing.

The recoverable amount of the CGU has been determined based on a value in use calculation using cash flow projections based on financial budgets covering a eight-year period approved by senior management. The discount rate applied to the cash flow projections is 10% and cash flows beyond the eight-year period are extrapolated using a growth rate of 12% which is the same as the long term average growth rate of the industry.

Key assumptions were used in the value in use calculation of the CGU for 31 December 2007. The following describes each key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill.

Budgeted gross margins – The basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved in the year immediately before the budget year, increased for expected efficiency improvements, and expected market development.

Discount rates – The discount rates used are before tax and reflect specific risks relating to the relevant unit.

Raw materials price inflation – The basis used to determine the value assigned to raw materials price inflation is the forecast price indices during the budget year. The values assigned to key assumptions are consistent with external information sources.

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19. INTERESTS IN SUBSIDIARIES

	Company	
	2007	2006
	RMB'000	RMB'000
Unlisted shares, at cost	**425,467**	12,676
Due from subsidiaries	**15,340**	—
Due to subsidiaries	**(142,334)**	(46,924)
	298,473	(34,248)

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

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19. INTERESTS IN SUBSIDIARIES *(continued)*

Particulars of the subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity directly attributable to the Company		Principal activities
			2007	2006	
Molong Drilling Equipment (a)	The PRC/ Mainland China	RMB6,000,000	**100%**	90%	Manufacture and sale of petroleum extraction machinery
MPM International Limited ("MPM") (b)	Hong Kong	HK$7,800,000	**90%**	90%	Trading
Shouguang Baolong (c)	The PRC/ Mainland China	RMB150,000,000	**70%**	—	Manufacture and sale of casing pipes
Maolong Machinery (d)	The PRC/ Mainland China	RMB12,380,000	**100%**	—	Manufacture and sale of oil extraction machinery accessories
Molong Equipment (e)	The PRC/ Mainland China	US$1,000,000	**97.5%**	—	Manufacture and sale of oil extraction machinery accessories
Shouguang Maolong Old Metals Recycle Company Limited ("Maolong Recycle") (f)	The PRC/ Mainland China	RMB500,000	**100%**	10%	Trading of scrap metals
Weihai Baolong Special Petroleum Materials Company Limited ("Weihai Baolong") (g)	The PRC/ Mainland China	RMB10,000,000	**99.9%**	—	Manufacture and sale of special petroleum metal materials
Wendeng Baolong Recyclable Resource Company Limited ("Wendeng Recyclable") (h)	The PRC/ Mainland China	RMB300,000	**99.99%**	—	Trading of scrap metals

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19. INTERESTS IN SUBSIDIARIES *(continued)*

Notes:

(a) Molong Drilling Equipment is a welfare enterprise established on 29 September 2004, whose 90% equity interest was held by the Company with cash of RMB5,400,000. On 30 June 2007, the Company purchased the rest 10% equity interest from the Shangkou Town Government, at a cash consideration of RMB7,340,000.

Up to 31 December 2007, the Company held the 100% equity interest of Molong Drilling Equipment.

(b) MPM was established in Hong Kong on 24 May 2004, 90% of its equity interest was held by the Company and the rest 10% of its equity interest was held by Maolong Machinery. On 26 January 2007, Shengcheng Investment, a third party of the Company, acquired 10% equity interest of MPM from Maolong Machinery at a cash consideration of HK$780,000.

(c) Shouguang Baolong was incorporated on 30 April 2007. 70% of its total equity interest was held by the Company with cash of RMB105,000,000, and the rest 30% equity interest was held by Shengcheng Investment with cash of RMB12,600,000 and a land use right (area of 120,105 square metres) of RMB32,400,000.

The land use right invested by Shengcheng Investment to Shouguang Baolong was purchased from Maolong Machinery, at a price of RMB9,000,000 based on the valuation report of Shou Lu Hui Ping Zi [2007] No.2（壽魯會評字[2007]No.2）issued by Shouguang Lu Dong Certified Public Accountants（壽光魯東有限責任會計師事務所） on 5 January 2007. On 15 September 2007, the land use right was reappraised at a value of RMB32,400,000 based on the valuation report of Shou Lu Hui Ping Zi [2007] No.56) (壽魯會評字 [2007]No.56) issued by Shouguang Lu Dong Certified Public Accountants （壽光魯東有限責任會計師事務所）.

Up to 25 September 2007, the injection of the above registered capital of RMB150,000,000 was fully paid.

(d) Maolong Machinery is a limited liability company established in the PRC on 30 December 2001. Maolong Machinery has four subsidiaries, Molong Equipment, Maolong Recycle, Weihai Baolong and Wendeng Recyclable.

On 25 September 2007, according to an equity transfer agreement entered into between the Company and all natural shareholders of Maolong Machinery, the whole equity interest of Maolong Machinery was acquired by the Company at a cash consideration of RMB305,000,000. The completion date of such acquisition was 27 December 2007.

(e) Molong Equipment is a limited liability company established in the PRC on 6 November 2001.

Up to 31 December 2007, the 75% equity interest of Molong Equipment was held by Maolong Machinery and the rest 25% equity interest was held by MPM.

(f) Maolong Recycle is a limited liability company established in the PRC on 13 December 2002. Up to 31 December 2007, the 90% equity interest of Maolong Recycle was held by Maolong Machinery and the rest 10% equity interest was held by the Company.

(g) Weihai Baolong is a limited liability company established in the PRC and it is principally engaged in the manufacture and sale of special petroleum metal materials. Up to 31 December 2007, the 95% equity interest of Weihai Baolong was held by Maolong Machinery and the rest 5% equity interest was held by Molong Equipment.

(h) Wendeng Recyclable is a limited liability company established in the PRC and is principally engaged in the purchase of unwanted and used metals for Weihai Baolong. Up to 31 December 2007, the 95% equity interest of Wendeng Recyclable was held by Maolong Machinery and the rest 5% equity interest was held by Weihai Baolong.

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20. INVESTMENT IN AN ASSOCIATE

Particulars of the associate are as follows:

	Group 2007 RMB'000	Group 2006 RMB'000
Share of net assets	**2,142**	—

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity directly attributable to the Group	Principal activities
Kelamayi Ya Long Oil Pump Company Limited ("Yalong Oil Pump")	The PRC/ Mainland China	RMB4,500,000	30%	Manufacture and sale of oil well pumps

The following table illustrates the summarised financial information of the Group's associate extracted from its financial statements:

	2007 RMB'000
Assets	**8,834**
Liabilities	**1,212**
Revenues	**15,460**
Profit	**737**

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21. AVAILABLE-FOR-SALE INVESTMENT

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Unlisted equity investment, at cost				
– Maolong Recycle	**—**	50	**—**	50
– Shouguang Mihe Water Company Limited ("Mihe Water")	**10,000**	—	**10,000**	—
	10,000	50	**10,000**	50

The unlisted equity investment of the Group and the Company at 31 December 2007 represented a 9.73% equity interest held in Mihe Water, which was incorporated in the PRC on 5 November 2007 with a registered capital of RMB102,800,000.

The unlisted equity investment of the Group and the Company at 31 December 2006 represented a 10% equity interest held in Maolong Recycle, which was incorporated in the PRC on 13 December 2002 with a registered capital of RMB500,000. The investment cost has been transferred to investments in subsidiaries following the acquisition of the remaining 90% equity interests therein during the year.

22. INVENTORIES

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Raw materials	**238,560**	118,855	**195,123**	106,740
Work in progress	**187,744**	205,967	**166,353**	200,360
Finished goods	**172,864**	122,757	**157,243**	113,209
	599,168	447,579	**518,719**	420,309

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23. TRADE RECEIVABLES

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Trade receivables	**238,123**	176,312	**213,643**	174,517
Impairment	**(5,166)**	(6,434)	**(3,958)**	(6,434)
	232,957	169,878	**209,685**	168,083

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of three months, extending up to six months for major customers. Each customer has a maximum credit limit. The Group seeks to maintain strict control over its outstanding receivables to minimise credit risk. Overdue balances are reviewed regularly by senior management. Trade receivables are non-interest-bearing. In view of the aforementioned and the fact 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 aged analysis of the trade receivables as at the balance sheet date, based on the invoice date, and net of provisions, is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within three months	**206,293**	155,018	**196,494**	153,223
Three to six months	**20,131**	14,145	**10,083**	14,145
Six months to one year	**4,497**	715	**2,813**	715
One to two years	**2,036**	—	**295**	—
	232,957	169,878	**209,685**	168,083

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23. TRADE RECEIVABLES *(continued)*

The movements in provision for impairment of trade receivables are as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
At 1 January	**6,434**	9,712	**6,434**	9,712
Amount written off as uncollectible	**(236)**	—	**(236)**	—
Impairment losses reversed *(note 7)*	**(2,240)**	(3,278)	**(2,240)**	(3,278)
Acquisition of subsidiaries	**1,208**	—	**—**	—
	5,166	6,434	**3,958**	6,434

Included in the above provision for impairment of trade receivables is a provision for individually impaired trade receivables of RMB5,166,000 (2006: RMB3,958,000) with a carrying amount of RMB5,166,000 (2006: RMB3,958,000)

The aged analysis of the trade receivables that are not considered to be impaired is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Neither past due nor impaired	**226,424**	169,163	**206,577**	167,368
One to six months past due	**4,497**	715	**2,813**	715
Six months to one year past due	**2,036**	—	**295**	—
	232,957	169,878	**209,685**	168,083

Receivables that were neither past due nor impaired relate to a large number of diversified customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Group. Based on past experience, the directors of the Company are of the opinion that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral or other credit enhancements over these balances.

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24. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Prepayments	**39,434**	31,212	**36,235**	28,885
Deposits and other receivables	**21,184**	6,596	**4,205**	6,367
	60,618	37,808	**40,440**	35,252

None of the above assets is either past due or impaired. The financial assets included in the above balances relate to receivables for which there was no recent history of default.

25. CASH AND BANK BALANCES AND PLEDGED DEPOSITS

		Group		Company	
	Note	**2007**	2006	**2007**	2006
		RMB'000	RMB'000	**RMB'000**	RMB'000
Cash and bank balances		**112,980**	34,138	**85,973**	32,459
Time deposits pledged as security for bills payable	26	**160,557**	219,254	**160,557**	219,254
		273,537	253,392	**246,530**	251,713
Less: Time deposits with original maturity of over three months when acquired, pledged as security for bills payable		**(160,557)**	(218,177)	**(160,557)**	(218,177)
Cash and cash equivalents		**112,980**	35,215	**85,973**	33,536

At the balance sheet date, the cash and bank balances of the Group denominated in RMB amounted to RMB111,488,000 (2006: RMB32,333,000). The RMB is not freely convertible into other currencies, however, under the PRC Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

The bank balances and pledged deposits are deposited with creditworthy banks with no recent history of default. The carrying amounts of the cash and bank balances and the pledged deposits approximate to their fair values.

26. TRADE AND BILLS PAYABLES

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

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within three months	**323,888**	362,625	**232,658**	358,783
Three to six months	**220,371**	234,639	**214,718**	234,183
Six months to one year	**11,274**	6,843	**7,751**	6,588
One to two years	**10,258**	2,667	**7,034**	2,704
Two to three years	**1,659**	4,947	**99**	4,852
Over three years	**7,589**	—	**573**	—
	575,039	611,721	**462,833**	607,110

The Group and the Company's bills payable of RMB345,255,000 (2006: RMB485,481,000) were secured by the pledge of certain of the time deposits amounting to RMB160,557,000 (2006: RMB219,254,000) (note 25). The trade payables are non-interest-bearing and are normally settled on terms of six months.

27. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Advances from customers	**36,302**	33,506	**53,304**	33,506
Payroll payable	**23,191**	11,292	**13,294**	11,149
Welfare payable	**—**	3,595	**—**	2,954
Other payables	**198,621**	2,917	**158,684**	6,213
Accruals	**1,003**	7,714	**831**	7,223
	259,117	59,024	**226,113**	61,045

Other payables are non-interest-bearing and have an average term of three months, except the payable to the previous shareholders of Maolong Machinery for acquisition with an amount of RMB103,868,000 will be paid within 360 days after finishing the relevant registration with the local administrative bureau for industry and commerce.

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28. INTEREST-BEARING BANK AND OTHER BORROWINGS

Group

	2007			2006		
	Effective interest rate (%)	**Maturity**	**RMB'000**	Effective interest rate (%)	Maturity	RMB'000
Current						
Bank loans – Unsecured	**6.12-6.75**	**2008**	**152,120**	6.12	2007	135,000
Other borrowing – Unsecured (note)	**7.29**	**2008**	**5,000**			—
			157,120			135,000
Non-current						
Bank loans – Unsecured	**6.39-6.75**	**2009**	**380,000**	6.12-6.30	2008	70,000
			537,120			205,000

Company

	2007			2006		
	Effective interest rate (%)	**Maturity**	**RMB'000**	Effective interest rate (%)	Maturity	RMB'000
Current						
Bank loans – Unsecured	**6.12-6.57**	**2008**	**128,000**	6.12	2007	135,000
Non-current						
Bank loans – Unsecured	**6.39-6.75**	**2009**	**270,000**	6.12-6.30	2008	70,000
			398,000			205,000

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28. INTEREST-BEARING BANK AND OTHER BORROWINGS *(continued)*

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Analysed into:				
Bank loans repayable:				
Within one year	**152,120**	135,000	**128,000**	135,000
Beyond one year	**380,000**	70,000	**270,000**	70,000
	532,120	205,000	**398,000**	205,000
Other borrowing:				
Within one year	**5,000**	—	**—**	—
	537,120	205,000	**398,000**	205,000

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

Note: The other borrowing was a short-term loan borrowed from the Rong Gao City Construction Service Center of Wendeng City in Shandong Province, the PRC, which was unsecured.

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29. DEFERRED TAX

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

Deferred tax assets

Group

	2007					
	Provision against fixed assets RMB'000	Provision against inventories RMB'000	Provision against receivables RMB'000	Accrued expenses RMB'000	Depreciation in excess of depreciation allowance RMB'000	Total RMB'000
At 1 January	—	4,482	2,069	1,542	849	8,942
Deferred tax credited/(charged) to the income statement during the year	—	(2,019)	(1,319)	(1,318)	(550)	(5,206)
Acquisition of subsidiaries	10,424	673	872	—	—	11,969
Gross deferred tax assets at 31 December	10,424	3,136	1,622	224	299	15,705

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29. DEFERRED TAX *(continued)*

Deferred tax assets *(continued)*

Company

	2007				
	Provision against inventories RMB'000	Provision against receivables RMB'000	Accrued expenses RMB'000	Depreciation in excess of depreciation allowance RMB'000	Total RMB'000
At 1 January	**4,482**	**2,069**	**1,542**	**849**	**8,942**
Deferred tax credited/(charged) to the income statement during the year	**(2,208)**	**(1,319)**	**(1,317)**	**(550)**	**(5,394)**
Gross deferred tax assets at 31 December	**2,274**	**750**	**225**	**299**	**3,548**

Group and Company

	2006				
	Provision against inventories RMB'000	Provision against receivables RMB'000	Accrued expenses RMB'000	Depreciation in excess of depreciation allowance RMB'000	Total RMB'000
At 1 January	(1,412)	(3,148)	—	(678)	(5,238)
Deferred tax credited/(charged) to the income statement during the year	(3,070)	1,079	(1,542)	(171)	(3,704)
Acquisition of subsidiaries	—	—	—	—	—
Gross deferred tax assets at 31 December	(4,482)	(2,069)	(1,542)	(849)	(8,942)

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

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29. DEFERRED TAX *(continued)*

Deferred tax liabilities

Group

	Fair value adjustment arising from acquisition of subsidiaries RMB'000
At 1 January 2006 and 2007	—
Acquisition of subsidiaries	**13,631**
Gross deferred tax liabilities at 31 December 2007	**13,631**

30. SHARE CAPITAL

Shares

	Group and Company	
	2007 RMB'000	2006 RMB'000
Authorised:		
3,289,242,000 (2006: 647,998,000) ordinary shares of RMB0.10 (2006: RMB0.10) each	**328,924**	64,800
Issued and fully paid:		
3,289,242,000 (2006: 647,998,000) ordinary shares of RMB0.10 (2006: RMB0.10) each	**328,924**	64,800

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

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30. SHARE CAPITAL *(continued)*

According to the resolution of the Company's general meeting held on 25 May 2007, the Company announced and approved the issue of two new shares for every one share from the retained profits, resulting in a transfer of RMB129,600,000 with the shares of 1,295,996,000; the Company also announced and approved the issue of two new shares for every one share from the capital reserve, resulting in a transfer of RMB129,600,000 with the shares of 1,295,996,000. Upon the said new issue on 18 July 2007, the share registration date, the Company's paid-in capital increased to RMB323,999,000 with the shares of 3,239,990,000.

On 19 September 2007, the Company placed 49,252,000 new H shares of par value of RMB0.10 at a placing price of HK$1.70 per H Share. After the successful issue of the new H shares, the paid-in capital increased to RMB328,924,000 with the shares of 3,289,242,000.

31. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on pages 51 to 52 of the financial statements.

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

(b) Company

	Notes	Capital reserve RMB'000	Statutory reserve fund RMB'000	Statutory welfare fund RMB'000	Retained profits RMB'000	Total RMB'000
At 1 January 2006		175,653	16,698	8,348	102,065	302,764
Profit for the year	11	—	—	—	110,226	110,226
Interim 2006 dividend	12	—	—	—	(9,708)	(9,708)
Proposed final 2006 dividend	12	—	—	—	(12,960)	(12,960)
Transfers from retained profits to statutory funds		—	13,936	—	(13,936)	—
At 31 December 2006 and 1 January 2007		175,653	30,634	8,348	175,687	390,322
Profit for the year	11	—	—	—	223,015	223,015
Issue of shares		72,906	—	—	—	72,906
Transfers to paid-in capital		(129,600)	—	—	(129,600)	(259,200)
Transfers from retained profits to statutory funds		—	20,342	—	(20,342)	—
Transfers from statutory welfare fund to statutory reserve fund		—	8,348	(8,348)	—	—
Proposed final 2007 dividend	12	—	—	—	(49,339)	(49,339)
At 31 December 2007		118,959	59,324	—	199,421	377,704

For the details of the statutory funds, please refer to the consolidated statement of changes in equity on pages 51 to 52 of the financial statements.

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32. BUSINESS COMBINATION

On 27 December 2007, the Group acquired the 100% equity interest in Maolong Machinery, which was controlled by a related party of the Company. Maolong Machinery and its subsidiary were engaged in the manufacture and sale of special petroleum metal materials and oil extraction machinery accessories. Further details of the transaction are included in note 19(d) and 36(b). The consideration for the acquisition was in the form of cash, with RMB183,000,000 paid at the acquisition date. The remaining RMB122,000,000 will be paid within 360 days after finishing the relevant registration with the local administrative bureau for industry and commerce.

The initial accounting for the above business combination has been determined provisionally by the end of the period in which the combination was effected because the completion of the acquisition was effected towards the year end date and the fair values being assigned to the acquiree's identifiable assets and liabilities can be determined provisionally.

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

	Fair value recognised on acquisition RMB'000	**Previous carrying amount** RMB'000
Property, plant and equipment	85,094	80,037
Investment properties	3,574	1,030
Prepaid land lease payments	42,064	7,247
Investment in an associate	2,142	2,142
Long term prepayment	6,704	6,704
Deferred tax assets	11,969	11,969
Inventories	157,135	145,765
Trade receivables	22,695	22,695
Bills receivable	2,400	2,400
Prepayments, deposits and other receivables	14,673	13,939
Due from an associate	677	677
Cash and bank balances	9,506	9,506
Trade and bills payables	(78,160)	(78,160)
Other payables and accruals	(30,478)	(30,478)
Other borrowings	(5,000)	(5,000)
Due to related parties	(14,524)	(14,524)
Tax payable	(14,524)	(14,524)
Deferred tax liabilities	(13,631)	—
Interest-bearing bank loans	(30,000)	(30,000)
NET ASSETS	172,316	131,425
Minority interests	(12,687)	
Goodwill on acquisition	147,115	
Satisfied by cash (note)	306,744	

32. BUSINESS COMBINATION *(continued)*

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

	RMB'000
Cash consideration	306,744
Cash and bank balances acquired	(9,506)
Net outflow of cash and cash equivalents in respect of the acquisition of a subsidiary	297,238

Since its acquisition, Maolong Machinery has no significant contribution to the Group's turnover and the consolidated profit for the year ended 31 December 2007.

Had the combination taken place at the beginning of the year, the revenue from continuing operations of the Group and the profit of the Group for the year would have been RMB1,834,900,000 and RMB213,909,000, respectively.

Note: The acquisition cost included the cash consideration of RMB305,000,000 according to the equity transfer agreement entered into between the Company and all natural shareholders of Maolong Machinery and the professional fee of RMB1,744,000.

33. PLEDGE OF ASSETS

Details of the pledged deposits of the Group are included in note 25 to the financial statements.

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34. OPERATING LEASE ARRANGEMENTS

(a) As lessor

In the prior year, the Group leased its investment properties to related parties. Such related parties have become subsidiaries of the Group with effect from 27 December 2007. Accordingly, no future minimum lease receivable were noted at 31 December 2007.

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

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within one year	—	690	—	1,006
In the second to fifth years, inclusive	—	2,070	—	3,019
After five years	—	2,613	—	3,879
	—	5,373	—	7,904

(b) As lessee

In the prior year, the Group leased certain buildings from related parties. Such related parties have become subsidiaries of the Group with effect from 27 December 2007. Accordingly, no future minimum lease payables were noted at 31 December 2007.

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

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within one year	—	558	—	558
In the second to fifth years, inclusive	—	1,674	—	1,674
After five years	—	1,189	—	1,189
	—	3,421	—	3,421

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35. COMMITMENTS

In addition to the operating lease commitments detailed in note 34(b) above, the Group and the Company had the following commitments at the balance sheet date:

Capital commitments:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	RMB'000	**RMB'000**	RMB'000
Contracted, but not provided for:				
Land and buildings	**29,240**	6,147	**4,800**	6,147
Plant and machinery	**99,079**	46,292	**40,955**	46,292
	128,319	52,439	**45,755**	52,439

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36. RELATED PARTY TRANSACTIONS

(a) In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year. These transactions were entered into between the Group and the following related parties for the period from 1 January 2007 to the date when these related parties became the Group's subsidiaries and associate (see note 32 for the details of Business Combination):

	Notes	2007 RMB'000	2006 RMB'000
Purchases of raw materials from:			
Weihai Baolong	(i)	**448,658**	189,070
Molong Equipment	(i)	**97,739**	92,995
		546,397	282,065
Sales of scrap and raw materials to:			
Molong Equipment	(ii)	**26,461**	3,994
Weihai Baolong	(ii)	**1,547**	—
		28,008	3,994
Sales of goods			
Yalong Oil Pump	(iii)	**9,880**	13,460
Subcontracting income from:			
Molong Equipment	(iv)	**176**	194
Subcontracting fees to:			
Molong Equipment	(iv)	**156**	299
Fixed assets purchased from:			
Maolong Machinery	(v)	**43**	—
Molong Equipment	(v)	**30**	4,061
		73	4,061
Fixed assets sold to:			
Molong Equipment	(v)	**264**	104
Rental income from:			
Molong Equipment	(vi)	**690**	690
Rental expenses to:			
Maolong Machinery	(vi)	**253**	390
Molong Equipment	(vi)	**70**	168
		323	558

36. RELATED PARTY TRANSACTIONS *(continued)*

Notes:

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

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

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

(iii) The sales of goods were made reference to the price mutually agreed by parties.

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

(v) The fixed assets were purchased and sold at prices which approximated to their net book values.

(vi) These transactions were determined at rates mutually agreed by the parties.

(b) Other transaction with related parties:

On 25 September 2007, pursuant to the equity transfer agreement entered into between all natural shareholders of Maolong Machinery and the Company, the Company has agreed to acquire all equity interests in Maolong Machinery for an aggregate consideration of RMB305,000,000. The equity transfer transaction was completed on 27 December 2007. As Maolong Machinery was controlled by certain directors and a related party before the acquisition date, the equity transfer transaction was treated as a related party transaction. With respect to the consideration paid and payable to the previous shareholders of Maolong Machinery, a consideration of RMB27,198,000 was paid and payable to these directors of the Company.

(c) Outstanding balances with related parties of the Group:

Group

(i) Included in the balances due from related party in the consolidated balance sheet at 31 December 2007 were trade receivables from Yalong Oil Pump, the associate, of RMB1,449,000 (2006: Nil). The balance due from the associate is interest-free, unsecured and is repayable on demand or within one year.

(ii) Included in the balances due to related parties in the consolidated balance sheet at 31 December 2007 was an acquisition consideration of RMB18,132,000, who were also the previous shareholders of Maolong Machinery. The balance will be repaid within 360 days after finishing the relevant registration with the local administrative bureau for industry and commerce.

36. RELATED PARTY TRANSACTIONS *(continued)*

(d) Outstanding balances with related parties of the Company:

Company

(i) Included in the balances due from related party in the balance sheet at 31 December 2007 were trade receivables from Yalong Oil Pump, an associate, of RMB771,000 (2006: Nil). The balance due from the associate is interest-free, unsecured and is repayable on demand or within one year.

(ii) Included in the balances due to related parties in the balance sheet at 31 December 2007 was an acquisition consideration of RMB18,132,000, who were also the previous shareholders of Maolong Machinery. The balance will be repaid within 360 days after finishing the relevant registration with the local administrative bureau for industry and commerce.

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

	2007 **RMB'000**	2006 RMB'000
Short term employee benefits	**2,042**	1,902
Post-employment benefits	**18**	15
Total compensation paid to key management personnel	**2,060**	1,917

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

The related party transactions in terms of compensation of key management personnel above also constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules.

37. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

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

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

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

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

(i) Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long term debt obligations with a floating interest rate.

The Group's policy is to manage its interest cost using a mix of fixed and variable rate debts. The Group maintains 45.61% (2006: 65.85%) of its interest-bearing borrowings at fixed interest rates at 31 December 2007.

(ii) Foreign currency risk

The Group has transactional currency exposures. Such exposures arise from sales or purchases by operating units in currencies other than the units' functional currency. The Group tends to accept foreign currency exchange risk avoidance or allocation terms when arriving at purchases and sales contracts. The Group takes rolling forecast on the foreign currency revenue and expenses, matches the currency and the amount incurred, so as on alleviate the impact to business due to exchange rate fluctuations.

(iii) Credit risk

The Group trades only with recognised and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant.

The credit risk of the Group's other financial assets, which comprise cash and cash equivalents, pledged deposits, other receivables, arises from default of the counterparty, with a maximum exposure equal to the carrying amounts of these instruments. There is no significant concentrations of credit risk within the Group in relation to the other financial assets.

Since the Group trades only with recognised and creditworthy third parties, there is no requirement for collateral. Further quantitative data in respect of the Group's exposure to credit risk arising from trade receivables are disclosed in note 23 to the financial statements.

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

(iv) Liquidity risk

The Group monitors its risk to a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of both its financial instruments and financial assets (e.g., trade receivables) and projected cash flows from operations.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of interest-bearing bank loans and other borrowings. 29.25% of the Group's debts would mature in less than one year as at 31 December 2007 (2006: 65.85%) based on the carrying value of borrowings reflected in the financial statements.

The maturity profile of the Group's financial liabilities as at the balance sheet date, based on the contracted undiscounted payments, was as follows:

Group

		2007	
	Less than 1 year RMB'000	**Over 1 year RMB'000**	**Total RMB'000**
Interest-bearing bank and other borrowings	157,120	380,000	537,120
Trade and bills payables	575,039	—	575,039
Other payables	221,812	—	221,812
	953,971	380,000	1,333,971

		2006	
	Less than 1 year RMB'000	Over 1 year RMB'000	Total RMB'000
Interest-bearing bank and other borrowings	135,000	70,000	205,000
Trade and bills payables	611,721	—	611,721
Other payables	17,804	—	17,804
	764,525	70,000	834,525

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

(iv) Liquidity risk *(continued)*

The maturity profile of the Group's financial liabilities as at the balance sheet date, based on the contracted undiscounted payments, was as follows: *(continued)*

Company

	2007		
	Less than 1 year RMB'000	**Over 1 year RMB'000**	**Total RMB'000**
Interest-bearing bank and other borrowing	128,000	270,000	398,000
Trade and bills payables	462,833	—	462,833
Other payables	171,978	—	171,978
	762,811	270,000	1,032,811

	2006		
	Less than 1 year RMB'000	Over 1 year RMB'000	Total RMB'000
Interest-bearing bank and other borrowings	135,000	70,000	205,000
Trade and bills payables	607,110	—	607,110
Other payables	20,316	—	20,316
	762,426	70,000	832,426

(v) Capital management

The primary objective of the Group's capital management is to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2007 and 31 December 2006.

The Group monitors capital using a gearing ratio, which is net debt divided by the total capital plus net debt. Net debt includes interest-bearing bank and other borrowings, amounts due to related parties, trade, bills and other payables, accruals, less cash and cash equivalents, and excludes discontinued operations. Capital includes equity attributable to equity holders of the parent.

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

(v) Capital management *(continued)*

The gearing ratios as at the balance sheet dates were as follows:

Group	2007 RMB'000	2006 RMB'000
Interest-bearing bank and other borrowings (note 28)	**537,120**	205,000
Trade and bills payables (note 26)	**575,039**	611,721
Other payables and accruals (note 27)	**259,117**	59,024
Due to related parties	**18,132**	22,966
Less: Cash and cash equivalents	**(112,980)**	(34,138)
Net debt	**1,276,428**	864,573
Equity attributable to equity holders	**793,113**	528,604
Capital and net debt	**2,069,541**	1,393,177
Gearing ratio	**62%**	62%

38. POST BALANCE SHEET EVENT

Pursuant to the board resolution on 16 March 2008, the directors recommended the payment of a final cash dividend of RMB0.015 per share (inclusive of tax).

39. OTHER EVENTS

(i) Pursuant to the board of directors meeting held on 9 September 2007, the Company will apply to the Regulatory Authorities for the allotment and issue of not more than 700 million A shares of RMB0.10 each (or 70 million A shares of RMB1.00 each if required by the Regulatory Authorities) to the individuals, legal entities and other organisation with A share accounts at the Shenzhen Stock Exchange (expect those who are prohibited from subscribing for A shares pursuant to the relevant PRC laws and regulations and other applicable regulatory requirements).

(ii) During the year, the Group was involved in the dumping and subsidy investigations imposed by Canada. On 7 February 2008, the President of the Canada Border Services Agency made final determinations (the "Final Determinations") that certain goods exported by the Group have been dumped and subsidised. The Canadian International Trade Tribunal will commence its inquiry to the question of injury to the Canadian industry and will issue its decision upon completion of the inquiry. The directors, after seeking legal advice, are of the opinion that the aforesaid investigations have not caused any significant financial impact to the Group's financial statements for the year ended 31 December 2007.

31 December 2007

40. COMPARATIVE AMOUNTS

As further explained in note 2.2 to the financial statements, due to the adoption of the new and revised HKFRSs during the current year, certain comparative amounts have been adjusted to conform with the current year's presentation and to show separately comparative amounts in respect of items disclosed for the first time in 2007.

41. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors of the Company on 16 March 2008.

NOTICE IS HEREBY GIVEN that an Annual General Meeting (the "**AGM**") of Shandong Molong Petroleum Machinery Company Limited* (the "**Company**") will be convened and held at 3:00 p.m. on 5 May 2008 at the conference room on the 5th Floor, at No. 99 Beihai Road, Shouguang City, Shandong Province, the People's Republic of China (the "**PRC**") for the following purposes and to pass the following resolutions:

ORDINARY RESOLUTIONS

1. to consider and approve the Report of the Board (the "**Board**") of Directors of the Company for the year ended 31 December 2007;

2. to consider and approve the Report of the Supervisory Committee of the Company for the year ended 31 December 2007;

3. to consider and approve the Consolidated Audited Financial Statements of the Company and the Report of the International Auditors for the year ended 31 December 2007;

4. to consider and approve the declaration by the Board of a final dividend of Renminbi ("**RMB**") 0.015 per share (inclusive of applicable tax) for the year ended 31 December 2007, payable to each shareholder whose names appear on the Company's register of members as at 5 April 2008 and to authorise the directors of the Company (the "**Directors**") to take any necessary actions required under the applicable laws and regulations in connection hereto;

5. to consider and approve the change of the registered address of the Company from "99 Beihai Road, Shouguang, City Shandong Province" to "99 Beihuan Road, Shouguang City, Shandong Province";

6. to consider and approve the re-appointment of the PRC and international auditors of the Company for the year ending 31 December 2008 and to authorise the Board to determine their remuneration; and

7. to consider and approve the re-appointment of Mr. Chen Jianxiong as a non-executive Director.

SPECIAL RESOLUTIONS

8. **THAT:**

    (1) there be granted to the Board an unconditional general mandate to allot, issue and deal with additional shares in the capital of the Company, whether domestic shares or H shares, and to make or grant offers or agreements in respect thereof, subject to the following conditions:

    (a) such mandate shall not extend beyond the Relevant Period save that the Board may during the Relevant Period make or grant offers or agreements which might require the exercise of such powers after the end of the Relevant Period;

    (b) the aggregate nominal amount of shares allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the Board otherwise than pursuant to any scrip dividends or similar arrangement providing for the allotment of such shares in lieu of the whole or part of a dividend on such shares or any share option scheme adopted by the Company and in accordance with the articles of association of the Company (the "**Articles of Association**"), shall not exceed:

(i) in case of domestic shares, 20 percent. of the aggregate nominal amount of domestic shares of the Company in issue; and

(ii) in case of H shares, 20 per cent. of the aggregate nominal amount of H shares of the Company in issue,

in each case as at the date of passing of this resolution; and

(c) the Board will only exercise its power under such mandate in accordance with the Company Law of the PRC and the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (as the same may be amended from time to time) and only if all necessary approvals from the China Securities Regulatory Commission and/or other relevant PRC governmental authorities are obtained; and

For the purposes of this resolution:

"**Relevant Period**" means the period from the date of passing this resolution until the earliest of:

(a) the conclusion of the next annual general meeting of the Company following the passing of this resolution; or

(b) the expiry date of the 12-month period following the passing of this resolution; or

(c) the passing of a special resolution of the Company in a general meeting revoking or varying the authority set out in this resolution.

(2) contingent on the Board resolving to issue shares pursuant to this resolution, the Board be authorised:

(a) to approve, execute and do or procure to be executed and done all such documents and matters which it may consider necessary in connection with the issue of such new shares, including but not limited to the time, quantity and place for such issue, to make all necessary applications to the relevant authorities, and to enter into underwriting agreement(s) or any other agreement(s);

(b) to determine the use of proceeds and to make necessary filings and registration with the relevant authorities in the PRC, and/or Hong Kong Special Administrative Region of the PRC ("**Hong Kong**") and any other places and jurisdictions (as appropriate);

(c) to increase the registered capital of the Company and make any amendments to the Articles of Association in accordance with such increase and to register the increased capital with the relevant authorities in the PRC and/or Hong Kong and any other places and jurisdictions (as appropriate) so as to reflect the new capital and/or share capital structure of the Company resulting from the intended allotment and issue of the shares of the Company pursuant to paragraph (1) of this resolution.

9. **THAT** upon the passing of a special resolution at the AGM to approve the fifth motion in this notice, the Directors be authorised to make amendments to the Articles of Association:

   Article 3 The registered address of the Company: changed from "99 Beihai Road, Shouguang City, Shandong Province" to "99 Beihuan Road, Shouguang City, Shandong Province".

By Order of the Board
Shandong Molong Petroleum Machinery Company Limited*
Zhang En Rong
Chairman

Shandong, People's Republic of China
18 March 2008

Notes:

(A) The register of members of the Company will be closed from 5 April 2008 (Saturday) to 5 May 2008 (Monday) (both days inclusive) for the purposes of 1) the AGM and 2) declaration and payment of final dividend during which period no transfer of the Company's shares will be effected.

In order to be entitled to attend and vote at the AGM, share transfer documents should be lodged with the Hong Kong registrar of H Shares of the Company no later than 4:00 p.m. on 3 April 2008 (Thursday).

In order to qualify for entitlement to the proposed final dividend, share transfer documents accompanied by relevant H Share certificates should be lodged with the Hong Kong registrar of H Shares of the Company, Tricor Investor Services Limited, as soon as practicable and in any event not later than 4:00 p.m. on 3 April 2008 (Thursday).

The address of the Hong Kong registrar of H Shares of the Company is as follows:

Tricor Investor Services Limited
26th Floor
Tesbury Centre
28 Queen's Road East
Hong Kong

(B) Holders of H Shares and domestic Shares who intend to attend the AGM must complete the reply slips for attending the AGM and return them to the registered office of the Company (for holders of domestic Shares), or to the Hong Kong registrar of H Shares of the Company, Tricor Investor Services Limited (for holders of H Shares) no later than 20 days before the date of the AGM, i.e. no later than 15 April 2008 (Tuesday).

Details of the registered office of the Company are as follows:

No. 99 Beihai Road
Shouguang City
Shandong Province
The People's Republic of China

(C) Each holder of H Shares who has the right to attend and vote at the AGM is entitled to appoint in writing one or more proxies, whether a shareholder or not, to attend and vote on his behalf at the AGM. A proxy of a shareholder who has appointed more than one proxy may only vote on a poll. Each shareholder who wishes to appoint one or more proxies should first review the annual report of the Company for the year ended 31 December 2007.

(D) The instrument appointing a proxy must be in writing under the hand of the appointor or his attorney duly authorised in writing. If that instrument is signed by an attorney of the appointor, the power of attorney authorising that attorney to sign, or other documents of authorisation, must be notarially certified.

(E) To be valid, the form of proxy, and if the form of proxy is signed by a person under a power of attorney or other authority on behalf of the appointor, a notarially certified copy of that power of attorney or other authority, must be delivered to the Hong Kong registrar of H Shares of the Company, Tricor Investor Services Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Hong Kong, not less than 24 hours before the time for holding the AGM or any adjournment thereof.

(F) Each holder of Domestic Shares is entitled to appoint in writing one or more proxies, whether a shareholder or not, to attend and vote on its behalf at the AGM. Notes (C) to (D) also apply to holders of Domestic Shares, except that the proxy form or other documents of authority must be delivered to the registered office of the Company, the address of which is set out in Note (B) above, not less than 24 hours before the time for holding the AGM or any adjournment thereof in order for such documents to be valid.

(G) If a proxy attends the AGM on behalf of a shareholder, he should indicate his identification and the instrument signed by the proxy or his legal representative, which specifies the date of its issuance. If the legal representative of a legal person shareholder attends the AGM, such legal representative should produce his/her own identification and valid documents evidencing his capacity as such legal representative. If a legal person shareholder appoints a representative of a company other than its legal representative to attend the AGM, such representative must indicate his identification and an authorization instrument affixed with the seal of the legal person shareholder and duly signed by its legal representative.

(H) The information required under Rule 13.51(2) of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited in respect of the director of the Company who is proposed for re-election at the AGM is set out under the section entitled "Directors, Supervisors and Senior Management" in the annual report of the Company for the year ended 31 December 2007.

(I) The AGM is expected to last for about an hour. Shareholders attending the AGM are responsible for their own transportation and accommodation expenses.

* For identification purpose only