Overview

We are a manufacturer of land drilling rigs and rig parts and components. In addition, we offer drilling-related training as well as after-sales support services to our customers. For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, our revenue amounted to RMB539.3 million, RMB501.6 million, RMB2,335.9 million and RMB1,518.6 million, while our profit attributable to equity shareholders of the Company amounted to RMB32.2 million, RMB18.5 million, RMB412.8 million and RMB201.1 million, respectively.

We were the second largest land rig manufacturer in the world and the largest in China in terms of revenue and production volume in 2006, according to the Independent Technical Report contained in Appendix V of this Prospectus. We design, manufacture and sell drilling rigs for use in the exploration and production of oil and gas, by drilling down to oil and gas reservoirs located in a variety of geological formations and at considerable depths.

In addition to drilling rigs, we manufacture rig parts and components for our own use in the production of our own rigs, as well as for external sales. Our external rig parts and components sales consist primarily of mud pumps. Mud pumps are used to circulate drilling fluid through a rig's circulation system. We also produce and sell, among other things, masts, substructures, drawworks, VFD drive systems and solids control systems. For a detailed description of this equipment, please refer to the section entitled "Glossary of Technical Terms" of this Prospectus. We also produce and sell rig parts and components in the form of offshore drilling modules for offshore platforms. Sales of rig parts and components accounted for approximately 13.1%, 13.5%, 12.8% and 17.5% of our revenue for the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, respectively.

We procure raw materials (e.g., steel) and certain rig parts and components which we do not produce (e.g., diesel engines and AC variable-frequency motors) from external suppliers. We currently source almost all the raw and processed steel we need from five domestic suppliers based in Chongqing and Chengdu. We typically source rig parts and components that we do not produce ourselves through local distributors from manufacturers located in the United States, Finland, and Germany.

A substantial portion of our revenue is generated from exports. We are one of the largest land rig exporters in China in terms of revenue and sales volume. Our leading exported rigs are digitally-controlled land rigs, which are priced higher than our conventional land rigs. Our main customers in the overseas market are major multinational oil and gas drilling companies and contractors such as Nabors Group. For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, revenue from exports amounted to approximately RMB15.0 million, RMB158.1 million, RMB1,949.8 million and RMB829.9 million, accounting for approximately 2.8%, 31.5%, 83.5% and 54.6%, respectively, of our total revenue.

We have established a diversified global marketing network, with sales offices in North America, the Middle East and Africa, and have developed partnerships with local distributors in Russia and other regions such as Asia. There has been growing international demand for our rigs from the emerging markets in Russia, the Middle East, Africa and Latin America. In an effort to meet demand from these markets, we have begun to assemble rigs in the USA and Egypt, and plan to manufacture certain rig parts and components in Egypt.

The Chinese market has been an important and stable source of demand for our rigs over the past three years. Most of our customers in China are drilling companies owned by large Chinese oil and gas companies with whom we have established long-term and stable relationships. Some notable examples of these customers are the following, all of which are subsidiaries of CNPC or Sinopec: Material and Equipment Department of China

Petroleum & Chemical Corporation, Changqing Petroleum Administration Bureau, Material Co. of Sichuan Petroleum Administration Bureau, and China Petroleum Technology & Development Corporation. For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, we sold 31, 28, 32 and 31 rigs, respectively, in the Chinese market.

Company Background

We began our business as a privately-owned land rig manufacturer in 1998. As part of our Reorganization, we incorporated a company in the Cayman Islands, Honghua Group Limited, on June 15, 2007, which became the holding company of our various operating subsidiaries based in China and other countries. As of the date of this Prospectus, our major shareholders include our own top management and key technical personnel, as well as our strategic and Financial Investors, such as COOS and Carlyle Funds.

For details of our Reorganization, please refer to the section entitled "Company History and Reorganization" in this Prospectus.

Competitive Strengths

We offer a large and diversified range of drilling equipment, together with support services.

We offer our customers a comprehensive supply of customized drilling rigs, rig parts and components, and training as well as follow-up support services. Our diverse line of drilling rig products ranges from heavy 9,000-meter depth drilling rigs to light 1,000-meter depth drilling rigs and offshore drilling modules. We also realize earnings from the sale of rig parts and components, which are either used for replacement or refurbishment purposes in the existing drilling rig market, or sold to other drilling rig manufacturers. Our customer services include training at our main production facility in China and after-sales technical support administered at our customers' drilling sites by a team of experienced engineers.

We are a low-cost manufacturer of high-performance, quality land rigs.

We believe that we provide high-performance, quality drilling rigs at a lower cost than our international competitors, allowing for increased price competitiveness and greater profit margins. We are able to maintain a low cost structure due to our integrated approach to the manufacturing of rigs and rig parts and components, our proximity to a supply network of parts and components and raw materials, and our large scale of production.

We produce rigs utilizing many of the world's leading rig technologies, such as those used in our digitally-controlled VFD rigs. We have implemented the ISO 9001 system and the API quality standard to ensure effective quality control of our products. We believe that our integrated approach to the manufacturing of select parts and components and the manufacturing of rigs ensures a high level of quality and guarantees reliable delivery of rig orders, thus encouraging repeat business from existing customers.

We have an established global marketing network.

We have a diverse global marketing network that includes our overseas affiliates in Houston, Texas (USA), Cairo (Egypt) and Dubai (UAE), as well as our local distributor networks in other key drilling rig markets, such as Russia and Indonesia. Our subsidiary in Houston assembles and sells our drilling rigs and rig parts and components to drilling contractors based in North America and Latin America. We believe that this provides a sound base for further expansion in the North American and Latin American markets. In Egypt, we have formed a joint venture with three enterprises to increase our market share in Africa. Our subsidiary in Dubai serves our customers across the Middle East. In Russia and Indonesia, our close relationships with local distributors have helped us enhance our presence in the oil and gas drilling equipment markets within these countries.

We have advanced technological and engineering expertise and a track record of developing successful new technologies.

We are one of the leading developers of land rig technologies in China, and we have created a wide range of patented technologies and proprietary designs which enhance the function and performance of our rigs. We are strongly committed to strengthening the global competitiveness of our rigs and rig parts and components. We have focused on research and development, assembling a team headed by leading Chinese experts in the oil and gas equipment industry. As a result of our dedication to technological innovation, we have successfully developed globally-competitive products such as our digitally-controlled VFD rigs which, since being developed in 2001, have become our best selling rigs. More recently, we have developed low-temperature tolerant rigs (高寒鑽機) for the Russian market, semi-trailer drilling rigs for the markets in the USA, the Middle East and India, and digitally-controlled offshore drilling modules for the offshore drilling market.

We have an experienced and dedicated management team.

We are able to quickly adapt to changing trends in the regional and global drilling markets because our top management and key technical personnel are major shareholders, who are involved in the everyday operations and have first-hand knowledge of the latest market developments through direct customer contact. All of these individuals have extensive experience in the drilling equipment industry; Chairman Zhang, in particular, has over 20 years of experience in the industry. Our strategic shareholder, COOS through its parent Company, CNOOC, actively supports and participates in our Company's marketing and product development for offshore drilling products. CNOOC, founded in 1982, is one of the largest state-owned oil companies in China, as well as China’s largest offshore oil and gas producer. It is authorized to cooperate with foreign partners for oil and gas exploitation in China’s offshore areas. We have an established record of rapid growth, from a relatively-small land rig manufacturer in China to the second largest in the world and the largest in China in terms of revenue and production volume in 2006, within a period of 10 years.

Business Strategies

Increase our production capacity

We plan to raise our annual rig production capacity, from 86 rigs in 2006, to 150 rigs by 2008. We also intend to increase our annual mud pump production capacity, from 410 pumps in 2006, to 500 pumps by 2008. Upon completion of these expansions, we expect that our site in Sichuan will become the world's largest single manufacturing base for land rigs, by production capacity, making our company more competitive by virtue of economies of scale. In order to improve market penetration and reduce transportation costs, we plan to utilize our international joint ventures to manufacture rigs locally in selected emerging markets, such as Egypt.

Expand our global marketing platform to increase sales

We plan to take advantage of the global demand for rig upgrades, refurbishments and replacements, as well as the demand for new rigs in emerging markets. We aim to strengthen and expand our presence in several key international markets, including North America, Russia, the Middle East and Africa. Our goal is to accelerate the development of our overseas affiliates in these markets by making them regional hubs, capable of assuming responsibility for: marketing, direct sales and managing logistics, assembling integrated rigs and providing training, technical services, repairs and replacements. To increase our sales in emerging markets, we plan to establish ten or more additional distribution and service networks within the major oil and gas producing regions of Latin America (particularly Brazil), India and Southeast Asia.

Further improve the technology and innovation of our product lines

We are committed to developing new product technologies that increase sales and margins, provide a broader range of products and expand our market share in key target markets. The development of our top drive units and 12,000-meter depth offshore drilling rig module are in progress. We plan to complete the development of our top drive units for the Russian and Chinese markets by the end of September 2008. We also expect to develop semi-trailer-rig units for the Russian and Canadian markets, as well as rigs capable of withstanding extreme arctic temperatures (極地鑽機) for the Russian market and desert temperatures for the Middle Eastern market.

Enter into the offshore drilling rig manufacturing market

We plan to increase our sales of offshore drilling modules for 4,000-meter depth offshore drilling rigs, used on offshore drilling platforms. We sold two 4,000-meter depth offshore drilling modules to CNOOC in 2006 and 2007. We expect to produce offshore drilling modules for 7,000 to 12,000-meter depth offshore drilling rigs, including modules for newly built or refurbished jack-up rigs, semi-submersible rigs and drill ship rigs. We expect that further development of our offshore drilling modules will pave the way for our future entry into the manufacturing of offshore drilling platforms and jack-up rigs. We are in the process of planning the construction of a new offshore equipment manufacturing base in China, to produce jack-up rigs and fixed rigs. We believe that this will allow us to extend our existing rig manufacturing capability into the high-demand offshore drilling rig market.

Expand our business through acquisitions, joint ventures or business alliances

We will consider suitable opportunities to enter into strategic alliances, joint ventures or acquisitions that provide synergies or otherwise strengthen our current market-leading position. We believe that our relationships with many industry participants and our knowledge of the oilfield service equipment industry allows us to understand industry trends, technological developments and applications of oil equipment technologies, which will assist us in making decisions regarding such alliances, ventures or acquisitions. While we currently do not have any firm plans for strategic alliances, joint ventures or acquisitions, we will seek and exploit opportunities to expand into manufacturing of other parts and components or other oilfield service equipment segments which are related to the oil and gas drilling process.

Our products have been sold to Nabors Group since 2005, and we have chosen to participate in the global supply chain of Nabors Group since then. The currency of sales to Nabors Group is USD. For the years ended December 31, 2005, December 31, 2006 and August 31, 2007, our sales to Nabors Group amounted to RMB89.6 million, RMB1,493.9 million and RMB490.5 million, respectively. With a view to strengthening our relationship with Nabors Group, and as part of our future plans to increase our production volume of rigs and rig equipment, it is our intention to explore ways to cooperate with Nabors Group in the development, manufacturing and sale of, among other things, offshore platform rigs, land drilling rigs, tubing rigs, workover rigs, jack-up rigs and barge rigs. On October 17, 2007, Nabors Group and the Company entered into a “the Technology License Agreement”. Pursuant to the Technology License Agreement, the parties agreed to cooperate in the development and production of drilling rig equipment, to be manufactured and sold by us to customers in the PRC and overseas.

We believe that the technical know-how used with respect to the 2000HP offshore platform rig (which meets the API standards), 3000HP land drilling rig, coiled tubing rig, MWD system, workover rig, jack-up rig, barge rig and MASE platform rig granted under the Technology License Agreement can contribute to the Group’s financial position by improving our profit margins and enhance our product diversification in the following manners:

(1) enhance our research and development capability by increasing our knowledge base;

(2) shorten our research and development time line required to launch new products;

(3) broaden our land drilling rig product types; and

(4) accelerate our expansion into the offshore drilling rig markets.

Products

We design, manufacture and sell drilling rigs and related parts and components, for use in the exploration and production of oil and gas. The following table reflects the percentage of our total revenue contributed by each product type for the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2006, and 2007.

	Year ended December 31,						Eight months ended August 31,			
	2004		2005		2006		2006		2007	
							(unaudited)		(unaudited)	
	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue
Sale of drilling rigs	468,783	86.9%	433,976	86.5%	2,037,272	87.2%	718,432	85.2%	1,253,349	82.5%
Sale of parts and components	70,482	13.1%	67,594	13.5%	298,676	12.8%	124,398	14.8%	265,298	17.5%
	539,265		501,570		2,335,948		842,830		1,518,647	

For definitions of technical terms, please refer to the section entitled "Glossary of Technical Terms" in this Prospectus.

Drilling rigs

Drilling rigs can generally be divided into two categories: land rigs and offshore rigs. Although our focus has historically been on manufacturing land rigs, we also manufacture drilling modules for offshore platforms and are currently in the early phases of developing our offshore rig manufacturing capabilities. Both land and offshore drilling rigs have similar rig systems, though their sizes and capabilities vary.

Drilling rigs are designed to drill down to oil and gas reservoirs in a variety of geological formations and at considerable depths. During drilling, rigs suspend a long and heavy drill string, consisting of a line of connected drill pipes and a drill bit, down into the well hole. The drill string is turned by a rotating system, which consists of a rotary table in the drill floor that spins the drill pipe, and the swivel, which connects the drill pipe to the mud circulation system. Drilling mud is a man-made fluid, which is pumped at high pressure down the drill pipe during drilling, in order to lubricate the drill bit, remove cuttings and circulate them to the surface, and maintain down-hole pressure to keep the well bore stable. Mud is pumped by this method down into the hole by large, high-powered mud pumps, which act as the heart of the circulation system. The solids control unit is also an important part of this system, as it removes the cuttings and solid materials from the drilling mud, so that the mud can be recycled and sent back into the circulation system.

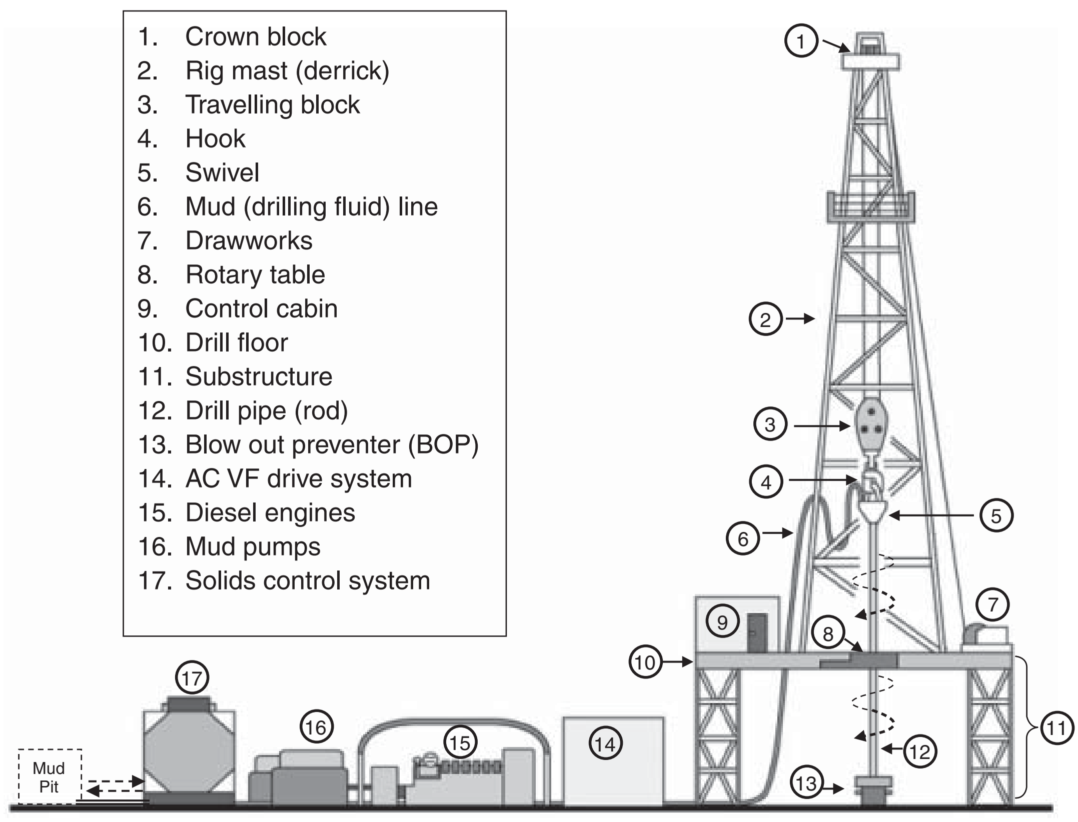
In order to hold and move the heavy drill string, a strong hoisting system is necessary. This consists of drawworks, which act as a large winch to lower and raise cable lines that run to the fixed pulley block on top of the rig mast (or crown block), and down to the suspended travelling block. The travelling block acts as a pulley-block and is attached to the hook, which holds the swivel and drill string.

A rig must be equipped with a large rig mast (or "derrick") to support the weight of the long drill string required in deep drilling as well as to allow for vertical piling and insertion of a drill pipe. The lifting capacity of the drawworks is measured in horsepower and is often used, in addition to drilling depth, in categorizing land rigs. In general, as the depth of a drilling rig's design increases, the rig bearing load becomes heavier, the horsepower increases, and the rig equipment becomes heavier.

Large power systems are needed to drive the rotary table, drawworks, and mud pump. Traditionally, rigs used mechanical or diesel engines to power all three such units by a direct mechanical connection. In the 1970's, DC-powered (diesel to AC to DC) electric engines, commonly known as "SCR" rigs, were developed and became quite common. Though these are still widely used, in recent years, the safer and more dynamic AC VFD-powered (diesel to AC) electric engines have become popular as the more advanced drive system. Electrical-powered rigs are more expensive, but have many operational and safety benefits over their mechanical predecessors. Some drilling rigs have a single power system to drive the rotary table, drawworks and mud pump; others, called electromechanical rigs, use mechanical diesel power to run the mud pump and an electric engine to run the rotary table and drawworks. The most advanced land rigs today use a single AC VFD system to run all three units.

Most offshore rigs and some land rigs have a top drive system installed on the rig, which serves as the primary rotating system of the drill string. The system is essentially a rotary motor, which is held up by the hoist system on top of the drill string, in the position where the swivel and travelling block sit on a traditional rig. The top drive system is more advanced than the rotary table and allows for greater ability of directional drilling and an ability to continue turning the drill string while tripping, or pulling in and out of the hole. This allows for greater efficiency in the drilling process, as well as an extra level of safety while tripping.

The following diagram summarizes the key components of an electromechanical rig, which utilizes a diesel engine to run the mud pump and an AC VFD electrical system to drive the rotary table and drawworks.



Note: This diagram is for illustrative purposes only; it is neither complete nor to scale.

We manufacture a wide range of land rigs, from heavy rigs capable of deep drilling (5,000 to 9,000 meters), to medium-sized rigs for moderate drilling depths (3,000 to 4,000 meters), to lighter rigs, economically-designed for shallower drilling (1,000 to 2,000 meters). Demand for our rigs is primarily focused on our medium to heavy rigs, in the 3,000 to 7,000-meter drilling-depth range, which is indicative of the global drilling market requirements for deep rig drilling capacity. Rig types are typically classified according to horsepower in the international market and according to depth in the PRC market. Based on depth ranges and horsepower, we have sold or received orders for the following rigs since 2004.

Rig Sales By Depth and Horsepower ("hp")

		For the three years ended December 31,			Rigs contracted to be delivered before	Rigs contracted to be delivered after
Drilling Depth (m)	**Drawworks (hp)**	**2004**	**2005**	**2006**	**December 31, 2007[1]**	**December 31, 2007**
1,000	<500	—	—	1	—	—
2,000	500	—	—	1	5	—
3,000	600-800	2	2	23	17	—
4,000	900-1300	5	5	8	12	6
5,000	1400-1900	12	18	39	23	31
7,000	2000-2600	13	7	10	32	11
9,000	4,000					1
Total		**32**	**32**	**82**	**89**	**49**

Note: (1) includes orders delivered in 2007 and orders to be delivered in 2007.

Our Drilling Rig Classes

Since our establishment in 1998, we have focused on developing and manufacturing land drilling rigs and rig parts and components. We currently manufacture two general classes of drilling rigs:

- Digitally-controlled land rigs, or rigs that utilize real-time digital feedback, instrumentation and control during the drilling process, all of which are technologies we developed in 2001; and

- Conventional land rigs, or rigs that utilize traditional, standard-technology instrumentation and control during the drilling process.

Digitally-Controlled Land Rigs

Our digitally-controlled land rigs are our most sophisticated and popular rigs. This class of rig integrates digital measurement, automatic feedback and control through a computer, which allows the technician to operate the rig from a centralized digital control system. It utilizes our own patented digitally-controlled weight-on-bit (WOB) auto-bit-feedback device, which allows a high degree of precision in measuring and controlling the WOB during the drilling process. The digitally-controlled land rig has several advantages over its conventional counterparts, including automated feedback of down-hole drilling data while drilling, directional drilling capabilities, more accurate and systematic control over the drilling process, a lower risk of drilling accidents which commonly occur under manual operation, lower maintenance requirements and greater energy efficiency during operations. This class includes two primary model types:

- The digitally-controlled VFD rig (DBS), which utilizes a single alternating current variable frequency electric motor for its drive systems; and

- The trailer drilling rig (DT/DBST), which is a variation of the digitally-controlled VFD rig, which can be disassembled onto a semi-trailer for ease of transportation.

The digitally-controlled land rig is popular with drilling companies that operate in complex geological conditions or require superior control and time efficiency during the drilling process. It is our leading rig class for export, but it has also become popular with our domestic buyers. Our revenue from digitally-controlled land rig sales amounted to RMB206.2 million, RMB193.6 million, RMB1,536.9 million, and RMB1,015.7 million, and accounted for 44.0%, 44.6%, 75.4% and 81.0% of our total annual rig sales, respectively, for the three years ended December 31, 2004, 2005 and 2006 and the eight months ended August 31, 2007.

Digitally-Controlled VFD Rigs (DBS)

Our digitally-controlled VFD rig (DBS) was launched in 2001 and has since become our most popular rig in terms of revenue. A single alternating current variable frequency motor-drive powers the drawworks, rotary table and mud pump, is capable of gearless speed regulation, and has better control than mechanical drives. This rig provides better working conditions for rig operators, including an independent control cabin, which can be hydraulically lifted and is not attached to the drill floor. It can be equipped with a rig-moving device, which allows it to move quickly between wells and is thus suitable for cluster well drilling. We offer the digitally-controlled VFD rig in a full range of light to heavy rig designs, from a drilling depth of 2,000 meters (500 horsepower) to 9,000 meters (4,000 horsepower). The main customers for this rig type are international drilling companies and Chinese drilling companies operating abroad, that require high-tech rigs for a variety of drilling operations. We estimate that this rig class accounts for approximately 50% of the current global market demand for land rigs.

We also sell an electromechanical compound drive rig (DBS-L(J)), which is a variation of the digitally-controlled VFD rig. It utilizes an alternating current variable frequency motor-drive for gearless speed regulation of the drawworks and rotary table, but utilizes a less expensive mechanical drive for the mud pump. The main customers for this type of rig are Chinese drilling companies that conduct drilling operations within China.

Trailer Drilling Rig (DT/DBST)

Our digitally-controlled trailer drilling rig (DT/DBST) is the most sophisticated and expensive of our rigs. It has all the functions of a digitally-controlled VFD rig, including the use of a single alternating current variable frequency motor-drive as a drive system, but is also mobile and can be disassembled onto a semi-trailer for ease of transportation. The mast telescopes and the substructure, are lifted hydraulically, allowing for easy rig assembly and disassembly within one day, compared to the four to five days required by our other rig types, thus saving drilling companies time and costs. This makes the trailer drilling rig suitable for low to medium depth drilling, which requires a relatively short drilling time. We offer this rig in a medium-size rig design, from a drilling depth of 4,000 meters (1,300 horsepower) to 5,000 meters (1,600 horsepower). The main customers for this type of rig are Chinese drilling companies or international drilling contractors, that have drilling operations in the Middle East.

Conventional Land Rigs

Our conventional land drilling rigs utilize more traditional technology in their instrumentation and control systems and are less expensive than our digitally-controlled rigs. These rigs are popular among drilling providers who generally operate in less challenging geological conditions or work in a low-cost drilling service market. We offer three types of drilling rigs in this rig class, which are grouped according to their motor drive systems:

- The mechanical rig with independent electrical drive rotary table (LDB), which uses an alternating current variable frequency electrical drive for the rotary table and a mechanical drive for its other works;

- The DC rig (D), which uses a single direct current electrical drive system for the drawworks, rotary table and mud pump; and

- The mechanical rig (L), which uses a strictly diesel-powered drive system for the drawworks, rotary table and mud pump and is the least expensive of the rigs we produce.

Our revenue from conventional land rigs amounted to RMB262.6 million, RMB240.4 million, RMB500.4 million and RMB237.7 million, and accounted for 56.0%, 55.4%, 24.6% and 19.0% of our total annual rig sales, respectively, for the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007.

Mechanical Rig with Independent Electrical Drive Rotary Table (LDB)

Our mechanical rig with independent electrical drive rotary table (LDB) utilizes an alternating current variable frequency motor drive for gearless speed regulation of the rotary table and a mechanical drive for the drawworks and mud pump. As a result, it is approximately 40% less expensive than the digitally-controlled VFD rig and is regarded by many of our clients as having the best performance-to-price ratio among the land rigs we manufacture. This particular rig is not suitable for cluster well drilling, as the mechanical drive for the drawworks and mud pump make it difficult to move freely between the well pads. We offer this rig in a light-to-heavy rig design, from a drilling depth of 3,000 meters (750 horsepower) to 7,000 meters (2,000 horsepower).

The main customers for our mechanical rig are Chinese drilling companies that conduct drilling operations within China. This rig type was our second-best-selling rig in 2005 and in 2006, in terms of sales volume.

DC Rig (D)

The DC Rig (D) is equipped with a single DC-powered motor drive and is capable of gearless speed regulation of the rotary table, drawworks and mud pump. It is approximately 10% to 15% less expensive than the digitally-controlled VFD rig, but lacks the drilling precision, power and control of a DBS rig. This rig type, commonly known in the market as an “SCR” rig, first entered the drilling rig market in the 1970’s and remains popular among those customers who are familiar with and prefer more traditional rig designs. We offer this rig in a medium-to-heavy rig design, from a drilling depth of 5,000 meters (1,500 horsepower) to 7,000 meters (2,000 horsepower). The main customers for the DC rig are Chinese oil and gas field service companies that conduct drilling operations within China.

Mechanical Rig (L)

The least expensive of our rigs, the mechanical rig (L), employs various diesel drive modes for the drawworks, rotary table and mud pump. It is normally used for drilling production wells in more mature oil basins, as such wells require drilling rigs with only basic functions and less accuracy, compared to what is needed for exploration wells or more advanced production wells. We offer this rig in a light-to-heavy rig design, from a drilling depth of 3,000 meters (750 horsepower) to 7,000 meters (2,000 horsepower). The main customers for this type of rig are Chinese drilling companies that provide services in China. Our mechanical rig was our third best selling rig in 2005 and in 2006, in terms of sales volume.

Our digitally and conventionally-controlled land rig lines and their design and performance specifications are summarized below.

Summary of Land Rig Specifications

		Drilling Depth (m)	Drawworks (hp)	Maximum load (tons)	Mud Pumps (hp)	Drive Mode			Production lead time (months)
						Rotary table	Drawworks	Mud pump	
Digitally-controlled VFD Rigs									
DBS	ZJ20DBS	2000	500	135	1x 800	AC	AC	AC	4.5
	ZJ30DBS	3000	750	170	2x1000	AC	AC	AC	5
	ZJ40DBS	4000	1300	225	2x1300	AC	AC	AC	5
	ZJ50DBS	5000	1600	315	2x1600	AC	AC	AC	5.5
	ZJ70DBS	7000	2600	450	3x1600	AC	AC	AC	5.5
	ZJ90DBS	9000	4000	675	2x2200 / 3x1600	AC	AC	AC	6
DBS-L(J)	ZJ40DBS-L(J)	4000	1300	225	2x1300	AC	AC	Chain(belt)	5
	ZJ50DBS-L(J)	5000	1600	315	2x1300	AC	AC	Chain(belt)	5
DT/DBST	ZJ40DBST	4000	1300	225	2x1300	AC	AC	AC	5.5
	ZJ50DBST	5000	1600	315	2x1600	AC	AC	DC (SCR)	6
Conventionally-controlled Land Rigs									
LDB	ZJ30LDB/ZPD	3000	750	170	1x1300	AC	Chain Chain AC	Chain Chain AC	4
	ZJ50LDB/ZPD	5000	1500	315	2x1300	AC	Chain Chain AC	Chain Chain AC	4.5
	ZJ70LDB/ZPD	7000	2000	450	2x1600	AC	Chain Chain AC	Chain Chain AC	5
D	ZJ50D	5000	1500	315	2x1300	DC(SCR)	DC(SCR)	DC(SCR)	5.5
	ZJ70D	7000	2000	450	2x1600	DC(SCR)	DC(SCR)	DC(SCR)	5.5
L	ZJ30L	3000	750	170	2x1000	Chain	Chain	Chain	4
	ZJ40L	4000	1000	225	2x1300	Chain	Chain	Chain	4
	ZJ50L	5000	1500	315	2x1300 / 2x1600	Chain	Chain	Chain	4.5
	ZJ70L/LC	7000	2000	450	2x1600	Chain	Chain	Chain	4.5

Breakdown of land rig sales

The following table summarizes our land rig sales, according to rig class and type, during the three years ended December 31, 2004, 2005 and 2006, as well as the number of orders received and sales booked as of August 31, 2007.

Sales by Rig Type

	For the three years ended December 31,			Rigs delivered before	Rigs contracted to be delivered after
	2004	2005	2006	December 31, 2007[1]	December 31, 2007
Digitally-controlled VFD Rigs					
Digitally-controlled VFD (DBS)	11	4	48	46	34
Trailer (DT/DBST)	—	2	2	6	—
Subtotal	11	6	50	52	34
Conventionally-controlled Land Rigs					
Mechanical with Rotary Table (LDB)	11	7	16	16	—
DC (D)	—	2	3	5	8
Mechanical (L)	10	17	13	16	6
Subtotal	21	26	32	37	14
Total	**32**	**32**	**82**	**89**	**48**

Note: (1) includes orders from Nabors for 15 DBS rigs that were delivered by the end of May, 2007.

The following table summarizes the basic specifications and numbers sold of our five best-selling rigs, for the three years ended December 31, 2004, 2005 and 2006, as well as the number of rigs contracted to be delivered before December 31, 2007, and contracted to be delivered after December 31, 2007.

Top Five Rigs Sold or Contracted to be Delivered

Rigs		Drilling depth (m)	Drawworks (hP)	2004	2005	2006	Rigs delivered before December 31, 2007	Rigs contracted to be delivered after December 31, 2007
1	ZJ50DBS (Digitally-Controlled VFD)	5,000	1,600	2	4	32	18	30
4	ZJ30DBS (Trailer)	3,000	750	1	0	15	16	—
2	ZJ70LDB (Mechanical/Electrical)	7,000	2,600	5	6	7	16	—
3	ZJ50L (Mechanical)	5,000	1,500	4	9	4	5	—
5	ZL40L (Mechanical)	4,000	1,000	2	5	8	9	4
	Total			**14**	**24**	**66**	**64**	**34**

The following table summarizes the price range of domestic sales and exports of our rigs during the Track Record Period. The differences between the prices of domestic sales and exports exist as a result of:

(1). certain international customers required more complete sets of drill rig systems, which included more expensive top drives or drilling bits than those required by domestic customers;

(2). certain international customers required more expensive brands of parts and components for their rig systems than domestic customers; and

(3). prices for international orders included higher transportation costs than domestic orders.

Price Range of Rig Sales

Rig Type	Price range of domestic sales in the Track Record Period	Price range of exports in the Track Record Period
	(RMB'000)	(USD'000)
Digitally-controlled VFD Rigs		
ZJ30DBS	5,580	2,270-2,700
ZJ40DBS	9,770-15,280	—
ZJ50DBS	10,640-40,230	3,300-7,520
ZJ70DBS	20,750-41,520	7,950-18,600
ZJ40DBST		2,700-5,580
ZJ50DBST	31,030	—
Conventionally-controlled Land Rigs		
ZJ30LDB/ZPD	8,250	—
ZJ50LDB/ZPD	6,310-19,760	—
ZJ70LDB/ZPD	7,140-23,110	3,650
ZJ40D		
ZJ50D	6,390-12,380	—
ZJ70D		7,380-8,780
ZJ30L	4,770-6,940	—
ZJ40L	4,030-12,350	—
ZJ50L	5,710-12,010	2,460
ZJ70L	7,050-9,590	1,330

Rig parts and components

We manufacture rig parts and components, for internal use in the assembly of our integrated rigs and for external sales. Our main rig parts and components, in terms of revenue generated, are mud pumps, masts, substructures, drawworks, VFD drive systems and solids control systems.

While different types of rigs require different parts and components, almost all rigs contain the following four major systems:

- a hoisting system, which is used to raise, lower and suspend equipment in the well. This system consists mainly of a crown block, traveling block, hook, drawworks and mast, all of which are components that we manufacture and sell.
- a rotating system, which is used to cut the initial hole of the well. This system consists mainly of a swivel and rotary table, both of which are components that we manufacture and sell.
- a circulating system, which pumps drilling mud in and out of the well. This system consists mainly of the mud pump, drilling fluid manifold and solids control system, all of which we manufacture and sell.
- a power system, which supplies power to the rig. This system consists mainly of the engine, which we source from external suppliers, and associated control equipment, such as VFD drive systems, SCR and MCC, all of which we manufacture and sell.

Mud pumps accounted for 5.0%, 45.1% and 48.4% of our revenue from the rig parts and components segment in the three years ended December 31, 2004, 2005, 2006, respectively.

The following table contains sales figures for mud pumps.

	Year ended December 31, 2004	2005	2006	Mud pumps delivered before December 31, 2007
Production volume (units)	6	47	410	n/a
External sales (units)	6	32	191	106

The following table shows the types of parts and components that we produce. It is categorized according to the four major systems of a rig, and other parts and components.

Hoisting system	Crown block, Travelling block, Hook, Mast, Drawworks
Rotating system	Swivel, Rotary table
Circulating system	Mud pump, Drilling fluid manifold, Solids control systems
Power system	VFD, SCR, MCC, Diesel-engine generator set control system, Drilling site standard electricity supply control system, Electrical drive system
Other parts and components	Substructure, Driller control cabin of DBS drilling rig, Electromagnetic eddy current brake, Automatic pipe transport system, Low-temperature tolerant drilling rig heating system, Drilling house

Mud pumps

Mud pumps are essentially large reciprocating pumps, used to circulate drilling fluid (or drilling “mud”) through a rig’s circulation system. The circulation system is one of the crucial systems in an oil drilling operation, and mud pumps are the heart of that system. The circulation system distributes the mud, to lubricate and cool the equipment, control pressures in the well, and remove cuttings from the drilling surface.

Mud pumps are either duplex or triplex in design. Duplex pumps use two double-acting pistons in cylinders that drive the mud on both forward and backward strokes. A triplex pump uses three single-acting pistons in cylinders that drive the mud only during forward strokes. We manufacture a wide range of triplex pumps that use three single-acting pistons. The power output of our mud pumps ranges from 500 hp to 1,600 hp.

We use advanced machinery, including digitally-controlled floor milling and boring machines, digitally-controlled lathes and UK-made herringbone gear generators, to produce mud pumps. This machinery enables us to achieve a high degree of precision when processing key components of our mud pumps, such as the gears. As a result of our advanced production process, we believe that we are able to provide customers with mud pumps that work better, last longer and produce less noise than those offered by our domestic competitors.

Of the 410 mud pumps we manufactured in 2006, 191 were sold directly to customers as stand-alone pieces of equipment.

The following table shows the number of mud pumps sold externally, for the three years ended December 31, 2004, 2005 and 2006.

External Mud Pump Sales

Mud Pump Design	Power (hp)	Year ended December 31, 2004	2005	2006	Delivered before December 31, 2007	Contracted to be delivered after December 31, 2007
500F	500	—	—	—	—	—
800F	800	—	1	—	4	—
1000F	1,000	—	26	132	20	—
1300F	1,300	4	2	2	10	—
1600F	1,600	2	3	57	72	—
Total		**6**	**32**	**191**	**106**	**0**

Components sourced from external suppliers

We reserve our internal manufacturing capacity for the production of our core products. We usually source parts and components with the following characteristics from external suppliers: (a) those that are low value-adding; (b) those that are non-critical; or (c) those that are critical, but due to quality and cost-effectiveness considerations, are sourced from external suppliers who specialize in manufacturing certain parts and components (e.g., engines). In some cases, we also source components from external suppliers upon special request by our customers.

Offshore drilling modules

In addition to land rigs, we also manufacture and sell offshore drilling modules to offshore drilling, engineering, exploration, and production companies. Offshore drilling rig modules consist of certain major parts and components of land rigs, such as rig masts, drawworks and mud pumps, which are modified for use on offshore production platforms.

Since 2002, we have been selling rig modules and components for 4,000-meter depth offshore drilling rigs to offshore oil and gas companies, including CNOOC Engineering, CNOOC Limited, and China Ocean Oilfields Services (Hong Kong) Limited ("COOS"). We have sold four rig modules which included masts in 2004, and two such rig modules in 2006. Our revenue from offshore drilling modules amounted to RMB4,811,965 and RMB22,011,399, for the years ended December 31, 2004, and 2006 respectively. We plan to expand our offshore drilling module sales by developing and selling our 7,000-meter and 12,000-meter offshore rig modules to large offshore rig units, such as semi-submersible rigs and drill ships.

One of the Company's Financial Investors, COOS, is a subsidiary of CNOOC. See the sub-section entitled "Financial Investors" in the "Company History and Reorganization" section of the Prospectus for details of our relationship with CNOOC.

Training and after-sales services

In order to ensure that our customers know how to use our products effectively, we administer training with a 1,000-meter depth digitally-controlled VFD training rig, at our main production facility in China, for a period of five to ten days before or after the delivery of our products.

Our training course covers the following topics:

(1) turning the training rig on and off;

(2) setting the screen of the training rig;

(3) use and maintenance of equipment on the training rig;

(4) operating the training rig;

(5) set-up and adjustment of the parameters of the training rig;

(6) how to deal with breakdowns of the training rig; and

(7) practice on the training rig by trainees.

During training, customers are taught how to use and control drilling rigs, so that they may use the rigs more efficiently. Overseas customers normally send their staff to the Company's site in Guanghan for training. Depending on the terms of the contract between the Company and our customers, such training can be provided either free of charge or for a fee.

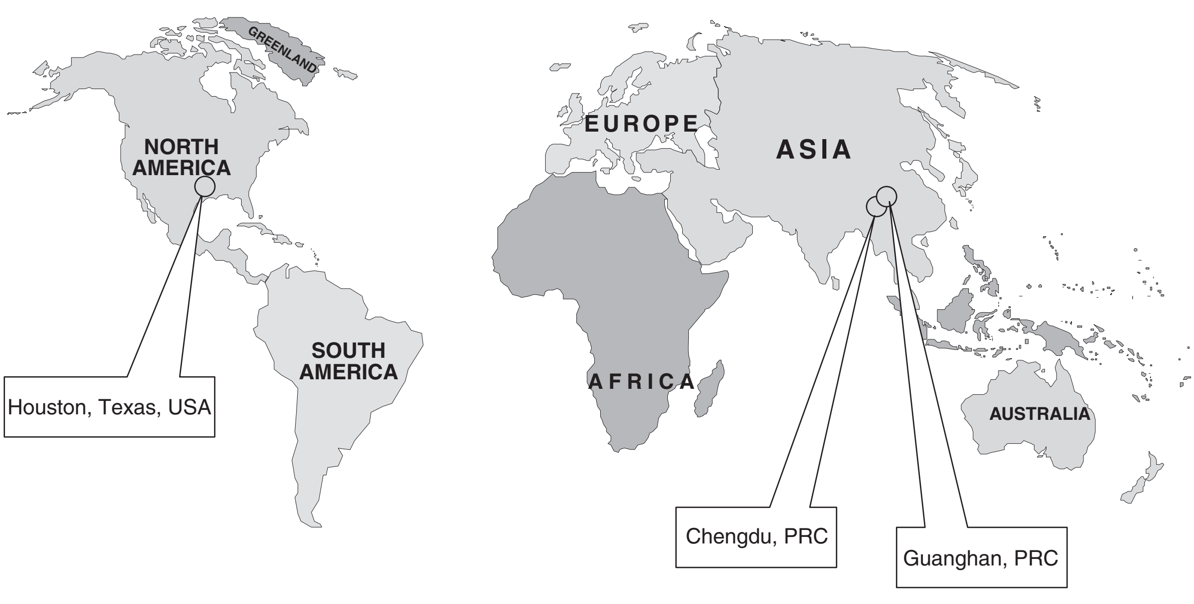
In addition, we have a team of experienced engineers who, upon request, provide short-term, onsite technical support at our customers' oil and gas fields.

In response to the increasing demand for drilling technicians, we intend to offer the services of our drilling technicians on a contract basis to assist customers in the operation of their drilling rigs. We expect that this proposed service will generate additional revenue for us in the future.

Manufacturing

Production facilities

We have three manufacturing facilities, located in Guanghan, Chengdu and Houston, with an aggregate gross land area of approximately 391,142 sq.m. The map below shows the location of each of our manufacturing facilities.



The table below sets out the details of our manufacturing facilities.

Manufacturing facilities	Location	Gross land area (sq.m.)	Main operations	Planned production capacity	Current utilization rate	Production equipment employed	Year of commencement of production
Honghua Company	Guanghan	222,733	Manufacturing of rigs as well as rig parts and components, such as mud pump, crown block, travelling block, hook and mast	100 drilling rigs; 500 units of mud pumps	99%	Lathe, boring machine, milling machine, horizontal gear-generator, CNC spiral/bevel gear generator, and crane	1998
Youxin Company	Guanghan	38,943	Manufacturing of rig parts and components, such as cargo hoist, drilling fluid manifold and rig solid control system	70 sets of solid control systems; 80 sets of drilling fluid manifolds	83%	Travelling crane, truck crane, plane shears, sandblasting machine, automatic submerged arc welding machine, and lathe	2000
Hongtian Company	Chengdu	48,529	Manufacturing of rig parts and components, such as VFD, SCR, MCC and driller control cabin	100 sets of VFD drive systems and driller control cabins	70%	Travelling crane and forklift	2001
Honghua America	Houston, Texas, USA	80,937	Assembling rigs	Assembling and renewing 20-30 drilling rigs	20%	CAT C6000 forklift, IW110D punching and cutting machine, TE-450M forklift, Miller CP-302 gas-shielding welding machine, and 20T travelling crane	2006

Honghua Company, Youxin Company and Hongtian Company have obtained all the land use right certificates and all the building ownership certificates for their current manufacturing facilities.

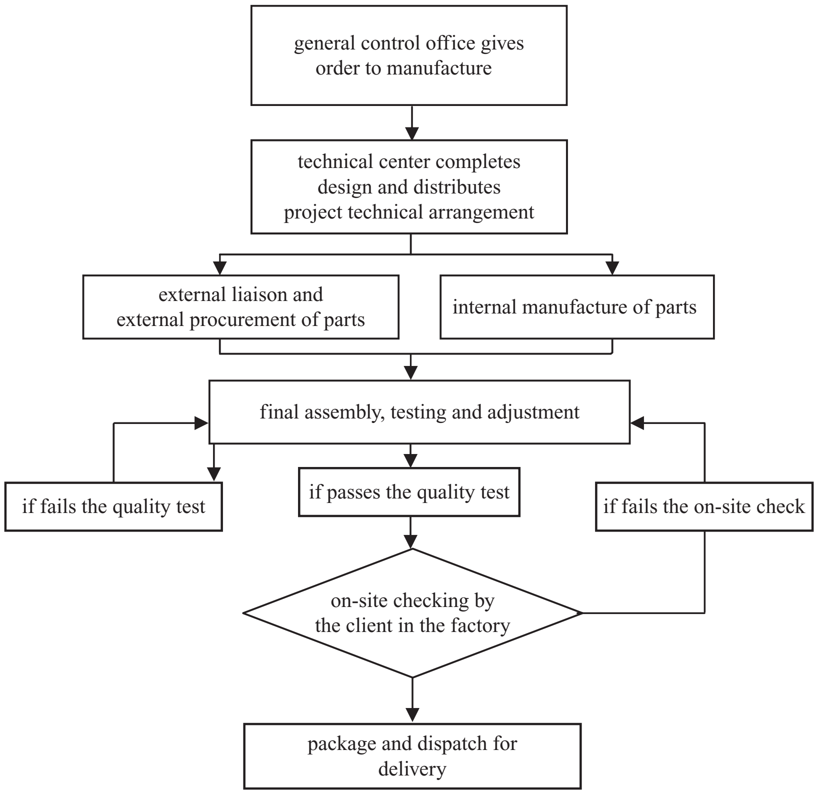
Honghua America has obtained the legal rights over the property used by its manufacturing facilities, including title guarantees and construction rights.

In order to expand our product and service lines, we intend to establish a production site in China that will specialize in producing offshore rigs and related products.

Production process

Our production process is designed to accommodate a wide range of customer specifications, while still meeting our high quality standards in the most cost-effective manner.

The following diagram illustrates the major production processes of our principal products.



Repair and Maintenance

We utilize regular repair and maintenance programs to ensure production efficiency, stability and safety. Our facilities are periodically shut down for overhauls and repairs, according to preset maintenance schedules, which can vary among our different production sites. Overhauls and repairs may also be conducted outside of these maintenance schedules as circumstances require. We regularly upgrade our facilities and quality control systems to ensure that we meet the stringent requirements of our customers. We experienced no major interruptions of production caused by equipment defects during the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007.

Quality Control

We have adopted a comprehensive quality control system. We administer preventive and corrective measures that optimize final product quality, by conducting a wide range of quality control tests at different stages of our production process. As of August 31, 2007, there have been no recalls of any of our products.

Our quality assurance program is divided into three stages:

(a) Raw materials quality control

All incoming raw materials used in our production processes are subject to inspection at the point of receipt, before being warehoused. We conduct sample inspections and tests on our raw materials and related accessory items when they are delivered to our manufacturing facilities, to ensure that they are in accordance with our standards. We document all quality control checks on all raw materials and conduct regular reviews of the quality of our suppliers. Raw materials that fail to meet our standards are returned to our suppliers for corrective measures or for replacement at the supplier's own cost.

(b) Production quality control

Our quality control personnel continuously monitor our production processes to ensure consistency in the quality of our products. Work-in-progress products are checked by the designated quality control personnel before being passed on to the subsequent stage of production. The quality control personnel at the next stage of production re-examine the work-in-progress products received, to ensure there are no defects before the products are further processed.

(c) Product quality assurance

At the end of the production process, we conduct physical analyses of our products on a selective basis to verify that their mechanical and dimensional properties and strength meet quality standards and specifications before delivery to our customers.

We employ the API Monogram and the ISO 9001 quality system to ensure our products meet high quality standards. We obtained an API Monogram license on July 6, 2005, and an ISO 9001 registration on November 1, 2000.

Research and Product Development

We believe that successful technological development is critical to our ability to stay competitive in the industry in which we operate. To this end, we have established research and development centers in Chengdu and Guanghan. As of August 31, 2007, we have a total of 222 research and development personnel working in these research and development centers. Teams are headed by leading Chinese experts in the oil and gas equipment industry. Our own research and development team has successfully developed 21 patents (including 14 patents pending before the State Intellectual Property Office in China). See the section below entitled "Our Business — Intellectual Property" for details of our patents.

In addition, we have entered into a cooperation agreement with Tsinghua University, in Beijing, for the design of digitally-controlled rig products. We have also devoted significant effort and resources to researching and developing new types of products for a variety of uses. We plan to offer the following new products in the next two years:

(1) top drive units;

(2) rigs capable of withstanding extreme temperatures in arctic and desert environments;

(3) land rigs with a depth range of 12,000 meters;

(4) offshore drilling modules for 7,000 to 12,000-meter depth offshore drilling rigs;

(5) semi-trailer rigs; and

(6) helicopter-mounted drilling rigs.

For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, our expenditure on research and development amounted to approximately RMB1,172,000, RMB5,233,000, RMB16,208,000 and RMB14,069,141, representing approximately 0.2%, 1.0%, 0.7% and 0.9% of our total revenue, respectively.

The Company's focus on research and development is demonstrated by the following.

(1) The Company has established an office in Chengdu, exclusively for research and development staff. To promote progress in research and development, the Company remunerates researchers according to the success of their projects.

(2) To achieve the highest cost-effectiveness, the Company is establishing a digital design system. The ultimate goal of the system is virtual machine manufacturing.

(3) To keep the Company's products on the leading edge, the Company has two experienced engineers who are constantly up to date on the latest information technology research. In addition, the Company has established technology teams in the United States, Egypt, Dubai and Russia, who keep the Company up to date on information and research.

(4) The Company is cooperating with several universities for research and development. The Company researched and developed its "Coiled Tubing Drilling" with Southwest Petroleum University, and its "Remote Transfer and Professional System" with the University of Electronic Science and Technology of China.

(5) The Company strives to enhance the academic level of its research staff and has proposed sponsoring a post-graduate class within the Company with Southwest Jiao Tong University. The Company is currently discussing with Southwest Petroleum University the possibility of sponsoring a multi-discipline post-doctoral program.

Technology Cooperation

The Group and Nabors Group will cooperate in connection with the production and development of, among other things, offshore platform rigs, land drilling rigs, tubing rigs, workover rigs, jack-up rigs and barge rigs. Technology controlled by Nabors Group will be licensed to the Group under the Technology License Agreement, and Nabors Group will provide to the Group's employees consulting services for such technology as necessary. The Group's employees, upon reasonable notice to Nabors Group, shall have the right to inspect any facilities used in relation to cooperative work.

We believe that the technical know-how used with respect to the 2000HP API offshore platform rig, 3000HP land drilling rig, coiled tubing rig, MWD system, workover rig, jack-up rig, barge rig and MASE platform rig, granted under the Technology License Agreement, can contribute to the Group's financial position by improving our profit margins and can enhance our product diversification in the following manners:

(1) enhance our research and development capability by increasing our knowledge base;

(2) shorten our research and development time line required to launch new products;

(3) broaden our land drilling rig product types; and

(4) accelerate our expansion into the offshore drilling rig markets.

Intellectual Property

As of the Latest Practical Date, we held 7 patents for oil equipment manufacturing technologies, and had 14 more patents pending before the State Intellectual Property Office of China. We have also registered our trademarks in Hong Kong and the PRC. We have not granted and do not intend to grant any licenses to other parties for the use of our patents and trademarks.

Our most important patents include a patent for AC VFD-controlled rig drawworks, a digitally-controlled WOB auto-bit-feed device, a hydraulic device for transporting land rigs horizontally, and belt-attached drawworks wheelwork. Some of our more important, patented, leading edge technology includes AC VFD-controlled rig drawworks and digitally-controlled WOB auto-bit-feed devices.

For details of these patents and trademarks, see the section entitled "B. Further Information About Our Business — 2. Intellectual property rights" in Appendix VII, "Statutory and General Information," to this Prospectus.

Procurement and Suppliers

We select our raw materials and components suppliers based on product quality, service and delivery time. We conduct inspections on all raw materials and components that we receive on a sampling basis, utilizing physical and chemical tests to ensure that they meet the specifications of our products as well as any relevant international standards.

Our major suppliers provide us with our basic raw material inputs, including steel and steel-based products, as well as with components and parts that we do not produce ourselves. We currently source almost all of our basic steel inputs domestically from five suppliers operating primarily in Chongqing and Chengdu, while our externally supplied parts and components that we do not produce ourselves, such as diesel engines, hydraulics and AC variable-frequency motors, are typically manufactured in the United States, Finland, or Germany and sourced through local distributors.

Generally, we make payment upon the receipt of goods. Occasionally, we are given 1-3 month credit terms. Under the sales contracts with our AC variable-frequency motor suppliers, we can retain 10% of the purchase price, which we release after 12 months' use of their products without encountering major problems. We have established long-term relationships, as far back as 1999, with some of our suppliers.

We have long-standing relationships with our major suppliers, and we have not experienced any significant difficulties in sourcing raw materials and components during the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007. Except for export contracts, which are denominated in US$ and settled by letters of credit, all of our purchase agreements are denominated in RMB. For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, we incurred costs of approximately RMB409 million, RMB344 million, RMB1,420 million and RMB943 million, respectively, for purchases of raw materials and components from suppliers.

For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, our single largest supplier accounted for approximately 27.95%, 12.06%, 15.09% and 12.42%, respectively, of our total purchases, and our five largest suppliers together accounted for 44.63%, 27.99%, 29.84% and 27.41%, respectively, of our total purchases in terms of cost.

None of the Directors or their Associates, or any shareholders of our Company, who, (to the knowledge of our Directors) beneficially own more than 5% of our issued share capital, had any interest in any of our five largest suppliers for the three years ended December 31, 2004, 2005 and 2006, or the eight months ended August 31, 2007.

Most supplies procured within the PRC have a delivery lead time of 1-2 months. Certain components and parts procured from National Oil Well Varco LP in the USA, and from Caterpillar SARL in Singapore, can have delivery lead times of 6-9 months, due to recent shortages in the supply of related products.

Inventory Management

We monitor and control the inventory levels of our raw materials, work-in-progress products and finished products to optimize our operations. We have in place an inventory management system, that monitors the planning and allocation of warehouse space and our stock of raw materials and finished products, in order to better coordinate our delivery requirements and schedules.

Due to the varying specifications and customizable features of many of our rigs and rig parts and components, we typically manufacture our products according to customer requirements. We make inventory and purchase plans for the common and standard raw materials and only purchase raw materials which are specific for each product after we have received an order. Our inventory of raw materials consists mainly of steel and steel products, parts and components. With regard to rig production, our policy is to reserve raw materials required for at least one and a half months of production, and parts and components for manufacturing two rigs.

Our inventory of finished products consists mainly of those awaiting delivery. As most of our finished products are large in size (i.e., rigs and mud pumps), we often enter into short-term leases for storage purposes. The duration of such short-term leases varies, depending on the delivery and transportation arrangements for the finished products, but usually such duration would not be longer than six months. Since the ownership of the products awaiting delivery remains with the seller, in the event that there is any damage to the finished products before delivery, we will bear the loss. We have employees to guard and look after finished products while they are awaiting delivery.

Sales and Marketing

Summary and strategy

We sell our products primarily to drilling companies owned by large Chinese oil and gas companies, as well as major multinational oil and gas drilling contractors in North America, Russia, the Middle East, Africa, Asia and other oil and gas producing regions.

During the year of 2006, the top ten customers of the Company by revenue were: (i) Nabors Group (US); (ii) ETA Star Holding LLC (Middle East); (iii) SOM Engineer Service Co. (Middle East); (iv) MH-Myramud Inc (US); (v) Changqing Petroleum Administration Bureau (PRC); (vi) Tu-ha Petroleum Exploration & Development Co. (PRC); (vii) Huabei Petroleum Administration Bureau (PRC); (viii) Red Maple International Inc. (Canada); (ix) Material Co. of Sichuan Petroleum Administration Bureau (PRC); and (x) Great Wall Drilling Rig Co., Ltd. (PRC).

The top ten customers of the Company by revenue during the period from January 1, 2007 to November 30, 2007 were: (i) Nabors Group (US); (ii) the Material and Equipment Department of China Petroleum & Chemical Corporation (PRC); (iii) Changqing Petroleum Administration Bureau (PRC); (iv) Material Co. of Sichuan Petroleum Administration Bureau (PRC); (v) Petrovietnam Drilling and Well Service Joint Stock Company (Vietnam); (vi) China Petroleum Technology & Development Corporation (PRC); (vii) Izhdrill-Honghua (Russia); (viii) Jiangsu Huashi Science Industry and Trade Co., Ltd. (PRC); (ix) ETA Star Holding LLC (Middle East); and (x) Eriell Corporation S.R.O (Czech).

During 2006, five of the top ten customers of the Company by revenue (namely, Changqing Petroleum Administration Bureau, Tu-ha Petroleum Exploration & Development Co., Huabei Petroleum Administration Bureau, Material Co. of Sichuan Petroleum Administration Bureau, and Great Wall Drilling Rig Co., Ltd.) were subsidiaries of CNPC or Sinopec, both of which are large, state-owned Chinese oil and gas companies. From January 1, 2007, to November 30, 2007, four of the top ten customers of the Company by revenue (namely, the

Material and Equipment Department of China Petroleum & Chemical Corporation, Changqing Petroleum Administration Bureau, Material Co. of Sichuan Petroleum Administration Bureau, and China Petroleum Technology & Development Corporation) were subsidiaries of CNPC or Sinopec.

Apart from Nabors Group, none of the above customers are pre-IPO investors of the Company.

We have established sales offices and subsidiaries in China and abroad, in order to provide onsite services (such as technical advice and support) at major oil and gas fields where our customers operate. Our sales and marketing department has expanded over the past few years. As of August 31, 2007, our sales and marketing team consisted of 237 employees.

The following table contains a geographical breakdown of our rig sales and our total rig sales, for the periods indicated.

	For the three years ended December 31,			For the eight months ended August 31,	Rigs delivered before December 31, 2007		Rigs contracted to be delivered after December 31, 2007		For the three years ended December 31,						For the eight months ended August 31,	
	2004	2005	2006	2007					2004		2005		2006		2007	
Regions	**Number of rigs sold**	**Number of rigs sold**	**Number of rigs sold**	**Number of rigs sold**	**Numbers of rigs**	**% of total rig**	**Number of rigs**	**% of total rig**	**Revenue generated**	**% of total rig sales**	**Revenue generated**	**% of total rig sales**	**Revenue generated**	**% of total rig sales**	**Revenue generated**	**% of total rig sales**
									RMB'000		**RMB'000**		**RMB'000**		**RMB'000**	
China	31	28	32	31	48	53.9%	10	20.4%	455,617	97.2%	306,472	70.6%	321,978	15.8%	638,756	51.0%
North America	—	3	45	15	16	18.0%	0	0.0%		—	120,699	27.8%	1,467,363	72.0%	312,137	24.9%
Russia	—	1	1	6	16	18.0%	28	57.1%		—	6,805	1.6%	6,466	0.3%	90,170	7.2%
Middle East	—	—	3	—	2	2.2%	4	8.2%		—		—	228,253	11.2%		—
Others	1	—	1	3	7	7.9%	7	14.3%	13,166	2.8%		—	13,212	0.7%	212,286	16.9%
Total	**32**	**32**	**82**	**55**	**89**	**100%**	**49**	**100%**	**468,783**	**100%**	**433,976**	**100%**	**2,037,272**	**100%**	**1,253,349**	**100%**

For the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, our single largest customer, Nabors Group, accounted for approximately 0.0%, 17.9%, 64.0% and 32.3%, and our five largest customers together accounted for approximately 84.3%, 72.8%, 80.2% and 65.2%, respectively, of our revenue.

We have established credit control and cash management procedures. We assess the creditworthiness of potential customers and determine the price and credit limits to be granted, after taking into account other factors, such as the market condition and sales scale. We usually require installment payments, according to our procurement and production process. After the sales agreement is signed, our salespeople will follow-up with the clients and monitor their payments. If there is a delay in payment, we will assess the client's creditworthiness and adjust our credit policy as necessary.

None of our Directors or their respective Associates, or any shareholders of our Company, who (to the knowledge of our Directors) beneficially own more than 5% of our issued share capital, have had any interest in any of our five largest customers for the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007.

Domestic Sales and Marketing

For the year ended December 31, 2006, approximately 16.5% of our products were sold in the domestic market. Of these, about 47% were sold in Eastern China, and about 53% were sold in Western China. Our domestic sales and marketing channels include direct sales, open and invited tenders, industry conferences and vendors' network websites. Our domestic sales department is divided into two teams, with one responsible for Eastern China and the other responsible for Western China.

Domestic Market Coverage

The triangle the location of the Group's headquarters as well as the location of Honghua International, Youxin Company and Hongtian Company.

The circles show the location of the customers who purchase the Group's products.

International Sales and Marketing, and Key Regions

We have established sales operations in North America, the Middle East and Africa, and we have formed an international distributors' network to cover Russia and Asia (excluding China). Our sales and marketing strategies vary from country to country. We use our own sales force in the USA, UAE and Egypt, while we rely on local agents in other countries e.g., Bangladesh and Vietnam. The agency fees range from 2% to 10% of the sale price. We attend open or invited tenders, and we participate in international trade fairs outside of China. For international markets, our sales department is divided into the following teams: Middle East/Africa, North America, Southeast Asia, and Russia.

North American market

We have established a USA subsidiary, Honghua America, in Houston, Texas. It acts as our major sales agent in the United States and Canada. Its primary business involves the assembly and sale of our drilling rigs and various parts and components. In addition, Red Maple International is our exclusive sales agent for mud pumps in Canada. Our agency contract with Red Maple International is renewable on an annual basis. Red Maple International is responsible for arranging the transportation of our products and providing after-sales services. Our major products sold in the USA and Canadian markets are semi-trailer drilling rigs and digitally-controlled VFD rigs. We have complied with all relevant laws and regulations in the USA.

Latin American market

The Company attaches great importance to the Latin American market and is in the process of engaging an exclusive sales agent for this market. Although this market is new, the Company has already contracted to sell two rigs in Brazil in 2008.

Russian market

We have two distributors in Russia: Izhdrill-Honghua; and Honghua-Ural. A National Standard Certification System certificate issued by local certification authorities in Russia is required for our products exported to Russia. Our distributor in Russia, Izhdrill-Honghua Co., Ltd, has obtained the National Standard Certification System certificates from Izhevsk Standard Institution for the export of our rigs and components to Russia. These certificates will not expire until May, 2009. The marketing strength and geographical advantages that these distributors have to offer have enabled us to expand our presence in the Russian oil drilling equipment market. Our most popular products sold in this region are digitally-controlled VFD rigs capable of withstanding low temperatures. In the eight months ended August 31, 2007, we sold six rigs and certain rig parts and components amounting to RMB92,212,000 in the Russian market through Izhdrill-Honghua. In 2006, we sold rig parts and components amounting to RMB667,000 in the Russian market through Honghua-Ural. We made no sales to Izhdrill-Honghua or Honghua-Ural in 2004 and 2005. We have complied with all relevant laws and regulations in Russia.

Rigs parts and components are sold to end users through Izhdrill-Honghua, a company located in Moscow, and rig parts and components are sold to end users through Honghua-Ural, a company located in Siberia.

Middle Eastern market

Our subsidiary located in the Jebel Ali Free Zone, Dubai, UAE, is responsible for our sales in the Middle Eastern market. We have also signed an agency agreement with Dhahran Global Co., which has become our leading sales agent in Saudi Arabia. Major drilling rigs in demand in this market are small to mid-sized and mobile; this is especially true for those rigs with drilling depths of 3,000 to 5,000 meters. We believe that our trailer drilling rig, which is mobile, digitally-controlled and possesses a drilling depth capacity of up to 5,000 meters, is well positioned in the Middle Eastern market. Our subsidiary in Dubai has complied with all relevant laws and regulations in the UAE.

African market

We have entered into a joint venture agreement with Petroleum Projects and Technical Consultations Company, Engineering For the Petroleum and Process Industries Company and Tharwa Petroleum Company, to establish a Sino-Egyptian drilling rig manufacturing joint venture in Cairo, Egypt. Products we intend to manufacture and sell there include digitally-controlled VFD rigs. We believe that this joint venture will be the only company in Africa that specializes in drilling rig manufacturing. We have complied with all the relevant laws and regulations in Egypt.

The joint venture is an Egyptian Joint Stock Company, established on April 24, 2007, and it commenced operation upon signing the rig drilling purchase contract with Honghua Company, on May 22, 2007. It has USD30,000,000 authorised capital. Our expected total investment is USD 12,000,000, all of which has already been made. The joint venture occupies 84,109 sq.m. of land. The duration of the joint venture company is 20 years, renewable upon mutual agreement of the investors and approval by the local authorities in Cairo. The objective of the joint venture is to construct and operate a plant in Egypt, for the manufacturing, assembly and after-sales service of land rigs and offshore drilling rigs, and to act as the sole agent selling our products in Egypt. According to the joint venture financial model, the factory will produce 20 sets of drilling rigs annually. There are a total of 134 persons employed by the joint venture, 40 of which are management level. The working capital of the joint venture was financed through bank loans and funds from the shareholders.

According to the joint venture agreement, we were responsible for contributing 50% of the capital of the joint venture, and the three Egyptian investors were responsible for contributing the remaining 50% of the capital. Capital contribution from parties to the joint venture was made in cash. Each of the parties to the joint venture appointed a representative to handle the establishment of the joint venture. The shareholders will share the profits and losses of the joint venture based on their respective contribution to the joint venture's capital (i.e., 50:50). The financial results of the joint venture are accounted for using the equity method, and are initially recorded at cost and adjusted thereafter for any change in the Group's share of the joint venture's net assets. The Group shares the post-tax results of the joint venture.

Before entering into the joint venture agreement, we had not had any previous dealings with Petroleum Projects and Technical Consultations Company, Engineering For the Petroleum and Process Industries Company and Tharwa Petroleum Company.

Sales to OFAC Countries

We are subject to the laws and regulations of the various countries in which we do business, in addition to the laws of the PRC. Certain countries in which we do business, or in which our products have been resold, including Iran and Sudan, are subject to sanctions administered by the United States Treasury Department's Office of Foreign Assets Control ("OFAC"). We have not engaged in any investment activities in Iran relating to the development of the petroleum industry there. No persons from the U.S. are involved in the supply of our products and services in countries subject to OFAC sanctions, and we are not involved in the re-exportation of goods originating in the U.S. to countries subject to such sanctions. We believe that the revenue generated by our transactions in the countries subject to OFAC sanctions is insignificant in the context of our total revenue. None of the proceeds of the Global Offering will be used to fund transactions or activities which would, if undertaken by a U.S. person as defined in U.S. economic sanctions, be prohibited by U.S. economic sanctions. See "Future Plans and Use of Proceeds—Use of Proceeds".

Contracts, Sales Process and Pricing Policy

We are typically required by our major customers to use their own standard forms as the basis for sales negotiations. Thus, our rig sales contracts tend to vary from customer to customer. The majority of these contracts provide that warranties for each rig and/or equipment expire on the earlier of (i) 12 months after the rig commences drilling operations, or (ii) 18 months after the rig is delivered to the customer.

Though time frames may vary according to each customer's specifications, it usually takes six months from the time an order is placed for us to manufacture and deliver a finished rig. We generally deliver finished rigs to our customers on an FOB or CIF basis. We fully assemble and test the ordered rigs in our factory, and then disassemble them into smaller units before delivery, for easy transportation to their destination. The disassembled units will be delivered by truck or train to destinations within the PRC, and will be delivered by truck combined with train or ship to destinations outside of the PRC. For PRC customers, the transportation cost is normally borne by the customers. For overseas customers, either we or the customers will bear the transportation cost, depending on the terms of the sales contract.

Since we typically source business through direct customer interfacing, open or invited tenders and customer referrals, pricing for many of our products is determined either through a bidding process or individual negotiations with our customers. Factors that we take into consideration in determining our tender prices and negotiated contract prices include our costs, the prevailing market price of the product and individual customer specifications.

Because we generally procure raw materials and parts and components for production only after we have secured a sales contract for a product, the costs of our raw materials and parts and components may not always be reflected in our contract prices. This is especially important since steel, a significant material used in constructing our rigs, parts and components as well as the parts and components we source from third parties, is subject to frequent price fluctuations. In order to minimize any adverse impact on our operations caused by fluctuations in the prices of raw materials, we have entered into strategic cooperation agreements with some suppliers, allowing us to purchase raw materials at a favorable price that is lower than the market price. According to such strategic cooperation agreements, we can enjoy favorable pricing, priority in after-sales services and a stable supply of raw materials from these suppliers, thus enabling us to manage our exposure to supply fluctuation of some key raw materials. The Company will not alter the prices of drilling rigs under signed contracts, unless the customers request a change in design or configuration. However, the Company may consider altering sale prices under contracts not yet signed, according to the fluctuating cost of raw materials. The Company bears the risk associated with the cost fluctuations of raw materials during a contract period.

We maintain different billing policies for different customers. From domestic customers, we usually receive 30% of the total price at the time the contract is made, and another 60% of the sales price when the rig is delivered to the customer's field and starts operation. The remaining 10% of the sales price is retained by the customer and is paid to us within one year of the delivery, if our products do not have any major quality problems in that year. For international customers, our billing policies vary, depending on the negotiated terms with each of the customers. The common practice with our international customers is that part of the purchase price is paid by wire transfer or a letter of credit upon signing the contract, part of the purchase price is paid upon delivering the shipping documents, and the remaining part of the purchase price will be paid after delivery of the products; the exact percentage of each part of payment varies from contract to contract.

Competition

We operate in a highly competitive environment. We principally compete with domestic and overseas oil drilling equipment companies on price, quality, advanced technology, reliability of supply and after-sales service. Our primary domestic competitors are: BOMCO; Lanzhou LS-National Oilwell Petroleum Engineering Co., Ltd.; Shanghai Sangao; and Nanyang. Our primary overseas competitors are National Oilwell Varco and Bentec.

In the rig manufacturing industry, we believe that the principal barriers to entry include: the ability to source a regular and sustainable supply of key components; the capital expenditure required to develop the infrastructure to manufacture, assemble and test large-size products; and the ability to meet industry quality standards, such as those of the API Monogram.

We believe that we are well-positioned to compete in both domestic and international markets, and that our strengths and strategies will differentiate us from our competitors. See the section entitled "Our Business – Competitive Strengths" in this Prospectus for a discussion of our competitive strengths.

Environmental Protection

Our operations are subject to various PRC laws and regulations concerning environmental protection. We have adopted various measures to abide by these environmental protection laws. Our policy is to develop and manage operations in a manner that effectively controls and minimizes pollution and strives to protect the environment. Various environmental standards are developed for each stage of our business, and we implement systems to identify, assess and manage environmental risks.

We enforce health, safety and environmental protection rules in our production process, so as to minimize the waste we produce. We require our employees to comply with these rules. As our inventories contain flammable goods such as paint, we also have emergency policies and procedures in place aimed at reducing damage in the event of a fire.

Our operations may produce various types of waste, including waste water, dust and solid waste. We have installed a ditch around our production site, which will collect the waste water produced during our production process. We regularly clean the waste water from the ditch, in order to collect and recycle the oil mixed into the waste water. We have six sand-painting rooms, where a dust-absorbing system is installed. This system absorbs the dust created during the sand-painting process and is cleaned regularly, thus preventing pollution to the air. The waste oil from machines used in each of our factories is collected in special oil tanks, and is subsequently gathered in our warehouse and delivered to a special unit designated by the Guanghan Environmental Bureau for processing. We are planning to install a new anti-erosion workshop. At this stage, we have finished the preliminary research and development and have produced a feasibility study report. The cost to the Company of environmental protection measures for the three years ended December 31, 2004, 2005 and 2006, and the 8 months ended August 31, 2007, were RMB14,802.10, RMB61,592.93, RMB126,521.40 and RMB25,715.50, respectively. The projected future costs for environmental protection measures will be less than RMB500,000 per year.

We had no breaches of any applicable environmental law or regulation during the Track Record Period. As of August 31, 2007, we are not subject to any material environmental claims, lawsuits, penalties or disciplinary actions.

Health and Safety

We regard the health and safety of our employees as one of our most important social responsibilities, and we have implemented a number of measures to ensure compliance with applicable Chinese health and safety requirements.

We have in place a detailed set of internal health and safety policies. Our quality control department is responsible for training staff as to such policies, reviewing our internal safety procedures, carrying out safety site inspections on a monthly basis and continuously monitoring the implementation of our safety policies. We have adopted an internal handbook on safety procedures that is utilized throughout our Group, and every employee is required to attend compulsory courses on our safety policies and procedures. Our handbook sets out certain guidelines on occupational safety, such as how to operate machinery safely and emergency plans.

Since we began operations in 1998, only one fatal accident has occurred at our facilities. That accident occurred on February 4, 2007, when one of our employees, due to his own negligence, was knocked down by a falling mast while undertaking painting work. According to PRC law, most of the compensation provided in the event of a fatal accident should be paid in a lump sum, and the remainder, if any, paid in monthly instalments. We were liable for the payment of compensation for this accident, which amounted to a one-time compensation in the amount of RMB174,904.5. We reached an agreement with the relatives of the deceased, and the father signed the agreement on February 8, 2007. According to the agreement, the one-time payment of RMB 174,904.5 is in full and final settlement and was made in full on February 10, 2007.

Except for the incident described above, we have not been subject to any material production and safety claims, lawsuits, penalties or disciplinary actions. There have not been any other material non-fatal injuries or fatal accidents during the Track Record Period.

Licenses

As advised by King & Wood, our PRC legal advisor, we are not required to obtain any licenses to manufacture our products under the Regulations on the Administration of Production Permits for Industrial Products, and its Implementation Rules (《中華人民共和國工業產品生產許可證管理條例》 及其 《實施辦法》), promulgated by the State Quality Inspection Bureau in July and September of 2005, respectively.

In order for us to sell our products to the subsidiaries or branch oilfields of CNPC and Sinopec, we must be a member of the China Petroleum Exploration and Development Equipment Supply Network (中石油勘探開發設備供應網絡), which is organized and authorized by the China Petroleum Material & Equipment Corporation (中國石油物資裝備(集團)總公司), and the List of Sinopec Suppliers. We have been a member of the China Petroleum Exploration and Development Equipment Supply Network since 2001, and a member of the List of Sinopec Suppliers since 2003.

In order to become a member of the China Petroleum Exploration and Development Equipment Supply Network, a supplier must submit an application form, its ISO9001 certificate, and recommendations from the material and equipment department of at least three subsidiaries of China Petroleum Group Company Limited (中國石油天然氣集團公司). Once admitted as a member, a supplier needs to pay RMB 5,000 as a membership fee. There will be continuous evaluation of the member's performance, focusing on the quality and price of products, delivery and after-sales service. Our current membership in the China Petroleum Exploration and Development Equipment Supply Network will expire in October, 2009.

In order to be a member of the List of Sinopec Suppliers, a supplier must submit an application form and then pass initial and final reviews by the relevant departments of Sinopec. There is no application or management fee for membership. There will be continuous evaluation after a membership is awarded, focusing on the quality and price of the products, delivery and after-sales service. The membership may be suspended in a number of circumstances, such as delay in delivery that affects the operation of Sinopec, failure to provide after-sales service, failure to solve problems related to the quality of the products, involvement in lawsuits with Sinopec or having a weak financial position. The membership may be terminated if a supplier provides false information to Sinopec, or refuses to perform a contract without good reasons.

Our sales to the subsidiaries or branch oilfields of CNPC and Sinopec accounted for approximately 93.8%, 62.3%, 14.5%, and 36.3% of our revenue, for the three years ended December 31, 2004, 2005 and 2006, and the eight months ended August 31, 2007, respectively.

The following table contains a list of some of the required documents for the Group to operate its business in certain countries other than the PRC, where the Group has or previously had a subsidiary or affiliate, as well as the status of obtaining such documents by the Group.

Country	Required license/ permit/other	Whether the Group has obtained such license/permit/other
USA	a. Certificate of Filing	Yes
	b. Tax ID Number	Yes
	c. Environmental Health Approval	Yes
	d. General Liability Insurance Policy	Yes
	e. Umbrella Liability Insurance Policy	Yes
Russia	a. Legal Person Registration certificate	Yes
	b. Legal Person Tax Registration certificate	Yes
	c. National Standard Certification System certificate	Yes
UAE	a. Trading License	Yes
	b. Share Certificate	Yes
Egypt	a. Approval for Establishing of EPHH Project (Decree No. 542)	Yes
	b. License for Commencing Activity (Decree No. 882)	Yes
	c. License for Establishing Industrial Project	Yes

Management Information Systems and Information Technology

Some of the management information systems that we currently utilize include a U8 System, which is used to plan production activities and raw material procurement and utilization, as well as to manage the level of stock and receivables and an office automation system, which is used to manage day-to-day administrative and office operations. We believe that our information systems have been effective in improving the efficiency and control of our operations, especially in the areas of production planning, manufacturing, inventory procurement and management, and sales and finance.

Employees

As of August 31, 2007, we had a total of 2,828 employees. These employees can be categorized according to their role, as follows:

Type of employee	Number of employees
Management	281
Production	1,671
Production Control	25
Quality Control	102
Research and Development	222
Marketing	109
Training	9
Services	137
Information Management	23
Internal Support	108
Logistics	82
Temporary Workers	59
Total	2,828

For the three years ended December 31, 2004, 2005 and 2006, and for the eight months ended August 31, 2007, the total numbers of our domestic employees were 863, 1469, 2562 and 2,816, and the number of overseas employees was 0, 0, 11 and 12, respectively. For the three years ended December 31, 2004, 2005 and 2006, and for the eight months ended August 31, 2007, the total number of our employees has increased by 29.77%, 70.22%, 75.15% and 10.62%, respectively, compared to the preceding year.

In 2005, we hired more factory workers to support manufacturing capacity expansion, enlarged our sales and after-sales service teams, and hired more engineers with design expertise.

In 2006, we employed more procurement and warehouse personnel, and further expanded our sales and after-sales service teams and our engineer teams, in order to support continuous sales growth.

The Company is optimistic about its operations in the emerging markets, particularly Russia and the Middle East, and we expect to increase the number of employees to assist with strategic development in those areas.

The majority of our domestic employees belong to a trade union which is a member of the All China General Trade Union. During the Track Record Period, we did not encounter any significant difficulties in recruiting employees, nor did we have any material labor disputes. We consider our relationship with our employees to be good.

Employee training

We understand that continuous training is critical in maintaining and improving our operations and product quality. As a result, we have sponsored some of our senior management to undertake further study in management courses, such as MBA programs. In addition, we have worked with Southwest Jiao Tong University to organize a master's degree program in engineering. We have also organized various classes for our employees, in order to keep them updated on the latest technological developments in our industry.

Employee benefits

For the years ended December 31, 2004, 2005, 2006, and for the eight months ended August 31, 2007, the wages of our employees have consistently increased, by 32.17%, 45.38%, 107.68% and 84%, respectively, compared to the preceding year. For the majority of our employees, we make contributions to mandatory social security funds, that provide retirement, medical, work-related injury, maternity and unemployment benefits. We contribute on a monthly basis to a housing fund organized by the Chinese government. Also, we make contributions to supplementary social security funds for certain employees for retirement and medical benefits, and we maintain various types of insurance, including accidental injury insurance, for a number of our employees.

We pay termination benefits when an employee's employment is terminated involuntarily before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for the benefits.

For each of the three years ended December 31, 2004, 2005, 2006, and for the eight months ended August 31, 2007, our contributions to mandatory social security funds were approximately RMB707,742, RMB1,485,399, RMB3,158,560 and RMB5,306,192, respectively, and our contributions to housing fund plans were approximately RMB43,504, RMB60,087, RMB81,658 and RMB60,019.

Real Properties

As of December 31, 2007, we held 23 parcels of land with a total site area of approximately 495,787 sq.m. We have obtained land use right certificates for 20 of the parcels of land; for the remaining three parcels of land, the land use right certificates have not been obtained.

In 2005 we acquired a parcel of land, having a site area of approximately 12,232 sq.m. (18.3 mu), located on Zhong Shan Da Dao Nan Duan, Guanghan City, which is currently utilized by Honghua Company. As of the Latest Practicable Date, we have not yet obtained a land use certificate for this property. We commenced use of this land on February 5, 2006.

In 2006, we acquired a parcel of land, having a site area of approximately 43,333 sq.m. (65 mu), located on San Ya Road Yi Duan, Guanghan City, which has not been utilized by Youxin Company. As of the Latest Practicable Date, we have not yet obtained a land use certificate for this property. We have not yet used this land.

In 2006, we acquired a parcel of land, having a site area of approximately 126,667 sq.m. (190 mu), located on Zhong Shan Da Dao Nan Duan, Guanghan City, which has not been utilized by Honghua Company. As of the Latest Practicable Date, we have obtained a land use certificate for approximately 82,692 sq.m. (124 mu) of this land but we have not yet obtained a land use certificate for 43,975 sq.m. (66 mu) of this land.

The local government in the areas in which we occupy land support our business and have issued written confirmations, assuring us that they will not impose a penalty on us or force us to relocate from the land for which we have not yet obtained land use certificates. We are making our best efforts to obtain land use right certificates for the three parcels of land as soon as possible. As a result, our expansion plans will not be affected by the lack of such certificates.

Land for which the land use right certificates have not been obtained:

Land area	Is it critical to the Company's operation during the Track Record Period?	Is it significant in terms of profit contribution during the Track Record Period?	Is it significant in terms of turnover during the Track Record Period?	Could the Company obtain the certificate before Listing?	Status of the application for certificate
12,232 sq.m. (18.3 *mu*)	No, only used for warehouse purposes	No, only used for warehouse purposes	No, only used for warehouse purposes	No, but the right to use the land is assured by the local government's written confirmation.	All land fees have been paid.
43,333 sq.m. (65 *mu*)	No, not yet in use	No, not yet in use	No, not yet in use	No, but the right to use the land is assured by local government's written confirmation.	All land fees have been paid.
43,975 sq.m. (66 *mu*)	No, not yet in use	No, not yet in use	No, not yet in use	No, but the right to use the land is assured by local government's written confirmation.	All land fees have been paid.

As of December 31, 2007, we held and occupied 29 buildings and 59 units, with an aggregate gross floor area of approximately 105,735.55 sq.m. We have obtained building ownership certificates for all of the buildings.

As of December 31, 2007, we rented and occupied four buildings, having an aggregate gross floor area of approximately 5,198.11 sq.m.. The leases for all of these buildings have been registered with the relevant authorities in China. There are no manufacturing facilities on these four leased premises, and no revenue is generated from such premises. As advised by King & Wood, our PRC legal advisor, the lessor of these four rented premises has valid title to the premises, and each of the leases is legal, valid and enforceable.

Details of our property valuations, together with the summary of valuation and valuation certificates from Sallmanns (Far East) Limited, are in Appendix IV to this Prospectus.

Insurance

We maintain different types of insurance policies, including property all risks insurance, transportation vehicle insurance, cargo transportation insurance, and mandatory social security insurance for our employees.

Legal Proceedings

Dispute with Nabors

We were involved in an arbitration proceeding with Nabors International on behalf of itself and its affiliates and assignees, arising from a Master Sales Agreement, dated May 18, 2005 (the "MSA"), the Heads of Agreement, dated August 9, 2005 (the "HOA"), and other related documents between Nabors Group and us. Honghua Company entered into the MSA to establish a mutually advantageous cooperation with Nabors Group for supply and procurement of drilling rigs and rig parts and components. Under the MSA, Nabors International purchased five drilling rigs, with an option to buy two additional drilling rigs at a predetermined price. Under the MSA, Nabors International may also place more orders for drilling rigs and rig parts and components with us from time to time at a price that is no higher than the price we offer to other non-Chinese customers. Nabors International was also granted a 15-day period to exercise a right of first refusal when we sell any drilling rigs to any non-Chinese or non-former Soviet Union drilling contractors, except for 14 companies specifically listed in the MSA. We agreed not to, directly or indirectly, market or sell drilling rigs or rig components to 24 companies worldwide specifically listed in the MSA, for a specified exclusivity period. Nabors International agreed to use us as its preferred supplier of drilling rigs in the PRC and allowed us to match other PRC manufacturers' commercial terms and conditions for sale of drilling rigs, during the specified exclusivity period we granted to Nabors International, unless we breached or failed to fully comply with the MSA.

The parties further entered into the HOA after the MSA to explore the opportunity to further develop a mutually advantageous commercial relationship. After signing of the MSA, there were some misunderstandings between the parties. Such misunderstandings arose from the different interpretations of the terms of the MSA by Honghua Company and Nabors International, such as (a) Honghua Company's obligation to afford Nabors International certain rights of priority and rights of first refusal, (b) deadlines for delivery of the drilling rigs by Honghua Company, (c) quality and conformity with Nabors International's specifications for drilling rigs and certain equipment supplied to Nabors International; (d) reimbursement to Nabors International of tax paid by Nabors International on account of Honghua Company; (e) condition for provision of technical assistance to Nabors International by Honghua Company; and (f) restrictions to Honghua Company concerning selling drilling rigs to certain competitors of Nabors International. These misunderstandings formed the basis of claims of Nabors International as set out in a request for arbitration to the International Court of Arbitration by Nabors International, described in the next paragraph below. Under the HOA, the parties agreed to use their best efforts to enable Nabors Group to acquire up to 50% of the total equity interest in Honghua Company on terms and conditions to be set forth in a definitive, legally binding, written agreement. However, the parties did not reach an agreement on the commercial terms for such equity investment. According to King & Wood, our PRC legal advisers, pursuant to relevant PRC rules and regulations, if the parties had successfully reached a definitive, legally binding, written agreement to allow Nabors Group to acquire 50% of the total equity interest in Honghua Company, such an agreement would have had to be approved by the PRC authorities.

Nabors International submitted a request for arbitration to the International Court of Arbitration in June 2007, claiming that we breached the MSA in the following respects: (a) we breached our obligation to afford Nabors International a right of priority in the allocation of our manufacturing capacity and a right of first refusal to purchase any drilling rigs manufactured by us for customers outside of China or the former Soviet Union; (b) we failed to meet delivery deadlines for the drilling rigs manufactured for Nabors International; (c) the drilling rigs and certain of the equipment we supplied to Nabors International had defects; (d) we did not reimburse Nabors International a portion of the value-added tax refunds we received from the Chinese government relating to the drilling rigs and spare parts supplied to Nabors International; (e) we failed to provide 30-day start-up technical assistance at initial field operating sites, as required under the MSA; and (f) we breached our obligations not to sell drilling rigs to any non-Chinese third parties at prices lower than those paid by Nabors International and not to sell drilling rigs to certain named competitors of Nabors International. Nabors International claimed damages of at least US$72 million, plus interest, relating to these alleged breaches.

In the same arbitration request, Nabors International also alleged that we breached our obligations under the HOA and related documents in relation to Nabors International's contemplated direct investment in up to 50% of the total equity interests in our company. Nabors International requested specific performance of our purported obligations or, in the alternative, an award of damages of at least US$100 million.

Prior to our receipt of the request for arbitration from Nabors International, we had sent a written demand letter to Nabors International, demanding that Nabors International promptly pay us US$51.7 million, which is the sum of all the payments that Nabors International owed us, as of June 15, 2007, for the drilling rigs and other related equipment and materials we provided to Nabors International and expenses we incurred in accordance with the MSA.

At all relevant times, Zhang Mi, the Chairman, actively participated in the negotiations and the discussions relating to the building up of the strategic business relationship with Nabors Group, particularly the MSA and the HOA. Since our Group believed (i) Nabors Group would bring us technology and promote our product image; and (ii) the equity investment aligned Nabors Group's interests with our interests, thus ensuring Nabors Group, the largest land drilling contractor in the world, would be more inclined to give more business opportunities to our Group, Honghua Company entered into the HOA with Nabors Group on August 9, 2005 in order to set out a framework for discussion on the proposed investment in Honghua Company by Nabors Group. The HOA was not intended to be legally binding at the initial stages of negotiation. Upon finalization of the material terms of the proposed acquisition, the parties would then enter into a definitive legally binding agreement to reflect their agreement. The Chairman made his best efforts to arrange and initiate various meetings and visits for discussions and negotiations in good faith for the best interests of Honghua Company with Nabors Group so as to finalize terms for the definitive agreement to effect the spirit under the HOA. However, despite having had such meetings, discussions and efforts involving intensive negotiations, the parties failed to reach agreement on the material terms of the proposed investment such as consideration, valuation mechanism and shareholding percentage.

Meanwhile, the Group was approached by some financial investors and strategic investors, including Carlyle Funds and DPF concerning proposed investment in the Group. The Group and the Financial Investors later reached consensus in mid-September, 2006, and executed, among other documents, the Investment Agreement in November, 2006, and March, 2007.

According to the Chairman, time was of the essence for the purpose of the Reorganization and the Listing. Honghua Company was required to complete the whole restructuring process to convert into a wholly foreign-owned enterprise with fully-paid up registered capital by mid-December, 2006, so as to fulfill the new requirements under the Provisions Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, promulgated by the PRC regulatory authorities on August 8, 2006, which took effect on September 8, 2006. At all relevant times, Mr. Zhang had made his best efforts to negotiate and finalize the terms of the proposed investments with Nabors Group, the Financial Investors and other potential financial investors and strategic investors, in order to maximize the shareholders' value of the Group.

Although the Group admitted no liability to the alleged claims initiated by Nabors International, it considered that the Arbitration would constitute a legal proceeding of material importance and might have an impact on the proposed Listing. Through amicable negotiations, we and Nabors International settled the above contractual disputes in October, 2007, and Nabors Group agreed to transfer certain of its know-how and technology to our Group (which was not previously agreed to be transferred to our Group) as a part of the settlement and building of a strategic business relationship package. In view of the numerous discussions that Honghua Company had with Nabors Group as well as Honghua Company's shareholders, and the amount of time that Mr. Zhang had spent in meetings and correspondence concerning the proposed transaction with Nabors Group, Nabors Group acknowledged that Mr. Zhang had indeed exercised "best endeavors" and was in ''good faith" during Honghua Company's negotiation with Nabors Group. For details, see the section entitled "Company History and Reorganization — Strategic Investor," in this Prospectus.

Dispute with 64 natural persons

We are engaged in a dispute with 64 natural persons claiming to be shareholders of Honghua Company. Upon the establishment of Honghua Company on December 31, 1997, Oil Drilling Plant was a shareholder, holding approximately 11.075% of Honghua Company. As an employee benefit offered by Oil Drilling Plant, the employees of Oil Drilling Plant were offered, through the trade union of Oil Drilling Plant, the opportunity to invest in Honghua Company. 841 employees of Oil Drilling Plant, collectively, invested an aggregate of RMB300,000 in Honghua Company when Honghua Company was established in 1997. Fu Chonglin represented these 841 employees and was registered as a shareholder with the Administration of Industry and Commerce of Honghua Company, holding an approximately 37.5% equity interest in Honghua Company.

To the best knowledge, information and belief of the Directors, having made all reasonable inquiries, in June, 2000, the labour union of Oil Drilling Plant (鑽採設備制造廠工會) organized an election, for the employees to elect individuals to represent them as shareholders in Honghua Company. The labour union of Oil Drilling Plant notified Honghua Company of the election results in a letter, dated June 9, 2000. The letter indicated that 11 representatives were elected by the employees of Oil Drilling Plant as their representatives in Honghua Company, and Honghua Company was requested to follow-up and do the appropriate filing. On September 16, 2000, Fu Chonglin transferred all of his equity interest in Honghua Company to these 11 representatives. The equity transfers to the said 11 representatives were filed with the Administration of Industry and Commerce, and the said 11 representatives were registered as shareholders of Honghua Company. The management of Honghua Company was responsible for the registration of the shares of these 11 representatives with the proper governmental authority.

As advised by our PRC legal advisor, King & Wood, the identity of the shareholders of a PRC company must be recorded in the register of members and filed with the competent Administration of Industry and Commerce.

Over the course of the period between 1997 and 2005, through various transfers and acquisitions, the number of investing employees decreased while the aggregate value of their investments increased. As of December 31, 2005, 728 employees of Oil Drilling Plant had invested an aggregate of RMB7,066,615 in Honghua Company as held by the 11 representatives registered as shareholders. Each of the 728 employees was issued with an "investment certificate" (出資証明) from Honghua Company to evidence his or her investment. The 728 people (excluding the 11 representatives) were not registered as shareholders of Honghua Company with the competent Administration of Industry and Commerce. However, according to King & Wood, the so-called "investment certificate" does not confer the rights of a shareholder on the holder of such certificate. In order to enjoy the rights of a shareholder, the person in question must be registered as the shareholder of the company with the competent Administration of Industry and Commerce.

After various shareholding changes and capital increases (as set out in the section entitled "Company History and Reorganization" of this Prospectus), as of December 31, 2005, 11 representatives of the said 728 employees, namely, Xing Manrong, Wang Yaoxin, Liu Chuanjun, Shi Shuming, Li Yan, Zhi Rongmu, Zhou Tao, Ni Xiurong, Yang Xuefeng, Yang Yuanchun and Yu Zhenghua, were registered as shareholders of Honghua

Company, as filed with the competent Administration of Industry and Commerce, holding approximately 33.632% of the equity interest of Honghua Company. As these 11 representatives were registered shareholders of Honghua Company, only they (and not the 728 employees other than the said 11 representatives) were entitled to enjoy the rights and obligations of shareholders of Honghua Company. The reason the 11 representatives were elected to represent these 728 employees of Oil Drilling Plant was to enable these employees, as investors of Honghua Company, to comply with the requirements of the PRC Company Law, which restricts the number of shareholders of a limited company to no more than 50. None of the 728 employees (other than the 11 representatives) ever attended shareholders meetings of Honghua Company. On January 7, 2006, Honghua Company passed a shareholders resolution, to reduce its registered capital and to repurchase all of the equity interest in Honghua Company held by these 11 registered shareholders. Honghua Company entered into an equity purchase agreement with such 11 registered shareholders on January 12, 2006, under which, with the written consent of such 11 registered shareholders, Honghua Company paid the equity repurchase price directly to the 728 employees. Honghua completed the capital reduction process with the competent Administration of Industry and Commerce on April 26, 2006. King & Wood, has advised us that as these 11 representatives were registered shareholders of Honghua Company, they were entitled to enter into and sign the said equity repurchase agreement with Honghua Company. Accordingly, the equity repurchase agreement was legally binding and enforceable against the 11 representatives who were parties to the equity repurchase agreements. No consent or authority from the 728 employees was required for entering into the equity repurchase agreement.

In relation to the proposed investment in Honghua Company by Nabors Group in August 2005, information regarding negotiations between Honghua Company and Nabors Group was not released to either the 11 representatives or the 728 employees of Oil Drilling Plant, because of the confidentiality provision contained in the HOA between Honghua Company and Nabors Group, and because the HOA only set out a framework for negotiations between Nabors Group and Honghua Company. The senior management of Honghua Company was of the view that there was no information in the HOA that was required to be provided to the shareholders as part of the buy-out arrangements. Furthermore, the main purpose of the buy-out was to regularize the shareholder structure of Honghua Company. The investment by Nabors Group and the buy-out of the 11 representatives were unrelated transactions.

Wang Yaoxin, who is a Non-executive Director, and Zhi Rongmu and Shi Shuming, who were Directors of Honghua Company at the time of the buy-out arrangement, all held equity interests in Honghua Company at that time. Except for Wang Yaoxin, Zhi Rongmu and Shi Shuming, the remainder of the 11 representatives are Independent Third Parties, and have no professional, business, or other relationship with any member of the Concert Group, the Directors or their Associates.

Wang Yaoxin, Zhi Rongmu and Shi Shuming disposed of all of their equity interests in Honghua Company during the buy-out arrangement. According to King & Wood, the buy-out arrangement and the capital reduction were carried out in accordance with the Articles of Association of Honghua Company and the applicable PRC laws and regulations. The Directors consider that the then directors carried out their fiduciary duty in proposing and implementing the buy-out arrangement. They are not aware of any violation of the director's duty under PRC laws as set out for them by King & Wood or the Articles of Association of Honghua Company by any of the then directors of Honghua Company.

The consideration in the equity repurchase agreement and the basis of its determination followed arm's length negotiations between the parties. The equity repurchase agreements were signed in January, 2006, when the audited accounts of Honghua Company for the year ended December 31, 2005, were not available. After arm's length negotiations, the parties agreed to use the audited net asset value of Honghua Company as of June 30, 2005, plus a premium of approximately 57.27%, as the basis for determining the consideration. The Directors believe this basis (i.e., the net asset value plus a premium) for determining the consideration is a method of valuation which is generally accepted for pre-IPO transactions in the PRC.

On November 26, 2006, 664 of the 728 original employees agreed to the buy-out arrangement and accepted payment from Honghua Company. The remaining 64 employees, who had invested an aggregate of RMB651,385 in the Company, claim that they are still shareholders and refused to accept the buy-out arrangement and payment from Honghua Company.

On December 12, 2007, the Company learned that 57 of the 64 employees initiated legal proceedings at the Intermediate Peoples' Court of Chengdu City, Sichuan Province (Action No.: (2008) Cheng Min Chu Zi No.53)) on December 11, 2007. Nothing further has been heard from the remaining seven investors. The 57 individuals joined as plaintiffs to the legal proceedings, against Honghua Company as the first defendant, Asia Harbour as the second defendant and 14 individuals as the remaining defendants, including Shi Shuming (third defendant), Huang Dequan (fourth defendant), Li Yan (fifth defendant), Wang Yaoxin (sixth defendant), Zhou Tao (seventh defendant), Wang Wei (eighth defendant), Chen Zhenghua (ninth defendant), Yang Xuefeng (tenth defendant), Yang Yuanchun (eleventh defendant), Ni Xiurong (twelfth defendant), Yu Zhenghua (thirteenth defendant), Xing Manrong (fourteenth defendant), Zhi Rongmu (fifteenth defendant) and Liu Chuanjun (sixteenth defendant) as the third to sixteenth defendants. There are a total of 16 defendants. The third to thirteenth defendants were the 11 registered representatives at the time of the repurchase and the fourteenth to sixteenth defendants were the three former registered representatives.

The relief sought by the 57 plaintiffs of these 64 employees includes:

(1) an adjudication by the court that the 592,250 shares held by the third to sixteenth defendants (the 11 representatives and three former representatives) were actually owned by the 57 plaintiffs, and all the benefits and rights in such equity interests be restored to the 57 plaintiffs and the names of the 57 plaintiffs be entered into the register of members of Honghua Company;

(2) an adjudication by the court that Honghua Company be ordered to pay to the 57 plaintiffs a total sum of RMB296,125, being the 2003 dividends;

(3) an adjudication that the repurchase of the 592,250 shares of Honghua Company be declared null and void;

(4) an adjudication that Asia Harbour be jointly and severally liable for the abovementioned relief sought by the 57 plaintiffs and the consequential liabilities thereof, and that Asia Harbour together with Honghua Company be ordered to apply to the competent Administration of Industry and Commerce to register the 57 plaintiffs as shareholders of Honghua Company; and

(5) an adjudication that all the defendants be jointly liable for the legal costs arising from these legal proceedings.

As advised by King & Wood, the entrustment arrangement was entered into between the 728 employees and 11 registered shareholders in good faith, and the entrustment arrangement is legal and valid under PRC laws and regulations.

The 11 representatives, but not the 728 employees (including the said 64 employees), were registered as shareholders with the competent Administration of Industry and Commerce, in accordance with the PRC laws and regulations; so, the 728 employees (including the said 64 employees, but excluding the 11 representatives) were not shareholders of Honghua Company. The reason the 11 representatives were elected to represent these 728 employees of Oil Drilling Plant was to enable these employees, as investors of Honghua Company, to comply with the requirement of the PRC Company Law, which restricts the number of shareholders of a limited company to no more than 50. Except for the 11 representatives, there is no legal basis under PRC law for the 728 employees (including the said 64 employees) of Oil Drilling Plant to be regarded as shareholders of Honghua Company, as these 728 employees (including the said 64 employees) were never registered as Honghua Company's shareholders with the Administration of Industry and Commerce. Neither the Company nor Honghua Company has distributed any dividends to the employees of Oil Drilling Plant. Each of the 728 employees (including the said 64 employees) may have received a certain sum of money from the 11 representatives based on the investment in Honghua Company made by each of the 728 employees (including the said 64 employees). Pursuant to PRC law, only shareholders, and not employees, are entitled to receive dividends. In addition, except for the distribution of dividends by Honghua Company in accordance with its shareholders' resolutions, Articles of Association and applicable PRC laws, none of Zhang Mi, Ren Jie or Zhang Xu have ever received any dividend payments from Oil Drilling Plant. According to King & Wood, our PRC legal advisers, the investors' investment and receipt of purchase money from Honghua Company as mentioned above are only evidence of sources of funds, and shall not affect the identities of the shareholders of Honghua Company. The identities of shareholders are recognized under PRC laws and regulations by reference to the register of members of the Company and filing with the competent Administration of Industry and Commerce. The Joint Sponsors' PRC legal advisers, Commerce & Finance, concur with this position.

According to King & Wood, since (i) only the 11 registered representatives, rather than the 728 employees, were recognized as the shareholders of Honghua Company pursuant to the applicable PRC laws, and (ii) the legal procedures regarding the buy-out arrangement complied with relevant PRC laws, any claim made by the 64 employees, or any employees represented by the 11 representatives, arguing that they were shareholders of Honghua Company is without legal basis under PRC laws, and no such claim would affect the existing or future shareholding structure of Honghua Company.

The Company's PRC legal advisors, King & Wood, and the Joint Sponsors' PRC legal advisor Commerce & Finance, have carried out due diligence on the history and Reorganization of the Company with the management of the Company, in particular, concerning the capital reduction process which is the subject of our dispute with the 64 natural persons. See the sub-section entitled "Risk Factors — Risks Relating to Our Business — Our dispute with 64 individuals may materially and adversely affect our business and financial condition". King & Wood advise that the capital reduction process was conducted in accordance with applicable PRC laws and regulations, and there was no violation of any minority shareholders' rights under PRC law.

Ally Giant, Ample Chance, Wealth Afflux Limited, Mowbray Worldwide Limited, Ecotech Enterprises Corporation, Otama Company Limited, Vast & Fast Corporation, Cavendish Global Corporation, Airtech Investments Limited, Ally Smooth, Charm Moral, Beauty Clear, Brondesbury Enterprises Limited, Oriental Starz Limited, Tech Express Enterprises Inc, Dobson Global Inc, Darius Enterprises Limited, Believe Power, Benefit Way, Birdview, and the Existing Shareholders of the Company have executed a deed of indemnity in respect of dispute and risk, dated February 15, 2008 in favor of the Group, under which they agree to jointly and severally indemnify any members of the Group for any potential damages that the Company may suffer as a result of the legal proceedings initiated by the 57 plaintiffs or the dispute with the 64 investors. Whatever the outcome of the said legal proceedings, any loss suffered by the Company as a result of the said legal proceedings will be covered by the indemnity.

Dispute with an ex-employee

Zhang Jing signed an employment contract in March, 2007, for the position of Chief Financial Officer of our Company. This contract was to run from April 5, 2007, to April 4, 2009, and provided for a basic monthly salary of RMB11,000, monthly bonus payments of RMB37,000 and an annual bonus payment of RMB120,000.

Prior to assuming his role as Chief Financial Officer on April 5, 2007, we attempted to rescind Zhang Jing's employment contract, as he was unable to provide us with an international accounting certificate. He had never obtained such a qualification. We offered to compensate Zhang Jing for this rescission, but we could not agree with him on an amount of compensation that would resolve the issue. Zhang Jing reported for work on April 30, 2007; however, no work was assigned to him and, on May 19, 2007, we issued Zhang Jing with a formal notice of termination of his employment contract, accompanied by two months' severance pay.

Zhang Jing then initiated arbitration proceedings against us on June 13, 2007, for rescinding his contract. Although we received a favorable ruling in the arbitration proceedings, Zhang Jing has since commenced legal proceedings against us in Sichuan Guanghan People's Court, for damages totalling RMB1,766,016, consisting of Zhang Jing's salary for the entire length of the contract, plus expenses and other bonuses he might have received during the course of the contract period. We have denied all of Zhang Jing's allegations and on December 13, 2007, Guanghan People's Court of Sichuan Province issued a judgment rejecting Zhang Jing's claim. Zhang Jing failed to appeal against the judgment within 15 days of it being delivered to him and the judgment is therefore final.

Except for that which is described above, no litigation or claim of material importance is known to the Directors to be pending or threatened by or against us that would have a material adverse effect on our results of operations or financial condition.

Non-competition Deed

Pursuant to a Non-competition Deed between the Ally Giant, Ample Chance, Ally Smooth, Charm Moral, Zhang Mi, Ren Jie, Liu Zhi, Zheng Yong, Zuo Huixian, Zhang Xu, Wang Jiangyang, Chen Jun, Fan Bing, Zhang Yanyong, Ao Pei, Tian Diyong, Shen Dingjian, Liu Xue Tian (deceased) Zhou Bing, Lu Lan, Tian Yu, Li Hanqiang, Liu Yingguo, Liu Lulu, He Guangfu, Zhang Zongyou and Chen Zongliang (the "Covenantors"), in favour of our Company, pursuant to which each of the Covenantors (collectively the "Covenantors") and our Company (the "Non-competition Deed"), each of the Covenantors has given certain non-competition undertakings to our Company (for ourselves and for the benefit of the members of our Group), to the effect that, he/it shall not, and he/it shall make his/its best efforts to procure that his/its Associates or connected persons do not and shall not, directly or indirectly, whether on his/its own or through any entities, be interested or engaged or otherwise be involved, whether for profit, reward or otherwise, in any business which is involved in any activity (the ''Restricted Activity''), conducted in the PRC or overseas, which is in competition with, or is likely to be in competition with, the business carried on by any member of our Group, from time to time during the restricted period set out in the Non-competition Deed.

There shall be no restriction on a Covenantor and/or his/its Associates or his/its connected persons holding or being interested in shares or other securities in any company which conducts or is engaged in any Restricted Activity (the ''Subject Company''), provided that:

(a) such shares or securities are listed on a stock exchange; and

(b) the aggregate number of shares, held by him/it and/or his/its Associates or his/its connected persons or in which he is interested, does not amount to more than 5% of the issued shares of the Subject Company, and he/it or his/its connected person or Associates at no time shall have the right to appoint more than 10% of composition of the board of the Subject Company.

Each of the Covenantors has undertaken further that he/it shall first refer to our Company any investment or other commercial opportunity relating to the Restricted Activity that is identified by, or offered by a third party, to him or any company controlled by him/it (other than those companies which are controlled by any Covenantors only by virtue of his/its shareholding in our Company), in the following manner:

(a) The relevant Covenantors or his/its Associates or connected persons shall give a written offer notice to our Company of such opportunity, identifying the nature of business, investment or acquisition costs and other details reasonably necessary for our Company to consider whether to pursue the opportunity.

(b) Our Company is required to notify the relevant Covenantors within 30 Days (which, if our Company in its sole discretion decides, may be extended for another 30 Days by our Company notifying the relevant Covenantors of such extension) in writing of any decision taken to pursue or decline such opportunity. Our Company will seek approval from its Board committee, consisting of Independent Non-executive Directors who do not have a material interest in the matter, as to whether to pursue or decline such opportunity.

(c) The relevant Covenantors or his/its Associates or connected persons will be entitled to pursue such opportunity if (i) he/it has received a notice from our Company declining the opportunity, or (ii) he/it has not received any notice from our Company within 30 days (which, if our Company in its sole discretion decides, may be extended for another 30 days by our Company notifying the relevant Covenantors of such extension).

(d) If there is a material change in the nature of the opportunity pursued by the relevant Covenantors or his/its Associates or connected persons, he/it will refer the opportunity as so revised to our Company in the manner as outlined above.

Each of our Covenantors has acknowledged that our Company may be required by law, regulatory bodies or the rules and regulations of the stock exchange(s) on which our Company may be listed from time to time, to disclose information on such opportunities, including but not limited to disclosure in public announcements or in our Company's annual report, of decisions made by our Company to pursue or decline such opportunities, and they have agreed to such disclosure to the extent necessary to comply with any such requirement.

The Non-competition Deed will terminate upon the earlier of:

(a) the anniversary date when the Covenantors and his/its Associates or connected persons cease to beneficially own , directly or indirectly, any Shares; or

(b) the date when our Shares cease to be listed on the Stock Exchange.

Previous Investment in Izhdrill-Honghua

Izhdrill-Honghua is a Russian company established with limited liability on July 8, 2005, and was 50% owned by Zhou Bing. At the time of investment, Zhou Bing was in charge of the Russian market in Honghua Company and was therefore selected to hold shares of Izhdrill-Honghua.

On October 10, 2007, Zhou Bing entered into a share transfer agreement with Izhdrill-Honghua pursuant to which Zhou Bing agreed to transfer all his interests in Izhdrill-Honghua, at a consideration of RUB150,000 (being the subscription price that Zhou Bing paid to Izhdrill-Honghua for the shares). The said share transfer was completed on October 11, 2007, upon amendment of the Share Register.

Previous Investment in Honghua-Ural

Honghua-Ural is a Russian company established with limited liability on September 12, 2005, and was owned by Zhang Mi, Liu Zhi, Ren Jie and Zhou Bing as to 16%, 13%, 13% and 8%, respectively. The remaining shares were owned by two Russian shareholders. Zhou Bing became one of the shareholders of Honghua-Ural (along with Zhang Mi, Liu Zhi and Ren Jie who hold more senior positions than him in Honghua Company) because he was in charge of the Russian market in Honghua Company at the time of the investment.

On November 15, 2007, Zhang Mi, Liu Zhi, Ren Jie and Zhou Bing entered into a share transfer agreement with the Russian Shareholder Трубкин Борис Владимирович, pursuant to which Zhang Mi, Liu Zhi, Ren Jie and Zhou Bing (as transferors) agreed to transfer all their interests, in Honghua-Ural to the Russian Shareholder Трубкин Борис Владимирович (as transferee), at a total consideration of RUB150,000 (being the subscription prices of RUB48,000, RUB39,000, RUB39,000 and RUB24,000 that Zhang Mi, Liu Zhi, Ren Jie and Zhou Bing paid to Honghua-Ural for the shares, respectively). The said share transfers were completed on November 15, 2007, upon amendment of register of members of Honghua-Ural.