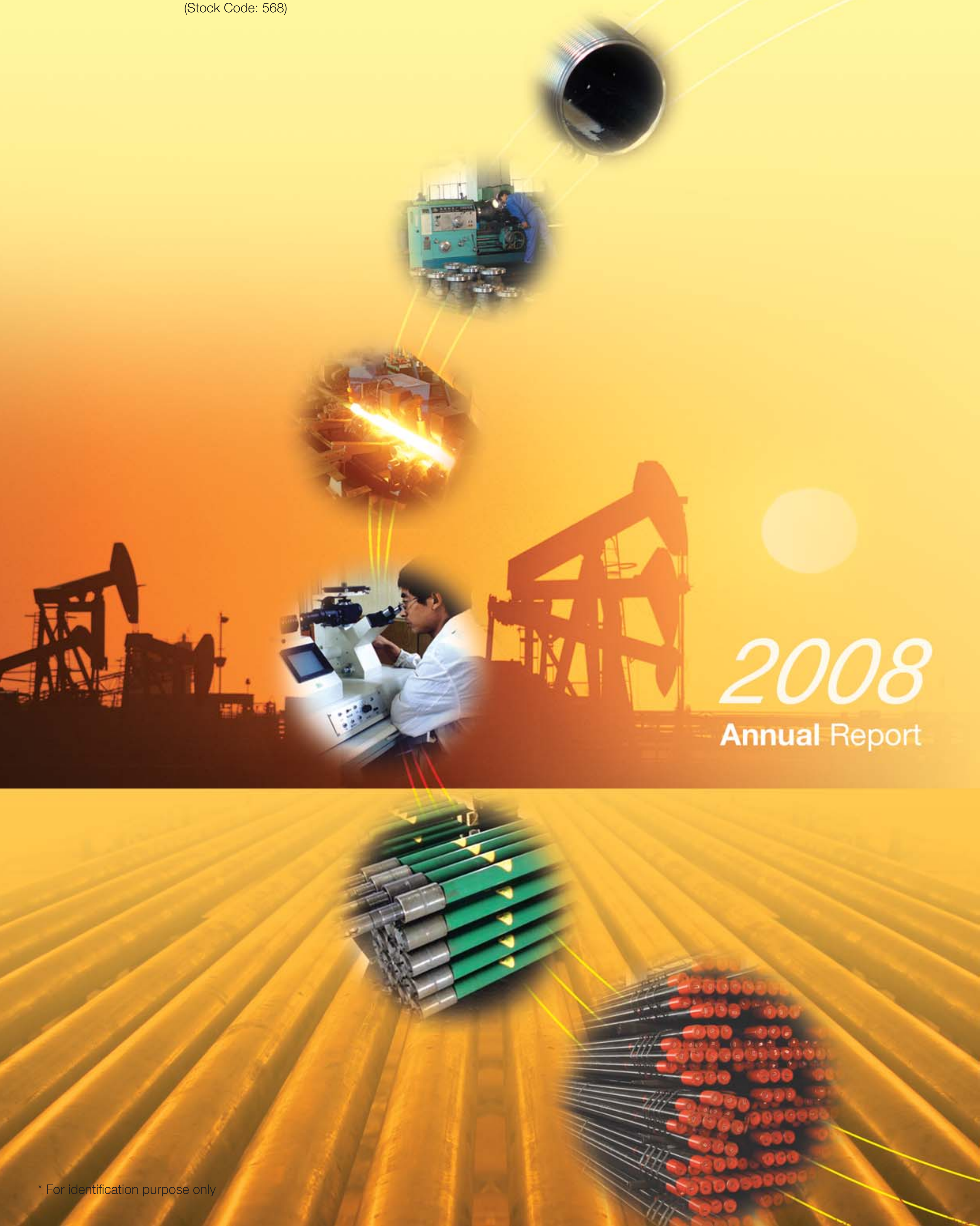
山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited*

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



2008 Annual Report

* For identification purpose only

Directors

Executive Directors

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

Non-executive Directors

Mr. Chen Jian Xiong
Mr. Wang Ping

Independent Non-executive Directors

Mr. Qin Xue Chang
Mr. Yan Yi Zhuang
Mr. Chau Shing Yim, David *(from 8 January 2009)*
Mr. Loke Yu alias Loke Hoi Lam *(ended 8 January 2009)*

Supervisors

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

Members of Nomination Committee

Mr. Yan Yi Zhuang *(Chairman of the Nomination Committee)*
Mr. Zhang Yun San
Mr. Qin Xue Chang
Mr. Chau Shing Yim, David *(from 8 January 2009)*
Mr. Loke Yu alias Loke Hoi Lam *(ended 8 January 2009)*

Members of Remuneration and Evaluation Committee

Mr. Chau Shing Yim, David *(Chairman of the Remuneration and Evaluation Committee) (from 8 January 2009)*
Mr. Loke Yu alias Loke Hoi Lam *(Chairman of the Remuneration and Evaluation Committee) (ended 8 January 2009)*
Mr. Zhang Yun San
Mr. Qin Xue Chang
Mr. Yan Yi Zhuang

Members of Audit Committee

Mr. Qin Xue Chang *(Chairman of the Audit Committee)*
Mr. Yan Yi Zhuang
Mr. Chau Shing Yim, David *(from 8 January 2009)*
Mr. Loke Yu alias Loke Hoi Lam *(ended 8 January 2009)*

Qualified Accountant

Mr. Chan Wing Nang, Billy

Company Secretary

Mr. Chan Wing Nang, Billy

Authorised Representatives

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

Authorised Person to Accept Service of Process and Notices

Mr. Chan Wing Nang, Billy

Auditors

Deloitte Touche Tohmatsu CPA Ltd. (in the PRC)
Deloitte Touche Tohmatsu (Hong Kong)

Compliance Adviser

Guotai Junan Capital Limited

Legal Advisers

DLA Piper Hong Kong (as to Hong Kong Law)
Kingfield Law Firm (as to PRC law)

Principal Bankers

Agricultural Bank of China
China Bank Co., Ltd
Weifang Commercial Bank
China Industrial and Commercial Bank Co., Ltd
China Merchants Bank Co., Ltd
Bank of Communications
China Min Sheng Bank Co., Ltd
China CITIC Bank Co., Ltd
Shenzhen Development Bank Co., Ltd

H Share Registrar and Transfer Office in Hong Kong

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

Registered Address

No. 99 Beihuan Road, Shouguang City,
Shandong Province, the People's Republic of China

Principal Place of Business in Hong Kong

Suite A, 11/F, Ho Lee Commercial Building,
38-44 D'Aguilar Street,
Central,
Hong Kong

Website

www.molonggroup.com

Stock Code

568

Results

	Year ended 31 December				
	2008	2007	2006	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
		(restated)			
Revenue	**2,758,678**	1,700,405	1,014,037	776,522	487,688
Profit from operating activities	**403,726**	261,905	173,863	118,963	70,148
Profit before tax	**353,256**	238,239	161,774	115,519	65,576
Profit for the year	**319,399**	201,029	142,674	88,248	64,091
Minority interests	**(13,588)**	(699)	(3,270)	(3,021)	(2,725)
Net profit from ordinary activities attributable to ordinary equity holders of the Company	**305,811**	200,330	139,404	85,227	61,366
Basic earnings per share (RMB)	**0.093**	0.062	0.043	0.028	0.024

Assets and Liabilities

	As at 31 December				
	2008	2007	2006	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
		(restated)			
Total assets	**3,335,409**	2,268,812	1,454,216	959,129	467,059
Total liabilities	**2,225,386**	1,429,034	917,451	544,063	220,415
Net assets	**1,110,023**	839,778	536,765	415,066	246,644

On behalf of the Board of Directors (the "**Board**" or "**Directors**") of the Company, I am pleased to present the annual report and the audited financial statements of the Company together with its subsidiaries (collectively the "**Group**") for the financial year ended 31 December 2008 ("**2008**" or the "**current year**" or "**Reporting Period**") to the shareholders of the Company (the "**Shareholders**").

Outstanding Achievements of the Year

The Group recorded impressive business growth in the current year. For the year ended 31 December 2008, the Group achieved revenue of approximately RMB2,758,678,000 (2007: RMB1,700,405,000), representing an increase of approximately 62.2% as compared with last year. Over the same period, the profit attributable to equity holders of the Company and earnings per share were approximately RMB305,811,000 (2007: RMB200,330,000) and RMB0.093 (2007: RMB0.062), representing an increase of approximately 52.7% and 50.0% respectively as compared with last year. All of these achievements clearly demonstrated the persistent efforts made by the management and employees of the Group in developing its business.

Business Review

After the 250,000-tonne oil casing production line was successfully put into trial production in the fourth quarter of 2006, it has achieved approximately 80% of its designed production capacity in 2008, and will reach its full designed production capacity in 2009. The release of the full potential of the production capacity of such production line are beneficial to the substantial growth in oil casing output and the production capacity of high-added value non-API casing of the Group, which are in turn beneficial to the future development of the business and the competitiveness of the Group. In addition, through improving the technology of the production line of the oil well pumping machines and adding some mechanical equipments, the production capacity of the oil well pumping machines has increased from 200 sets per year to 250 sets per year.

The construction of the "180mm special petroleum pipes technical reconstruction Project" (the "**180mm Project**") in which the Group intends to invest approximately RMB720 million has commenced. After the completion of the 180mm project, the Group is expected to produce an additional 300,000 tonnes of high grade special petroleum pipes per year. As at the date of this report, all contracts in relation to the equipments of the 180mm project have been signed. The 180mm project is expected to be completed and undergo trial run in the first quarter of 2010.

Shouguang Baolong Petroleum Material Project (the "**Project**") in which the Company invested in 2007 was completed on schedule and put into operation in July 2008. The Project mainly provides accessory services for the Company's petroleum drilling and extraction equipments and accessories. The Project is currently working well.

The Company submitted to the China Securities Regulatory Commission (the "**CSRC**") an application for A share issue in 2007 which was not approved by the CSRC. Pursuant to relevant laws and regulations, the Board held the 11th meeting of the 2nd Board on 9 November 2008 to present to the Shareholders the A share issue proposal and to obtain relevant authorizations. All the resolutions were approved at the extraordinary general meeting (the "**EGM**") and the Class Meetings on 8 January 2009. The Company will re-submit the application for A share issue to the CSRC.

On 15 January 2009, the Company, confirmed by the records of the Office of the National New & High Technical Enterprises Recognition Leading Group, was named one of the 2008 Shandong Province New & High Technical Enterprises, the certificate of which will be awarded later. The Company will be entitled to the preferential enterprise income tax pursuant to the relevant provisions and policies of the People's Republic of China (the "**PRC**").

In terms of domestic market expansion, the Group's main customers are major oil fields in the PRC, including Changqing Oil Field (長慶油田), Xinjiang Oil Field (新疆油田), Daqing Oil Field (大慶油田), Liaohe Oil Field (遼河油田), Qinghai Oil Field (青海油田), Talimui Oil Field (塔里木油田) , Huabei Oil Field (華北油田), Jidong Oil Field (冀東油田) and Jilin Oil Field (吉林油田), all of which branch oil fields of PetroChina Company Limited and its subsidiaries (collectively, "**PetroChina Group**"), as well as Shengli Oil Field (勝利油田), Zhongyuan Oil Field (中原油田), Jiangsu Oil Field (江蘇油田) and Jianghan Oil Field (江漢油田), all of which branch oil fields of China Petroleum & Chemical Corporation and its subsidiaries (collectively, "**Sinopec Group**"). Sales to the above oil fields under PetroChina Group and Sinopec Group accounted for approximately 39.9% of the Group's sales revenue.

After becoming the eligible supplier of the CNOOC Limited and its subsidiaries (collectively "**CNOOC Group**") in 2007, the Group continued to increase tubing supplied to the CNOOC Group during the Reporting Period. The Group has been supplying products to Shanxi Yanchang Petroleum (Group) Co., Ltd. ("**Yanchang Petroleum**") since 2007 and during the Reporting Period, the Group had successfully bid for the supply of 5,000 tonnes of casings and supplied smoothly to Yanchang Petroleum. During the current year, the cooperation between the Group with the four major domestic oil groups increased greatly. In terms of the market expansion of coal-bed gas, the Group's products such as oil well extraction machines, oil well pipes, oil well sucker rods, oil well pumps and extraction machinery accessories have continued to supply entered the domestic markets.

During the current year, the Group introduced various new products to the market. For example, high extrusion and damage resistant casings were supplied to Qinghai Oil Field while high-grade tubings and casings such as P110 were supplied to Jiangsu Oil Field and Zhongyuan Oil Field and all of which have received good feedbacks from the customers. Meanwhile, immediately following the development of new oil field blocks, tubing and casing products of the Group were launched in the Jidong Oil Field under the PetroChina Group (an integrated 1 billion-tonne oil field newly discovered in 2007 - Jidong Nanbao Oil Field). The LC casing with long round thread developed by the Company had successfully passed through wells in the Jidong Nanbao Oil Field on its first attempt which shows that the casing products of the Group have met the strict technical requirements of terrestrial mining in the offshore production well. The launch of the abovementioned new products and the development of new markets will increase the market share of Company's products in the domestic market.

In terms of overseas market, with the Group's continued effort to further expand such market, there was a rapid increase in both the number of and the business with overseas customers in 2008, while high-end products such as high-grade steel and non-API series occupied a leading position in the overseas business. At present, the Group has established good and long-term cooperative relationships with many overseas agencies and oil field service companies. There has been a significant increase in the exports of the Group's products to overseas regions, such as North America, Europe, Russia and Southeast Asia. Apart from the above, the Group has developed new client bases in regions such as the Middle East, Africa and South America. For the financial year ended 31 December 2008, the Group's revenue generated from exports increased significantly, which accounted for approximately 47.7% of the Group's total sales revenue. Such increase formed a solid foundation for the Group to further expand its overseas market in the future.

In terms of the development of new products, with the increasing demand for high-end products both in the PRC and overseas, the Group continues to increase investments in product development. Meanwhile, the Group has strengthened technological cooperation with research institutes such as Xi'an Jiaotong University, Xi'an Pipe Material Research Institute of PetroChina Group, and Xi'an Maurer Petroleum Engineering Material Lab, and has successively developed 20 new types of products with proprietary intellectual property rights attached such as non-API series high collapse-resistance casings, H_2S corrosion resistant series oil well pipes and casings, thermal well casing, low-temperature resistant tubing and casing, economic CO_2 Corrosion Resistant Tubings and Casings, CO_2 Corrosion Resistant Super 13Cr Tubings and Casings, 8-type Elephant, Molong Series Special Thread, among which eight types have been put into trial productions, and six types have been applied for patents registrations. Many new products have passed the testing and appraisal by domestic or international authorities, and have entered into the markets in large quantities. At the beginning of 2008, the pipeline pipes of the Group were licensed by the American Petroleum Institute under its API-5L Monogram Standards, thus laying the foundation for the Group's products entering into the field of oil transportation.

During the period under review, the Group achieved a breakthrough in the development of new products and patent applications: five research achievements such as "R&D on CO_2 Corrosion Resistant Super 13Cr Tubings and Casings", "R&D on MLC-1 Special Thread Casings", "R&D on High-pressure and Corrosion Resistant Casings", "R&D on H_2S Corrosion Resistant Tubings and Casings", "R&D on thermal well casing" were included in the 2008 Technology Innovation Projects of Shandong Province and one research was named a key project; two patents for utility models "Tubing and Casing Threaded Joint" and "Tubing and Casing Threaded Joint for Deep Wells" were awarded patent certificates by the State Intellectual Property Office of the PRC; the four patent applications for "Processing of Drill Pipe End Upsetting", "Casing and Tubing of Mid-High Strength against H_2S Corrosion and its manufacturing methods", "Casing and Tubing of Mid-Low Strength against H_2S Corrosion and its manufacturing methods" and "Casing and Tubing of High Strength against H_2S Corrosion and its manufacturing" were officially accepted by the State Intellectual Property Office of the PRC.

The Group was awarded a number of accreditations by the PRC government authorities, banks and tax bureaus for its continuous growth in its business performance including "Demonstrative Enterprise for Information in the Manufacturing Industry in Shandong Province", "High and New Technology Enterprise in Shandong Province", "Faithful Enterprise in Shandong Province", "Civilized Enterprise in the Manufacturing Industry in Shandong Province", "Top 100 Private Enterprises in Shandong Province", "Foreign Trade Advanced Enterprise in Shandong Province", "Foreign Trade Advanced Enterprise in Shandong Province", "Famous Export Brands in Shandong Province Entitling to Priority in Fostering and Development for 2008-2009", "Top 100 Industrial Enterprises in Weifang City", "Grade A Credit Rating Enterprise in Tax Payment", "2008 Top 100 Private Enterprises in Weifang City", "2007 Outstanding Contribution Award for Civil Economy Development in Weifang City", "Civilized Entity in Weifang City in 2006-2007", ranking No. 4 in "Top 50 Enterprises in Shouguang City" for five consecutive years"Mega Enterprises in Shouguang City", "Shouguang City Foreign Trade Advanced Enterprise" and "Triple A Credit Rating Enterprise" etc. The above accreditations demonstrated the recognition of the Group's outstanding results by the industry.

Prospects

The World Energy Outlook Report released by International Energy Agency in November 2008 states that to avoid the oil crisis and to deal with the increase in demand and the decline in the output of oil, there is a need to invest heavily in the crude oil production industry, to update the basic infrastructure and to improve the oil extraction ability of existing facilities over the next 20 years. At the same time, the Agency considers that investments in the oil-producing industry are long-term investments, and the financial crisis will not become the main reason for stopping the enterprises from investing more.

The 2009 Economy Blue Book released by the Chinese Academy of Social Sciences in December 2008 forecasts that China's GDP growth rate is still expected to remain over 9%. National Bureau of Statistics of the PRC recently indicated that the basic conformation of China's economic development has not changed, and China can achieve stable and rapid economic growth.

The Group considers that the economic depression and the staged decline in crude oil production volume has a certain degree of impact on the demand for petroleum machineries by oil fields in some foreign countries and regions. However, the oil industry as the pillar industry of the PRC will keep solid growth under the "keeping growth" fundamental key macro regulation policy of the PRC government and good policies such as the "RMB500 billion Revitalization Petroleum and Petrochemical Industry Investment Program" which will be rolled out by the PRC government. Therefore the petroleum machinery industry in which the Company operates will definitely benefit from these policies. The Group will continue to input more resources into new projects and R & D of the technology of high end products and the production technology so as to guarantee product quality, reserve high-quality technology and enhance accessory production capacity. Subject to ensuring the continuing growth in the domestic market, the Group will continue to consolidate the overseas markets. In addition, the Group will monitor closely the development trends of the global economic crisis and the changes in the RMB exchange rate, seize the opportunities of domestic demand and export stimulation policies to actively adjust the product mix, increase the sales volume of high-end products and high value-added products sold to abroad to neutralize the impact of the economic depression on export businesses.

With regard to product research and development, the Group plans to continue to strengthen the development of high grade steel oil well pipes, casings, pipeline pipes, drill pipe and other petroleum machineries and focus on the development of specially connected OCTG new pipeline pipes used in the acidity and Sea Service environment, CO_2 corrosion resistant casings, pressure and corrosion resistant casings, S corrosion resistant drill pipe body, perforating hole pipes, internal upsetting diameter connection oil well pipes, corrosion resistant and high-strength sucker rods, series of small oil pumping units(used in coal bed gas) and other new products, so as to meet different kinds of demands for the products of the Group from different PRC and overseas clients, to increase the share of high-grade products and to enhance the profitability and competitiveness of the Group's products.

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

In terms of production capacity, it is expected that the production line of 250,000 tonnes of oil casings will reach its full designed production capacity in 2009. The 180mm project , in which the Group is planning to invest RMB720 million, is expected to be completed and undergo trial run in the first quarter of 2010. The construction and capacity release of above two projects will increase the Group's total output of special petroleum pipes to 650,000 tonnes in 2010 which will further increase the Group's competitiveness in the industry.

In terms of the expansion of the domestic market, apart from maintaining and consolidating relationships with existing customers, the Group will further develop potential new customers. The Company will make use of the advantage of the continual increase of oil casing output and the increase of high-end products in 2009 to increase the sales volume of casings in the domestic market. On the condition that the Company becomes one of the top four outstanding suppliers of PetroChina Company Limited and the establishment of good reputation and good cooperation relationship, the Group will enhance the promotion of high-end products in the domestic market. At the same time, the Group will, on the basis of consolidating and developing relationships with existing customers, actively promote good cooperative relationships with Yanchang Petroleum and CNOOC Group so in order to gain more market share.

For overseas markets, the Company will, taking into account the different trade policies in each oil production country and the development demands of overseas markets, continue to increase the development in markets such as South America, the Middle East and Africa to eliminate the risks arising from over-concentration of the Company's products in particular overseas markets. Meanwhile, the Company will strengthen long-term cooperation relationships with overseas stock companies with sufficient market resources, dominant services and good reputations. With the Group's expansion into new markets such as Russia, the Middle East, South America and others, the Group is confident that it can actively carry out new products promotions through the strengthening of marketing activities so as to expand the Group's market coverage continuously.

In conclusion, the Group considers that the global demand for the oil energy will not be affected by the economy crisis for the long term, and policies on expanding domestic demand and revitalization petroleum and petrochemical industry investment which will be introduced by the PRC government will drive domestic petroleum industry for the better. The Group will seize opportunities, prepare new products and technologies, accumulate capacity, strictly and control costs, thus ensuring the profitability of the Company and achieving the best returns for Shareholders.

Acknowledgement

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

Zhang En Rong
Chairman

Shandong, the PRC
16 February 2009

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

Revenue

For the current year, sales of the Group's oil well pipes, casing, oil well pumping machines, oil well pumps and other products increased as a result of substantial increase of market demand in petroleum drilling and the extraction machinery industry and increased production capacity of the Group. There was also a substantial growth of revenue from overseas market. The Group's revenue was approximately RMB1,700.4 million for the year ended 31 December 2007 and surged to approximately RMB2,758.7 million for the current year, representing an increase of approximately 62.2%, while sales of casing has increased by 1.03 times when compared with previous year. However, sales of sucker rod deceased by approximately 34.4% compared to the same period last year. The decrease is mainly due to the sharp increase of raw materials prices which lead to a substantial increase in the cost production, the Company was unable to reach an agreement with the product's main overseas customer in respect of the price, and as a result, the overseas sales volume decreased sharply.

For the two years ended 31 December 2008, the Group's revenue breakdown by products are as follows:

	2008		2007		**Percentage of increase**
	RMB'000	**%**	RMB'000	%	**%**
Oil well pipes	**772,834**	**28.0**	673,875	39.6	**14.7**
Casing	**1,456,028**	**52.8**	717,236	42.2	**103.0**
Oil well sucker rods	**67,358**	**2.4**	102,704	6.0	**-34.4**
Oil well pumps	**33,325**	**1.2**	25,627	1.5	**30.0**
Oil well pumping machines	**28,742**	**1.1**	21,824	1.3	**31.7**
Other petroleum drilling and extraction machinery and accessories	**400,391**	**14.5**	159,139	9.4	**150.4**
Total	**2,758,678**	**100**	1,700,405	100	**62.2**

For the two years ended 31 December 2008, the Group's revenue breakdown by regions are as follows:

	2008 RMB'000	%	2007 RMB'000 (restated)	%	Percentage of increase %
PRC	**1,442,096**	**52.3**	892,161	52.5	**61.6**
USA	**608,191**	**22.0**	286,701	16.9	**112.1**
Europe	**350,245**	**12.7**	344,814	20.3	**1.6**
Japan	**238,089**	**8.6**	124,198	7.3	**91.7**
Others	**120,057**	**4.4**	52,531	3.0	**105.8**
Total	**2,758,678**	**100**	1,700,405	100	**62.2**

Gross Profit

The Group's gross profit increased from approximately RMB316.2 million for the year ended 31 December 2007 to approximately RMB536.6 million for the current year, representing an increase of approximately 69.7%.

Consolidated Gross Profit Margin

The consolidated gross profit margin of the Group is approximately 19.5% for the current year and the consolidated gross profit margin for the year ended 31 December 2007 was approximately 18.6%.

During the period under review, the increase in consolidated gross profit margin of the Group was mainly due to the following reasons: (1) the price of the raw materials of steel rose substantially as the exchange rate of RMB appreciated against USD rapidly in the first half of the current year, and the prices of the Group's products increased gradually as well. After the price of steel reached the top at the end of July 2008, the price fell quickly in the second half of the year as the RMB/USD exchange rate stabilized, but the changes of the prices of the Company's products had certain hysteresis, which reduced the impact of increase in raw material price on profit; (2) the percentage of the high-grade oil well pipes with higher gross margin was increased to 29.3%; (3) acquisition of Maolong Group extended the industrial chain of the Group which enlarged the profit margin of oil well pipes. During the current year; the gross profit contribution from Maolong Group to the Group is approximately RMB71.4 million; (4) the Shouguang Baolong Petroleum Material Project which was newly developed by the Company was put into operation in July 2008 which contributed approximately RMB23.4 million to the Group's gross profit.

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

The Group's net profit from ordinary activities attributable to equity holders of the Company increased from approximately RMB200.3 million for the year ended 31 December 2007 to approximately RMB305.8 million for the current year, representing an increase of approximately 52.7%. The substantial increase was mainly due to the rapid increase in the Group's revenue.

Cost of Sales

The Group's cost of sales increased from approximately RMB1,384.2 million for the year ended 31 December 2007 to approximately RMB2,222.1 million for the current year, representing an increase of approximately 60.5%. The significant increase in cost of sales was mainly attributable to the growth of the Group's revenue.

Distribution Cost

The distribution cost rose from approximately RMB39.8 million for the year ended 31 December 2007 to approximately RMB59.9 million for the year ended 31 December 2008. The increase of distribution cost is mainly due to the increase of the Group's transportation costs by approximately RMB20.9 million in the current year. Distribution cost was approximately 2.3% of the Group's total revenue in 2007 and decreased to approximately 2.2% in 2008.

Administrative Expenses

The Group's administrative expenses increased from approximately RMB65.3 million for the year ended 31 December 2007 to approximately RMB99.7 million for the current year, representing an increase of approximately 52.7%. Administrative cost has decreased from approximately 3.8% of the Group's revenue for the year ended 31 December 2007 to approximately 3.6% of the Group's revenue for the year ended 31 December 2008, which represents a decrease of approximately 5.3%.

Finance Cost

The finance cost of the Group for the current year was approximately RMB49.0 million, representing approximately 1.8% of the Group's total revenue and an increase of RMB22.5 million when compared to the finance cost of the Group for the year ended 31 December 2007 over the same period. The increase in finance costs was principally due to the increase of loan for business expansion.

Research and Development Cost

The research and development cost of the Group for the current year was approximately RMB30.2 million, representing an increase of approximately RMB10.4 million when compared to the research and development cost for the year ended 31 December 2007 (RMB19.8 million). The rise was mainly due to the Group's increasing efforts in the research and development of new products, such as high-pressure survivable and corrosion-resistant high-grade steel casing as well as oil pipes.

Liquidity and Financial Resources

As at 31 December 2008, the total current assets of the Group amounted to approximately RMB2,033.2 million (2007: approximately RMB1,168.5 million) which comprises: (1) cash and bank balances for the total amount of approximately RMB195.1 million (2007: approximately RMB109.6 million) and pledged time deposit to RMB414.0 million (2007: approximately RMB164.0 million). The Company was still mainly using the Bank Acceptance Bill and pledged approximately 30% to 50% fixed deposits, which did not only reduce the rate of bank loan, but also obtained interest from fixed deposit and hence increased earnings of the Company. (2) Trade receivable and notes receivable amounted to approximately RMB575.9 million (2007: approximately RMB297.0 million). The increase was mainly attributable to increased market demand for oil drilling and extraction machinery and related accessories, which further boosted sales of products. (3) Inventories amounted to approximately RMB795.9 million (2007: approximately RMB594.5 million).

As at 31 December 2008, the total current liability of the Group amounted to approximately RMB 1,656.0 million (2007: RMB1,065.8 million) which comprises: (1) trade and bills payables approximately RMB1,155.4 million (2007: RMB575.0 million) the increase of which was mainly attributable to the extensive use of bank acceptance for bill payments by the Company for financial expense saving; (2) bank loan amounted to approximately RMB253.5 million (2007: approximately RMB182.1 million), this is due to the increased short-term bank loans for the expansion of the scale of the Company. According to the planned arrangement of the present current asset condition and future cash flow, the Company anticipates that it will have sufficient repayment ability to support the Group's operation.

Banking Facilities

For the current year, the Group had interest-bearing bank credit loans amounting to approximately RMB 803.5 million (2007: approximately RMB532.1 million). In addition, eleven banks, including the Agricultural Bank of China, have granted credit facilities to the Group amounting to approximately RMB412.9 million (2007: approximately RMB700.0 million) that have not been utilised.

Cash Flow

As at 31 December 2008, the cash and cash equivalents of the Company increased by approximately RMB85.6 million as compared with that of the year ended 31 December 2007 (2007: an increase by approximately RMB77.8 million). The net cash flow from operations of the year amounted to approximately RMB512.0 million (2007: RMB93.5 million). Such increase is primarily attributable to an increase in sales volume during the current year, good debt collection and increase in the amounts for trade receivables and note receivables. Other cash flow items include approximately RMB250.1 million as the additional pledged fixed deposits, approximately RMB242.8 million as capital expenditures for the purchase of certain property, plant and equipment, approximately RMB19.7 million for distribution of dividends for 2007, and approximately RMB105.3 million as proceeds of new bank loan facilities.

Capital Structure

As at 31 December 2008, the liability ratio of the Group was approximately 200% (2007: approximately 170%). The increase was mainly attributable to the increase in bills payable, bank loans and reserves over those of last year, all these reflected the favorable conditions of market demand of the Group's product. The Group's production and operation have entered into a new chapter, and placed emphasis on financial management by way of using bills payable in the purchase of raw materials in the operation to enhance the returns on assets, which led to better control on the increase of bank loans. At present, the Company has strong debt repayment ability and has strong fund raising abilities in the future.

Gearing Ratio

The Group's gearing ratio was approximately 66.7% (2007: approximately 63.0%) which is calculated based on the Group's total liabilities of approximately RMB2,225.4 million (2007: approximately RMB1,429.0 million) and total assets of approximately RMB3,335.4 million (2007: approximately RMB2,268.8 million).

Pledge of Assets

The pledged deposits of the Group are as security for bills payable which amounted to approximately RMB770.2 million (2007: approximately RMB376.7 million).

Foreign Exchange Exposure

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

Segment Information

An analysis of the Group's revenue and segment results by geographical segments for the current year is set out in note 6 to the financial statements.

Capital Commitment

For the current year, the Group had capital commitments of approximately RMB255.7 million (2007: approximately RMB107.4 million) in respect of fixed assets.

Employees

For the year ended 31 December 2008, the Group had a total of 3,041 employees (31 December 2007: 2,247 employees). Staff costs including Directors' remuneration were approximately RMB 77.8 million (2007: approximately RMB50.0 million). The salaries and benefits of employees of the Group are kept at competitive levels. Employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system which is reviewed annually. A wide range of benefits are also provided to the employees by the Group.

For the year ended 31 December 2008, the breakdown of the number of employees of the Group is set out as below:

	As at 31 December	
	2008	2007
Research and development	**64**	60
Production	**2,541**	1,863
Quality control	**179**	98
Sales and marketing	**61**	65
Administration	**196**	161
Total	**3,041**	2,247

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

Significant Investments

In the year ended 31 December 2008, the Group has completed investment of approximately RMB82.6 million in the newly-commenced 180mm Project.

Acquisitions and Disposals during the Year and Future Investment Plans

In the year ended 31 December 2008, the Group did not have other relevant acquisitions, disposals or significant investment plans.

Directors

Executive Directors

Mr. Zhang En Rong (張恩榮先生), born in January 1940, is the chairman of the Company and an executive Director. Mr. Zhang is a founder of the Company and is responsible for the overall strategic planning, management and business development of the Group. Since the establishment of the Company, Mr. Zhang has held various positions in the Group including the general manager. Mr. Zhang was also a member of the 12th session, 13th session and 14th session of the Weifang City People's Congress of the PRC, a member of the 5th session and the 6th session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr. Zhang was the legal representative and factory manager of Shandong Shouguang Petroleum Machinery Parts Factory ("**Petroleum Machinery Parts Factory**"), Shandong Shouguang Petroleum Machinery Factory ("**Petroleum Machinery Factory**") and Weifang Molong Industrial Company ("**Weifang Molong**") from 1987 to 1993 and the general manager of Shandong Molong Holdings Company ("**Molong Holdings**") from 1994 to 2001. Mr. Zhang was granted the "Good Enterprise Management Personnel" certificate in 1988, the "Modern Industrial Manufacturing Producer" in 1991 and the "Wealth Attainment and Development of Shandong medal of Shandong Province ("山東省「富民興魯」勞動獎章") in 2004. Mr. Zhang is the father of Mr. Zhang Yun San, an executive Director.

Mr. Zhang Yun San (張雲三先生), born in January 1962, is a founder, the deputy chairman, an executive Director and the general manager of the Company. He is responsible for assisting the chairman of the Board in the overall strategic planning and management and business development of the Group. Mr. Zhang has served in the Company since 15 November 2007 as general manager. Since 1994, Mr. Zhang has held various positions in Molong Holdings and the Group, including deputy general manager and deputy chairman of the Company. Mr. Zhang graduated from Nanjing University with a bachelor of laws degree and holds an advanced certificate in Training Course of Chinese Communist Party School for Entrepreneurs and was granted the "Excellent Private Enterpriser of Weifang City" in 2004; "Top Ten Young Entrepreneurs of Weifang City" in 2005, "Excellent Chief Information Officer of Weifang City" in 2006 and was appointed as the member of the 10th session of the Weifang City People's Congress of the PRC and the member of the 15th session of the Shouguang City People's Congress of the PRC in 2007, and was awarded the "Model Worker of Shandong Province" ,"Top Ten Persons of "Moving State Duty" of Weifang in 2007" and " Media Man of the Year in Shouguang" in 2008. Mr. Zhang is currently a member of the 15th session of the Standing Committee of Shouguang City People's Congress of the PRC, Deputy Chairman of Shouguang City Association of Entrepreneurs and Vice President of Shouguang City Industries and Commerce Association. He has abundant experience in the development, manufacture and sales of petroleum drilling and extraction machinery and the management of the Group. Mr. Zhang is the son of Mr. Zhang En Rong, an executive Director.

Mr. Lin Fu Long (林福龍先生), born in November 1952, is a founder, and an executive Director and responsible for major project management of the Group. Mr. Lin was deputy factory manager of Petroleum Machinery Parts Factory, Petroleum Machinery Factory and Weifang Molong from 1989 to 1993, deputy general manager of Molong Holdings from 1994 to 2001 and general manager of the Company from 2001 to 2007. Mr. Lin was an executive director of Weifang Molong Machinery. Mr. Lin was awarded the "Capable Sales Person" title by the Shouguang City People's Government in 1994.

Mr. Xie Xin Cang (謝新倉先生), born in February 1962, is a founder, an executive Director, and deputy general manager of the Company. Mr. Xie has served in Molong Holdings since 1995 as deputy general manager. During his employment, Mr. Xie has applied the nickel plating phosphorus alloy technology in the manufacturing of petroleum drilling and extraction machinery and successfully invented the "MB424 steel wire teasel" that possess international advanced level. Mr. Xie graduated from Xian Jiaotong University with a Bachelor of Engineering degree in mechanical engineering and majored in metal materials and their heat treatment. Mr. Xie was awarded the "Shandong Province Town and Village Enterprise Technology Innovation Leader" certificate by the Shandong Province Town and Village Enterprise Management Bureau in 1998. Mr. Xie was a standing committee member of the seventh session of the Shouguang City committee of the National Committee of the Chinese People's Political Consultative Conference and is a member of the 8th Session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr Xie is the husband of Ms. Li Bao Hui, a supervisor (a "**Supervisor**") of the Company.

Non-executive Directors

Mr. Chen Jian Xiong (陳建雄先生), born in June 1955, is a non-executive Director. Mr. Chen has worked for Rodless Oil Pump Company of the Shengli Petroleum Administration Bureau ("**Rodless Oil Pump**") for over 20 years. Since 1994, Mr. Chen has been the chairman of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited ("**Kaiyuan Oil**") and was an assistant manager of Rodless Oil Pump. In 2004, he served as manager of Rodless Oil Pump. Mr. Chen is currently the Chairman of Kaiyuan Oil and Shengli Pump Industry Co., Ltd., Shengli Oilfield. Mr. Chen was appointed as a non-executive Director on 28 December 2001, and was re-appointed as a non-executive Director on 7 May 2005 and on 5 May 2008.

Mr. Wang Ping (王平先生), born in May 1955, is a non-executive Director. Mr. Wang has over 20 years of experience in metallurgy and received his doctorate degree in engineering from the University of Science and Technology Beijing. Since 2000, Mr. Wang is a professor at the University of Science and Technology of Beijing. Mr. Wang was appointed as a non-executive Director of the Company on 29 March 2003 and was re-appointed as a non-executive Director of the Company on 12 May 2006.

Independent non-executive Directors

Mr. Qin Xue Chang (秦學昌先生), born in July 1965, is an independent non-executive Director and the Chairman of the Audit Committee. Mr. Qin has over 20 years of experience in accounting and auditing industry. He received his bachelor degree in economics from Shanxi University of Finance and Economics and is a practicing certified public accountant in the PRC. Mr. Qin is a deputy chairman of Beijing Yongtuo Certified Public Accountants Co., Ltd., Director of Shandong Branch Office, Beijing Yongtuo Certified Public Accountants Co., Ltd. He is currently a member of the CPPCC Shandong Provincial Committee, a deputy to the Weifang City People's Congress and a member of the Foreign Affairs Committee under the Standing Committee, an executive member of the Shandong Provincial Industry & Commerce Federation, an executive director of the Shandong Provincial Accounting Society and vice-chairman of the Weifang Youth Federation. The deputy chairman of Industrial and Commercial Union of Weifang City, part-time professor of Shandong Economic and Trade Vocational College. He was acclaimed as the "Top Ten Intellectual Models of Shandong Province" and awarded the second-class honour from the Department of Science and Technology of Shandong Province in 2006. In March 2007, he was elected as the member of 10th session of the Weifang City People's Congress of the PRC. Mr. Qin was appointed as an independent non-executive Director of the Company on 29 March 2003 and was re-appointed as an independent non-executive Director of the Company on 12 May 2006.

Mr. Yan Yi Zhuang (閻翊莊先生), born in August 1957, is an independent non-executive Director and the Chairman of the Nomination Committee of the Company. He is also an operation manager of Shougang Concord Technology Holdings Ltd., a company listed on the Main Board of the Stock Exchange. Mr. Yan has over 10 years of management experience in electronics technology and graduated from the University of Western Sydney, Australia. Mr. Yan was appointed as an independent non-executive Director on 29 March 2003 and was re-appointed as an independent non-executive Director on 12 May 2006.

Mr. Loke Yu alias Loke Hoi Lam (陸海林先生) (a former independent non-executive Director and Chairman of the Remuneration and Evaluation Committee of the Company) has resigned as an independent non-executive Director and the memberships in the special committees of the Board on 6 November 2008, which was approved by the EGM on 8 January 2009.

Mr. Chau Shing Yim, David (周承炎先生), born in November 1963, was appointed as an independent non-executive Director by the approval of shareholders on 8 January 2009, with the terms of office from 8 January 2009 to the end of the term of the 2nd Board. On the same day, he was appointed as the Chairman of the Remuneration and Evaluation Committee, a member of the Audit Committee and a member of the Nomination Committee of the 2nd Board with terms in accordance with his term as the independent non-executive Director. Mr. Chau Shing Yim, David has over 20 years' experience in corporate finance, working on projects ranging from initial public offering transactions and restructuring of PRC enterprises to crossborder and domestic takeover transactions. Mr. Chau was formerly a partner of one the big four accounting firms in Hong Kong, holding the position as their head of Merger and Acquisition and Corporate Advisory. He is a member of the Hong Kong Securities Institute, the Institute of Chartered Accountants of England and Wales and the Hong Kong Institute of Certified Public Accountants ("**HKICPA**"), and was an ex-committee member of the Disciplinary Panel of HKICPA. He is also an executive director of Tidetime Sun (Group) Limited and a non-executive director of Lee & Man Paper Manufacturing Limited, both companies being listed on the main board of the Stock Exchange of Hong Kong Limited.

Supervisors

Ms. Li Bao Hui (李寶惠女士), born in July 1963, is a Supervisor and the chairman of the supervisory committee of the Company (the "**Supervisory Committee**"). She is currently the quality control manager of the Company and graduated from Shanxi Radio and Television University. She has worked in the quality control department of Molong Holdings since 1995 and has over 10 years of experience in quality control and quality management. Ms. Li is the wife of Mr. Xie Xin Cang, an executive Director. Ms Li was appointed as a Supervisor on 29 March 2003 and was re-appointed as a Supervisor on 12 May 2006.

Mr. Liu Wan Fu (劉萬賦先生), born in January 1939, is a Supervisor. Mr. Liu is a consultant of China National Petroleum Corporation. Mr. Liu has over 40 years of experience in the petroleum industry. Mr. Liu was appointed as a Supervisor on 29 March 2003 and was re-appointed as a Supervisor on 12 May 2006.

Mr. Fan Ren Yi (樊仁意先生), born in November 1965, is a Supervisor. Mr. Fan is the vice general manager and CFO of Shandong Charming Home-Textiles Co., Ltd. Mr. Fan holds a bachelor degree from Xian Jiaotong University and is a certified public accountant in the PRC. He was appointed as a Supervisor on 29 March 2003 and was re-appointed as a Supervisor on 12 May 2006.

Senior Management

Mr. Guo Huan Ran (國煥然先生), born in April 1967, is the deputy general manager of the Company and is responsible for marketing and technology research and development of the Group. Mr. Guo joined Molong Holdings in March 1991. Mr. Guo graduated from Weifang College with a major in Machine Manufacturing and Processing Equipment, and held various positions in the Company including technician, workshop supervisor and Production Director. Mr. Guo has extensive experience in areas including production management and technology research and development of petroleum drilling and extraction machinery. Mr. Guo has directed the innovation of various items for export, such as liner for mud pump and valve body. Some of the products, such as "Special Centralizer for Electrical Submersible Pump System", won the third prize of "Science and Technology Achievements Award from Village & Township Enterprises Administration of Ministry of Agriculture of People's Republic of China". Mr. Guo has been granted the title of "Outstanding Young Entrepreneur of Shouguang City" in November 2007.

Mr. Zhang Yu Zhi (張玉之先生), born in November 1958, is a deputy general manager of the Company. He is responsible for the logistics issues of the Group. Mr. Zhang has over 10 years of experience in petroleum drilling and extraction machinery industry. Before joining the Group, he was responsible for the management of Weifang Transportation Company and Shouguang Shangkou Sales Agency. He joined the Company in October 1994 as a general manager of Xinjiang office, and has participated in the petroleum drilling and extraction machinery industry since then.

Mr. Zhang Shou Kui (張守奎先生), born in August 1970, is the deputy general manager of the Company and is responsible for organizing the Group's production. Mr. Zhang joined Molong Holdings in 1990. He has been engaging in the production management for over ten years and has extensive related experiences. He held consecutively the positions of the Chief of Inspection Station, General Manager of Branch Plant, and Manager of Production Department in the Group. He is a member of the Communist Party of China. Having been appointed by the 8th meeting of the second session of the Board, Mr. Zhang will be the Deputy General Manager of the Company effective from 16 March 2008.

Mr. Cui Huan You (崔煥友先生), born in February 1949, is in charge of the finance, accounting and tax department of the Company. He graduated from Shandong Province Financial Zhigong University. Mr. Cui has significant experience in finance, accounting and taxation. He joined Molong Holdings as an accounting supervisor in June 1995. Mr. Cui was awarded the "Outstanding Financial Management Personnel" in 1992 and the "Advanced Accountant of Weifang City" in 2004.

Ms. Sheng Qiang (盛強女士), born in October 1963, is the secretary to the Board. Ms. Sheng graduated in the discipline of auto motion and instrumentation from Shandong University of Technology with a bachelor degree in engineering in 1986. Ms. Sheng was issued the certificate of "secretary to the directors' board" by the Shanghai Stock Exchange in 1997. Ms. Sheng was a secretary to the board of Qingdao HISENSE Electrical Holdings Co before joining the Group in August 2006. Ms. Sheng has many years of experience in management of securities matters.

Company Secretary

Mr. Chan Wing Nang, Billy (陳永能先生), born in June 1961, is the company secretary of the Company. Mr. Chan graduated from the University of Newcastle, United Kingdom with a bachelor degree in Civil Engineering in 1986. He also has a master degree in business administration from the University of Warwick, United Kingdom. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants and the Institute of Chartered Accountants in England and Wales. Mr. Chan has over 10 years of experience in the accounting and consulting field. Prior to joining the Group, Mr. Chan was a director in a consulting company. Mr. Chan joined the Group on 13 December 2004.

The Board is pleased to present the annual report and the audited consolidated financial statements for 2008 of the Group.

Principal Activities

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

Results

The Group's profit for the current year and the state of financial affairs of the Group and the Company at that date are set out in the consolidated financial statements on pages 46 to 98 of the annual report.

Financial Summary

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

Dividends

The Board has resolved to recommend a final dividend of RMB0.02 per share (inclusive of tax) for the current year. The proposal to declare and pay this final dividend will be submitted to the annual general meeting to be held on 12 May 2009 (the "**AGM**") for the approval of the Shareholders. Final dividend for domestic shares of the Company will be declared and paid in RMB whereas dividend for H shares will be declared in RMB and paid in Hong Kong dollars.

There was no arrangement under which the Shareholders waived or agreed to waive any dividends during 2008.

Changes in Share Capital

There was no change in the share capital of the Company for 2008, and the details are set out in note 33 to the consolidated financial statements.

Reserves and Distributable Reserves

Details of changes in the reserves of the Group for 2008 are set out in consolidated statement of changes in equity.

Under the PRC laws and regulations, the Company's distributable reserves will be based on the lower of the amount calculated according to the PRC accounting principles and rules and the amount calculated according to the Hong Kong generally accepted accounting principles. At the end of 2008, the Company's distributable profit was approximately RMB386,728,244 (2007: approximately RMB246,367,000).

Property, Plant and Equipment, and Investment Properties

Details of changes in the property, plant and equipment and investment properties of the Group for 2008 are set out in notes 15 and 17 to the consolidated financial statements.

Capitalised Interest

For 2008, the Group had capitalised interest amounting to RMB2.7 million.

Directors and Supervisors

The list of Directors and Supervisors during 2008 and up to the date of this report is set out on page 2 in this annual report.

Directors' and Supervisors' Service Contracts or Letters of Appointment

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

Re-election of the Board

Non-executive Director

Mr. Wang Ping (王平先生) was appointed as a non-executive Director of the Company from 29 March 2003, and re-elected as the non-executive Director on 12 May 2006. The appointment of Mr. Wang as a non-executive Director would end on 11 May 2009, so the Nomination Committee of the Board of the Company proposed to re-elect Mr. Wang Ping as the non-executive Director at the 13th Board meeting of the 2nd Board held on 16 February 2009, and an ordinary resolution will be put to the Shareholders of the Company at the AGM.

The profile of Mr. Wang Ping (王平先生) is set out in the "Directors, Supervisors and Senior Management" section.

Other than non-executive directorship held in the Company, Mr. Wang Ping does not hold any positions in the Company or its subsidiaries. Mr. Wang Ping entered into a service contract with the Company on 12 May 2006 for a term of three years. His director's emolument is zero. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of Listing Rule 13.51 (2). There are no other matters that need to be brought to the attention of the Shareholders in respect of the re-election of Mr. Wang Ping (王平先生).

Independent Non-executive Director

Mr. Loke Yu alias Loke Hoi Lam (陸海林先生) has resigned as independent non-executive Director and the memberships in the Special Committee of the Board on 6 November 2008. The Nomination Committee of the Board proposed to appoint Mr. Chau Shing Yim, David (周承炎先生) as the independent non-executive Director which was approved by the Shareholders at the first Extraordinary General Meeting in 2009 held on 8 January 2009.

The profile of Mr. Chau Shing Yim, David (周承炎先生) is set out in the "Directors, Supervisors and Senior Management" section.

Other than independent non-executive directorship held in the Company, Mr. Chau Shing Yim, David (周承炎先生) does not hold any positions in the Company or its subsidiaries. Mr. Chau Shing Yim, David (周承炎先生) entered into a service contract with the Company on 8 January 2009 for a term from 8 January 2009 to the end of the term of office of the 2nd Board of the Company. His director's emolument is HKD90,000 considering his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of Listing Rule 13.51 (2). There are no other matters that need to be brought to the attention of the Shareholders in respect of the election of Mr. Chau Shing Yim, David (周承炎先生).

The appointment of each of Mr. Qin Xue Chang and Mr. Yan Yi Zhuang as an independent non-executive Director would end on 11 May 2009. Then their appointment s would exceed the provisions of the CSRC that each Director shall be eligible for re-election by Shareholders upon end of term provided that an independent non-executive Director shall not serve more than 6 years upon re-election. The Board has nominated Mr. John Paul Cameron and Ms.Wang Chun Hua as candidates for election as independent non-executive Directors at the 13th board meeting of the 2nd Board held on 16 February 2009 and proposed to present ordinary resolution to the Shareholders at the AGM.

Re-elected Supervisors

The appointments of Ms. Li Bao Hui (李寶惠女士), Mr. Liu Wan Fu (劉萬賦先生) and Mr. Fan Ren Yi (樊仁意先生) as Supervisors, will end on 11 May 2009. Pursuant to the articles of association of the Company (the "**Articles**"), Mr. Liu Huai Duo (劉懷鐸先生) was elected as a Supervisor of the Company at the Employees' Association held on 13 February 2009 without the need of Shareholders' approval; Mr. Zhang En Rong as the main Shareholder of the Company recommends Mr. Liu Wan Fu and Mr. Fan Ren Yi as Supervisors of the Company, and an ordinary resolution will be put to the Shareholders of the Company at the annual general meeting. Pursuant to the Articles, after Mr. Liu Wan Fu (劉萬賦先生) and Mr. Fan Ren Yi (樊仁意先生) were re-elected as Supervisors at the AGM. Pursuant to the Articles, after the approval of the re-election of Mr. Liu Wan Fu (劉萬賦先生) and Mr. Fan Ren Yi (樊仁意先生), they, along with Mr. Liu Huai Duo (劉懷鐸先生) will form the new board of Supervisors.

Mr. Liu Huai Duo (劉懷鐸先生), born in October 1975, is the responsible officer for electricity of oil well pipes. Mr. Liu graduated from Liaoning Sciences and Technologies College with junior college degree in industrial automated instruments. Mr. Liu has abundant experience and technology in electric automatization and PLC Programmable control. Mr. Liu has served in Molong Holdings since 2000. Mr. Liu was rewarded as the advanced worker of the Company in 2006 and the model worker of the Company in 2008.

The profiles of Mr. Liu Wan Fu (劉萬賦先生) and Mr. Fan Ren Yi (樊仁意先生) are set out in the "Directors, Supervisors and Senior Management" section.

Other than the roles of Supervisor and quality technical position of the Company, Mr. Liu Huai Duo (劉懷鐸先生) does not hold any positions in the Company or its subsidiaries. Mr. Liu Huai Duo (劉懷鐸先生) will enter into a service contract after the AGM for a term of three years. His supervisor's emolument will be determined based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirements of Listing Rule 13.51 (2).

Other than the role of Supervisor, Mr Liu Wan Fu (劉萬賦先生) does not hold any positions in the Company or its subsidiaries. Mr. Liu entered into a service contract with the Company on 12 May 2006 for a term of three years. His supervisor's emolument is currently RMB20,000 per year which is based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirements of Listing Rule 13.51(2). There are no other matters that need to be brought to the attention of the Shareholders in respect of the re-election of Mr. Liu.

Other than the role of Supervisor, Mr. Fan Ren Yi (樊仁意先生) does not hold any positions in the Company or its subsidiaries. Mr. Fan entered into a service contract with the Company on 12 May 2006 for a term of three years. His supervisor's emolument is currently RMB 10,000 per year which is based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirements of Listing Rule 13.51(2). There are no other matters that need to be brought to the attention of the Shareholders of the Company in respect of the re-election of Mr. Fan.

Special Committees

The Board established the Nomination Committee, the Audit Committee and the Remuneration and Evaluation Committee.

The Nomination Committee was established on 18 January 2005 and its members are Mr. Zhang Yun San, Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam). Mr. Yan Yi Zhuang is the chairman of the Nomination Committee. Mr. Loke Yu (alias Loke Hoi Lam) has resigned as an independent non-executive Director. Approved by the Board, Mr. Chau Shing Yim, David (周承炎先生) works as a member of the Nomination Committee in place of Mr. Loke Yu (alias Loke Hoi Lam) (陸海林先生).

The Audit Committee was established on 20 March 2004 and its members are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam). Mr. Qin Xue Chang is the Chairman of the Audit Committee. Mr. Loke Yu (alias Loke Hoi Lam) has resigned as an independent non-executive Director. Approved by the Board, Mr. Chau Shing Yim, David (周承炎先生) works as a member of the Audit Committee in place of Mr. Loke Yu (alias Loke Hoi Lam) (陸海林先生).

The Remuneration and Evaluation Committee was established on 18 January 2005 and its members are Mr. Zhang Yan San, Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam). Mr. Loke Yu (alias Loke Hoi Lam) is the Chairman of the Remuneration and Evaluation Committee. Mr. Loke Yu (alias Loke Hoi Lam) has resigned as an independent non-executive Director. Approved by the Board, Mr. Chau Shing Yim, David (周承炎先生) works as a member and the Chairman of the Remuneration and Evaluation Committee in place of Mr. Loke Yu (alias Loke Hoi Lam) (陸海林先生).

Emoluments of Directors and Highest Paid Individuals

The emoluments of the Directors and the 5 highest paid individuals are calculated based on their scope of work, experience, qualification and/or performance, the details of which are set out in notes 11 and 12 to the financial statements.

Connected Transactions

Following the completion of the acquisition of all equity interest in Maolong Machinery at the end of December 2007, Maolong Machinery and its subsidiaries including Molong Equipment and Weihai Baolong, are not taken to be the related parties of the Company. For related transaction with Yalong Oil Well Pump, please refer to note 39 to the consolidated financial statements.

Retirement/Pension Scheme Benefits

	2008 RMB'000	2007 RMB'000
Salaries and other benefits	**72,206**	45,412
Retirement benefit scheme contributions	**5,621**	4,575
Total	**77,827**	49,987

As stipulated by the laws, orders and regulations of the PRC, the Group participated in various defined contribution retirement plans organised by municipal governments for its staff. Currently, the Group is required to make contributions to the retirement plans at a rate of 20% (2007: 18%) of the salaries, bonuses and certain allowances of its staff. A member of the plan is entitled to a pension, to be paid by the municipal governments, equal to a fixed proportion of the salary prevailing at his retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. When the staff leaves the positions, the Group is not entitled to recover the contributions paid in respect of their pension scheme benefits.

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

As at 31 December 2008, interests and short positions of the Directors, Supervisors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "**SFO**")), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to the Model Code for Securities Transactions by Directors of Listed Company as set out in Appendix 10 of the Listing Rules, to be notified to the Group and to the Stock Exchange, were as follows:

Long positions in the Shares

Name	Type of interest	Number of domestic shares *(Note 1)*	Percentage of domestic shares	Percentage of total registered share capital
Zhang En Rong	Beneficial	1,397,585,000	69.58%	42.49%
Lin Fu Long	Beneficial	171,080,000	8.52%	5.20%
Zhang Yun San	Beneficial	153,040,000	7.62%	4.65%
Xie Xin Cang	Beneficial	107,050,000	5.33%	3.25%
Li Bao Hui (Supervisor) *(Note 2)*	Interests of spouse	107,050,000	5.33%	3.25%

Note 1 Unlisted shares

Note 2 Ms. Li Bao Hui is the wife of Mr. Xie Xin Cang and is taken to be interested in the 107,050,000 domestic shares held by Mr.Xie Xin Cang under the SFO.

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

Directors' and Supervisors' Rights to Acquire Shares or Debentures

None of the Directors or Supervisors or their respective associates (as defined under the Rule 1.01 of the Listing Rules of the Main Board) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights in 2008.

Share Option Scheme

The Company does not have any share option scheme.

Substantial Shareholders

As at 31 December 2008, so far as known to the Directors, Supervisors or chief executive of the Company, the following persons (other than a Director, Supervisor or chief executive) had, or were deemed or taken to have interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO:

Long positions in the H Shares

Name	Type of interests	Number of H Share	Percentage of H shares	Percentage of total registered capital
Paul G. Desmarais *(Note 1)*	Interest of controlled corporation	275,376,000 *(Note 1)*	21.50%	8.37%
Nordex Inc. *(Note 1)*	Interest of controlled corporation	275,376,000 *(Note 1)*	21.50%	8.37%
Gelco Enterprises Ltd. *(Note 1)*	Interest of controlled corporation	275,376,000 *(Note 1)*	21.50%	8.37%
Power Corporation of Canada *(Note 1)*	Interest of controlled corporation	275,376,000 *(Note 1)*	21.50%	8.37%
Power Financial Corporation *(Note 1)*	Interest of controlled corporation	275,376,000 *(Note 1)*	21.50%	8.37%

Name	Type of interests	Number of H Share	Percentage of H shares	Percentage of total registered capital
IGM Financial Incorporation *(Note 1)*	Interest of controlled corporation	275,376,000 *(Note 1)*	21.50%	8.37%
Martin Currie (Holdings) Limited *(Note 2)*	Interest of controlled corporation	116,780,000	9.12%	3.55%
Atlantis Investment Management Ltd	Directly beneficially owned	65,000,000	5.08%	1.98%

Notes:

1. According to the disclosure of interest notices filed by Paul G Desmarais., Gelco Enterprises Ltd., IGM Financial Inc., Nordex Inc., Power Corporation of Canada and Power Financial Corporation, each of these companies is interested in 275,376,000 H Shares as at 31 December 2008. Among these 275,376,000 H Shares in which these companies are deemed to have interest, 260,000,000 H Shares were directly held by Mackenzie Cundill Investment Management Ltd. and 15,376,000 H Shares were directly held by Mackenzie Cundill Investment MGMT (Bermuda) Ltd.

   Mackenzie Cundill Investment Management Ltd. is a wholly-owned subsidiary of Mackenzie Financial Corporation, which in turn is a wholly-owned subsidiary of Mackenzie Inc. Mackenzie Inc. is a wholly-owned subsidiary of IGM Financial Inc., which in turn is owned as to 55.99% by Power Financial Corporation, Power Financial Corporation is owned as to 66.40% by 171263 Canada Inc, which in turn is a wholly-owned subsidiary of 2795957 Canada Inc. 2795957 Canada Inc is a wholly-owned subsidiary of Power Corporation of Canada, which in turn is owned as to 53.83% by Gelco Enterprise Ltd., Gelco Enterprise Ltd. is owned as to 94.95% by Nordex Inc., which in turn is owned as to 68% by Paul G. Desmarais.

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

2. According to the disclosure of interest notices filed by Martin Currie (Holdings) Limited, the company is interested in 116,780,000 H Shares of the Company as at 31 December 2008. Among these 116,780,000 H Shares, 50,220,000 H Shares were directly held by Martin Currie Inc and 66,560,000 H Shares were directly held by Martin Currie Investment Management.

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

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

Directors' Interests in Contracts

There were no contracts of significance to which the Company or any of its subsidiaries was a party and in which any of the Directors had a material interest, whether directly or indirectly, subsisted at the end of 2008 or at any time in 2008.

Material Contracts

None of the Company (or any of its subsidiaries) or the controlling Shareholders of the Company (or any of its subsidiaries) has entered into any material contracts between themselves, and none of the controlling Shareholders of the Company (or any of its subsidiaries) has provided any material service contract to the Company (or any of its subsidiaries).

Major Customers and Suppliers

In 2008, 52.3% of the Group's products were sold to domestic oil fields within the PRC. In addition, 47.7% of the Group's products were sold to customers in countries and regions such as North America, Europe, the Middle East, Southeast Asia, Africa, and Latin America, etc. The five largest customers accounted for approximately 62.7% of the Group's total revenue. The largest customer of the Group accounted for approximately 27.4% of the Group's total revenue.

In 2008, the Group's major suppliers are reputable material producers in the PRC, with whom the Group has established good relationships. Steel is the Group's principal raw material. The largest supplier was Zibo Shuntai Gold Company Limited, which the Group has signed strategic co-operation agreement with. The five largest suppliers accounted for approximately 33.1% of the Group's total procurement. The largest supplier accounted for approximately 9.7% of the Group's total procurement.

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

Purchase, Sale or Redemption of Securities

None of the Company or any of its subsidiaries has purchased, sold or redeemed any listed securities of the Company in 2008.

Pre-emptive Rights

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

Corporate Governance

The principal Code on Corporate Governance adopted by the Company is set out in the Corporate Governance Report on pages 35 to 42 of this annual report.

Sufficiency of Public Float

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

Auditors

As the Company was unable to reach an agreement with Ernst &Young (the "**E&Y**") and Ernst &Young Hua Ming (the "**E&Y Hua Ming**") in respect of the Hong Kong and PRC auditor fees for the financial year ended 31 December 2008, the Company decided to terminate the appointment of E&Y and E&Y Hua Ming as the Company's Hong Kong auditor and PRC auditor, which have been effective since 4 November 2008. Proposed by the Board, Deloitte Touche Tohmatsu (the "**Deloitte**") and Deloitte Touche Tohmatsu CPA Ltd. (the "**Deloitte CPA**") was approved as the Company's Hong Kong auditor and PRC auditor at the first EGM held on 8 January 2009.

The accounts have been audited by Deloitte. A resolution for the appointment of the auditors, who is eligible and will offer themselves for appointment as the next year Hong Kong auditor and PRC auditor of the Company for the next year, will be proposed at the forthcoming AGM.

By order of the Board of Directors
Zhang En Rong
Chairman

Shandong, the PRC
16 February 2009

To the Shareholders:

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

In 2008, the Supervisory Committee had convened two meetings. Three members of the Supervisory Committee attended the meetings, reviewed cautiously the development plans of the Company and provided reasonable suggestions and opinions to the Board whilst attending board meetings. It also strictly and effectively monitored and supervised the Company's management in making significant policies and decisions to ensure that they were in compliance with the laws and regulations of the PRC and the Articles, and that they were in the interests of the Shareholders.

In 2008, we reviewed a series of documents newly published by the Company about the internal control system of the Company, including the "Risk Management Policy", "Operational Analyses Management Policy", the "Subsidiary Company Financial Management Policy", the "Disclosure of Information Emergency Contingency Plans", the "Significant Information Internal Report Policy" "Anti-corruption Administration Measures" and the "Complaints and Reports Administration Measures". We also revised, for the issuance of A shares, the Articles, the "Rules and Procedures of the Meeting of the Shareholders", the "Rules and Procedures of the Board", the "Rules and Procedures of the Supervisory Committee" and the "Independent Directors Rules" . After reviewing these documents, we believe that the internal control policies published during the current year were in compliance with the requirements of the domestic regulatory authorities and the Listing Rules; the Company has strictly followed the essential information disclosure procedures that perfected the Company's governance structure, and has achieved great progress in standard operation.

We have carefully reviewed and agree with the Board of Directors' Report, audited financial statements and the plan of the declaration of a final dividend to be proposed by the Board for presentation at the AGM. The Supervisors believe that during 2008, the operating results of the Company adequately reflects its state of affairs; all expenses and costs incurred were reasonable; the plan for distribution of dividends accommodated Shareholders' interests and the long-term benefits of the Group, and the statutory surplus reserve and welfare fund provided from net profits for the year were made in compliance with applicable laws, regulations and the Articles.

Throughout 2008, to the best knowledge of the Supervisory Committee, none of the Directors or other officers of the Group had been found to have abused their authority, damaged the interests of the Company or infringed upon the interests of the Shareholders and the Company's employees. To the best knowledge of the Supervisory Committee, none of the Directors or other officers of the Company was found to be in breach of any applicable laws and regulations, the Articles or relevant regulations of China Securities Regulatory Commission. We are of the opinion that the Directors and other officers of the Company were able to strictly observe their respective duties, to act diligently and to exercise their authority faithfully in the best interests of the Company.

The Supervisory Committee is satisfied with the achievement and cost-effectiveness of the Company for 2008 and has great confidence in the future of the Company and would like to take this opportunity to express its appreciation to all Shareholders, Directors and staff of the Company for the strong support of our work.

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

Shandong, the PRC
16 February 2009

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

(a) Corporate Governance Practices

The Company put strong emphasis on the superiority, steadiness and rationality of corporate governance. In order to enhance the management standard, the Company has set up a committee to review its internal management structure. During the current year, the Company has complied with the requirements set out in the "Code on Corporate Governance Report", Appendix 14 of the Listing Rules.

(b) Directors' Securities Transactions

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "**Model Code**") as set out in Appendix 10 of the Listing Rules, which requires the securities transactions of the Directors of the Company to be conducted in accordance with the Model Code. The Model Code is also applicable to the senior management of the Company. After making specific enquiries, all Directors have confirmed that they have fully complied with the Model Code throughout 2008.

(c) The Board

The Board is responsible for planning and overseeing the overall development and management of the Group with the objective of enhancing Shareholders' value. The Board, led by the Chairman, is responsible for the approval and monitoring of the overall strategies and policies of the Group, approval of annual budgets and business plans, evaluation of the Company's performance and oversight of the works of management. In 2008, the Board comprised nine Directors, including four executive Directors, two non-executive Directors and three independent non-executive Directors. Biographical details of the Directors are set out in the "Directors, Supervisors and Senior Management" section from pages 18 to 22 in this annual report. Pursuant to Rule 3.13 of the Listing Rule, the Company has received the confirmation letter from each independent non-executive Director. The independence of an independent non-executive Director may only be established upon confirmation by the Board that such Director does not have any other direct or indirect relationship with the Group. The Chairman of the Board, Mr. Zhang En Rong, is the father of Mr. Zhang Yun San, an executive Director. Aside from this, there is no financial, business and relatives relationship among members of the Board.

In 2008, the Board had convened four meetings.

Attendence record of the directors:

Members of Directors	Position	Number of meetings attended
Zhang En Rong	Chairman and executive Director	4/4
Zhang Yun San	Deputy Chairman and executive Director	4/4
Lin Fu Long	Executive Director	4/4
Xie Xin Cang	Executive Director	4/4
Chen Jian Xiong	Non-executive Director	4/4
Wang Ping	Non-executive Director	4/4
Qin Xue Chang	Independent non-executive Director	4/4
Yan Yi Zhuang	Independent non-executive Director	4/4
Loke Hoi Lam	Independent non-executive Director	4/4

(d) Chairman and General Manager

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

(e) Non-executive Director

The appointment of non-executive Director, Mr. Chen Jian Xiong, was valid from 7 May 2005 to 6 May 2008. Mr. Chen Jian Xiong was re-elected as the non-executive Director at the AGM with the current terms of office from 6 May 2008 to 5 May 2011. The appointment of non-executive Director, Mr. Wang Ping, is valid from 12 May 2006 to 11 May 2009.

(f) Nomination Committee

The Nomination Committee was established on 18 January 2005 and its members are Mr. Yan Yi Zhuang, Mr. Zhang Yun San, Mr. Qin Xue Chang and Mr. Loke Yu (alias Loke Hoi Lam), with Mr. Yan Yi Zhuang as the Chairman of the Nomination Committee. Mr. Loke Yu (alias Loke Hoi Lam) has resigned as an independent non-executive Director. Approved by the Board, Mr. Chau Shing Yim, David (周承炎先生) works as a member of the Nomination Committee in place of Mr. Loke Yu (alias Loke Hoi Lam) (陸海林先生).

Summary of Tasks of the Nomination Committee

The Nomination Committee submitted to the Board motions relating to the nomination of new vice general manager or the independent non-executive Director at the 8th Session of the 2nd Board on 16 March 2008 and at the 11th Session of the 2nd Board on 8 November 2008 respectively, and submitted the candidate list to the Board following the process below:

1. Candidate gathering: any person can recommend candidates to the Nomination Committee as well as recommend oneself to be a candidate.

2. Qualification examination: as regards to the persons above, the Nomination Committee should strictly examine the qualifications of vice general manager and the independent non-executive Director candidates in accordance with vice general manager and the independent non-executive Director choice standard.

3. Written survey: the Nomination Committee should examine and verify the aptitude of the candidates who conform with the requirements and provide a written report.

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

Members of Nomination Committee	Position	Number of meetings attended
Yan Yi Zhuang	Committee Chairman and independent non-executive Director	2/2
Zhang Yun San	Deputy Chairman and executive Director	2/2
Qin Xue Chang	Independent non-executive Director	2/2
Loke Hoi Lam	Independent non-executive Director	2/2

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

(g) Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee was established on 18 January 2005 and its members are Mr. Loke Yu (alias Loke Hoi Lam), Mr. Zhang Yan San, Mr. Qin Xue Chang and Mr. Yan Yi Zhuang. Mr. Loke Yu (alias Loke Hoi Lam) is the Chairman of the Remuneration and Evaluation Committee. Mr. Loke Yu (alias Loke Hoi Lam) has resigned as an independent non-executive Director. Approved by the Board, Mr. Chau Shing Yim, David (周承炎先生) works as a member and the Chairman of the Remuneration and Evaluation Committee in place of Mr. Loke Yu (alias Loke Hoi Lam) (陸海林先生).

Summary of Tasks of the Remuneration and Evaluation Committee

The Remuneration and Evaluation Committee submits to the Board with motions in relation to the remuneration of Directors and follows the basic principles below to formulate the Directors' and senior management's remuneration:

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

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

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

Policy relating to the Formulation of Remuneration

1. Formulation of the remuneration of executive Directors

   Executive Directors' remuneration is formulated by the Remuneration Committee and consists of basic salary and bonuses. The Company and each executive Director should enter into an "Executive Director Service Agreement".

2. Formulation of the remuneration of non-executive Directors and independent non-executive Directors

   Non-executive Directors and independent non-executive Directors' remuneration are recommended by the Remuneration and Evaluation Committee and reported to the Board for permission. The Company and each non-executive Director or independent non-executive Director should sign a "Letter of Appointment of Non-executive Director" or a "Letter of Appointment of Independent Non-executive Director" respectively.

Summary of tasks of the Remuneration and Evaluation Committee

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

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

3. Formulation of the remuneration of senior management

Senior management's remuneration is formulated by the Remuneration and Evaluation Committee and consists of basic salary and bonuses.

(h) Audit Committee

The Audit Committee was established on 20 March 2004 and its members are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu (alias Loke Hoi Lam), with Mr. Qin Xue Chang as the Chairman of the Committee. Mr. Loke Yu (alias Loke Hoi Lam) has resigned as an independent non-executive Director. Approved by the Board, Mr. Chau Shing Yim, David (周承炎先生) works as a member of the Audit Committee in place of Mr. Loke Yu (alias Loke Hoi Lam) (陸海林先生).

Summary of tasks of Audit Committee for the Current Period

The Audit Committee had held two meetings this year to discuss matters relating to the accounting standards and practices adopted by the Group, and internal control and financial reporting matters, etc., including reviewing the financial results.

The Audit Committee had held meetings with the external auditors of the Company to discuss the interim report, the annual financial statements, the internal control system of the Company and the internal risk assessment report. The Directors and chief financial officer of the Company also attended the meetings to answer questions in respect of the financial results of the Company. The Audit Committee had also discussed the internal control system with the management of the Company, and ensured that the management had performed its duty to establish an effective internal system, including considering the sufficiency of resources, the qualification and the experience of the employees who were responsible for the accounting and financial reporting of the Company, and the sufficiency of training courses received by employees and the relevant budget.

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

Members of the Audit Committee	Duties	Number of meetings attended
Qin Xue Chang	Committee Chairman and Independent non-executive Director	2/2
Yan Yi Zhuang	Independent non-executive Director	2/2
Loke Hoi Lam	Independent non-executive Director	2/2

(i) Auditors' Remuneration

For 2008, auditing service fees payable to the Company's Hong Kong auditor ("**Deloitte**") amounted to approximately RMB0.60 million. The Company confirms that other professional fees paid and payable to Deloitte CPA amounted to approximately RMB2.4 million during the current year.

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

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

(k) Internal Control

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

The Company has an Internal Audit Department which plays a major role in monitoring the internal governance of the Company. The major tasks of the Internal Audit Department are reviewing the financial condition and management of the Company and conducting comprehensive audits of all branches and subsidiaries of the Company on a regular basis. The Company has taken many steps to enhance the internal control of the Company, such as having all departments internal control inspection and appraisal, strengthening the checks and supervision of implementation of the internal control systems by the Audit Department and according to some weakness found during examination of the internal control, further improving the internal control system and strengthening the implementation of all the internal control systems.

During the year of 2008, the Internal Audit Department issued reports to the senior management covering various operational and financial units of the Company and also conducted reviews of areas of concern identified by the Company's management.

(l) Going Concern

For 2008, there was no uncertainty or conditions of a material nature that would affect the Company's ability to continue as a going concern.

(m) Investor Relations

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

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

According to the proposal for issuing A share, the Company made references to the "Guidelines for Articles of Association of Listed Companies" (as amended in 2006) issued by CSRC and the PRC Company Law which took effect on 1 January 2006, the Articles was amended systematically which was approved by the Shareholders at the first general meeting in 2009. In addition, amendments were made to the "Rules and Procedures of the Meeting of the Shareholders", the "Rules and Procedures of the Board" and "the Rules and Procedures of the Supervisory Committee" in accordance with the relevant domestic regulatory requirements. The "Independent Directors Rules" was adopted as an appendix to the Articles. The above amendments and adoption were approved at the general meeting. In compliance with the requirements of domestic regulatory authorities in relation to external security, connected transactions and the administration of the use of proceeds, the Company has further upgraded the corporate governance structure, and ensured the regular operation of the Company's management structure. At the same time, the Company cordially invites Shareholders to express their opinions by filling out the feedback form enclosed with this annual report. Visits to our facilities in the PRC will also be arranged for Shareholders. Opinions from our Shareholders will be forwarded to senior management and the Directors of the Company.

(n) Sincere Communication

The Board understands that it is essential to establish good relationships with investors. The company has established good channels of communication with institutional investors and analysts, and updated them on the Company's performance on a timely basis. The migration from the GEM to the Main Board of the Stock Exchange and placing of H Share in 2007 attracted more attention from foreign institutional investors. We also participated in demonstrations, meetings with investors, and telephone conference to communicate with investors widely. The executives participated in more than 20 meetings of these kinds, which has effectively enhanced the Company's corporate transparency.

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

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

Re-submit Proposed A Share Issue

Because the first application for A share issue was not approved, the Board has resolved at the 11th session meeting of the 2nd Board on 9 November 2008 that the Company will apply for the issue of not more than 70 million A shares of RMB1.00 each, and the net proceeds from the A Share issue shall be used to finance the 180 Project. The resolution of proposed A share issue was approved by the Shareholders at the first EGM and Class Meetings held on 8 January 2009. Pursuant to relevant regulations, the proposed A share issue will be implemented upon approval by CSRC.

TO THE MEMBERS OF
SHANDONG MOLONG PETROLEUM MACHINERY COMPANY LIMITED
(established in the People's Republic of China with limited liability)

We have audited the consolidated financial statements of Shandong Molong Petroleum Machinery Company Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 46 to 98, which comprise the consolidated balance sheet as at 31 December 2008, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the consolidated financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2008 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong

16 February 2009

For the year ended 31 December 2008

	NOTES	2008 RMB'000	2007 RMB'000 (restated)
Revenue		**2,758,678**	1,700,405
Cost of sales		**(2,222,114)**	(1,384,199)
Gross profit		**536,564**	316,206
Other income	7	**21,476**	50,873
Distribution expenses		**(59,892)**	(39,846)
Administrative expenses		**(99,692)**	(65,328)
Gain on fair value change of foreign currency forward contracts	25	**5,270**	—
Other expenses		**(1,787)**	(1,338)
Finance costs	8	**(49,015)**	(26,524)
Share of results of associates		**332**	4,196
Profit before taxation		**353,256**	238,239
Income tax expense	9	**(33,857)**	(37,210)
Profit for the year	10	**319,399**	201,029
Attributable to:			
Equity holders of the Company		**305,811**	200,330
Minority interests		**13,588**	699
		319,399	201,029
Final dividends recognised as distribution: RMB0.015 (2007: RMB0.02) per ordinary share	13	**49,339**	12,960
Earnings per share - basic	14	**RMB0.093**	RMB0.062

As at 31 December 2008

	NOTES	2008 RMB'000	2007 RMB'000 (restated)
Non-current assets			
Property, plant and equipment	15	**1,009,695**	824,463
Deposit paid for acquisition of property, plant and equipment		**3,504**	6,738
Prepaid lease payments	16	**91,083**	91,516
Goodwill	18	**142,973**	142,973
Intangible assets	19	**11,429**	377
Investment in an associate	20	**2,339**	2,157
Available-for-sale investments	21	**10,000**	10,000
Long term prepayment		**3,275**	6,704
Deferred tax assets	32	**27,913**	15,407
		1,302,211	1,100,335
Current assets			
Inventories	22	**795,938**	594,533
Trade and other receivables	23	**543,764**	268,938
Bills receivables	23	**32,115**	28,080
Prepaid lease payments	16	**2,100**	1,940
Amount due from an associate	24	**531**	1,449
Derivative financial instruments	25	**49,650**	—
Pledged bank deposits	26	**413,967**	163,957
Bank balances and cash	26	**195,133**	109,580
		2,033,198	1,168,477
Current liabilities			
Trade and bills payables	27	**1,155,378**	575,039
Other payables and accrued charges	28	**155,254**	160,803
Amounts due to related parties	29	**—**	98,704
Derivative financial instruments	25	**44,380**	—
Bank borrowings - due within one year	30	**253,522**	182,120
Other borrowings	31	**15,000**	5,000
Tax payable		**32,488**	44,084
		1,656,022	1,065,750
Net current assets		**377,176**	102,727
Total assets less current liabilities		**1,679,387**	1,203,062
Non-current liabilities			
Bank borrowings - due after one year	30	**550,000**	350,000
Deferred tax liabilities	32	**19,364**	13,284
		569,364	363,284
		1,110,023	839,778

As at 31 December 2008

	NOTE	2008 RMB'000	2007 RMB'000 (restated)
Capital and reserves			
Share capital	33	**328,924**	328,924
Reserves		**720,792**	464,189
Equity attributable to equity holders of the Company		**1,049,716**	793,113
Minority interests		**60,307**	46,665
Total equity		**1,110,023**	839,778

The consolidated financial statements on pages 46 to 98 were approved and authorised for issue by the Board of Directors on 16 February 2009 and are signed on its behalf by:

Zhang Yun San
DIRECTOR

Xie Xin Cang
DIRECTOR

Consolidated Statement of Changes in Equity

For the year ended 31 December 2008

	Share capital RMB'000	Capital reserve RMB'000 (Note a)	Statutory surplus reserve RMB'000 (Note b)	Statutory public welfare fund RMB'000	Translation reserve RMB'000	Retained profits RMB'000	Dividend reserve RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
	Attributable to equity holders of the Company									
At 1 January 2007	64,800	177,712	35,941	11,982	(251)	225,460	12,960	528,604	8,161	536,765
Exchange difference arising on translation of foreign operations and net income recognised directly in equity	—	—	—	—	(691)	—	—	(691)	(228)	(919)
Profit for the year	—	—	—	—	—	200,330	—	200,330	699	201,029
Total recognised income and expense for the year	—	—	—	—	(691)	200,330	—	199,639	471	200,110
2006 final dividend declared and paid	—	—	—	—	—	—	(12,960)	(12,960)	—	(12,960)
Paid-in capital	4,924	72,906	—	—	—	—	—	77,830	—	77,830
Transfer from retained profits to capital reserve	—	650	—	—	—	(650)	—	—	—	—
Transfer from capital reserve and retained profits on bonus issue	259,200	(129,600)	—	—	—	(129,600)	—	—	—	—
Transfer from retained profits to statutory surplus reserve	—	—	11,086	—	—	(11,086)	—	—	—	—
Transfer from statutory public welfare fund to statutory surplus reserve	—	—	11,982	(11,982)	—	—	—	—	—	—
Capital contribution from minority shareholders of a subsidiary										
– in cash	—	—	—	—	—	—	—	—	12,600	12,600
– injection of asset	—	—	—	—	—	—	—	—	32,400	32,400
Acquired on acquisition of subsidiaries (restated)	—	—	—	—	—	—	—	—	375	375
Acquisition of additional interest in a subsidiary	—	—	—	—	—	—	—	—	(7,342)	(7,342)
Proposed 2007 final dividend	—	—	—	—	—	(49,339)	49,339	—	—	—
At 31 December 2007 (restated)	328,924	121,668	59,009	—	(942)	235,115	49,339	793,113	46,665	839,778
Exchange difference arising on translation of foreign operations and net income recognised directly in equity	—	—	—	—	131	—	—	131	54	185
Profit for the year	—	—	—	—	—	305,811	—	305,811	13,588	319,399
Total recognised income for the year	—	—	—	—	131	305,811	—	305,942	13,642	319,584
2007 final dividend declared and paid	—	—	—	—	—	—	(49,339)	(49,339)	—	(49,339)
Transfer from retained profits to statutory reserve	—	—	21,078	—	—	(21,078)	—	—	—	—
Proposed 2008 final dividend	—	—	—	—	—	(65,785)	65,785	—	—	—
At 31 December 2008	328,924	121,668	80,087	—	(811)	454,063	65,785	1,049,716	60,307	1,110,023

Notes:

(a) The capital reserve mainly represents the premium arised in share issue less the bonus issued by way of capitalisation of capital reserve.

(b) In accordance with the laws and regulations of the PRC, the Company and its subsidiaries in Mainland China are required to appropriate amounts equal to 10% of their profit after taxation as determined in accordance with the PRC accounting standards to statutory surplus reserve.

Statutory surplus reserve is part of shareholders' equity and when its balance reaches an amount equal to 50% of the registered capital, further appropriation needs not be made. The statutory surplus reserve may only be used, upon approval of the relevant authority, to offset accumulated losses or to increase capital.

For the year ended 31 December 2008

	NOTES	2008 RMB'000	2007 RMB'000 (restated)
Operating activities			
Profit before taxation		**353,256**	238,239
Adjustments for:			
Allowance for trade receivables		**24,576**	—
Amortisation of intangible asset		**941**	314
Depreciation of property, plant and equipment		**65,669**	39,917
Finance costs		**49,015**	26,524
Gain on disposal of prepaid lease payments		**—**	(2,394)
Gain on fair value change of foreign currency forward contracts		**(5,270)**	—
Interest income		**(8,363)**	(6,970)
Loss (gain) on disposal of property, plant and equipment		**600**	(5,997)
Release of prepaid lease payments		**2,050**	929
Reversal of allowance for inventories		**(4,138)**	(4,584)
Reversal of allowance for other receivables		**(219)**	—
Reversal of allowance for trade receivables		**—**	(2,240)
Share of results of associates		**(332)**	(4,196)
Operating cash flows before movements in working capital		**477,785**	279,542
Decrease in long term prepayment		**3,429**	—
(Increase) decrease in inventories		**(197,267)**	10,130
Increase in trade and other receivables		**(297,736)**	(25,799)
Increase in bills receivables		**(4,035)**	(21,894)
Decrease (increase) in amount due from an associate		**918**	(622)
Increase (decrease) in trade and bills payable		**580,339**	(114,842)
Increase in other payables and accrued charges		**479**	22,458
Decrease in amounts due to related parties		**—**	(37,490)
Cash generated from operations		**563,912**	111,483
PRC income tax paid		**(51,879)**	(18,012)
Net cash from operating activities		**512,033**	93,471

For the year ended 31 December 2008

	NOTES	2008 RMB'000	2007 RMB'000 (restated)
Investing activities			
(Increase) decrease in pledged bank deposits		**(250,010)**	54,220
Purchase of property, plant and equipment		**(242,793)**	(267,136)
Settlement of balance of consideration for acquisition of a subsidiary in 2007	36	**(134,363)**	—
Development cost paid		**(11,993)**	—
Deposit paid for acquisition of property, plant and equipment		**(3,504)**	(4,112)
Prepaid lease payment		**(1,777)**	(1,189)
Interest received		**8,363**	6,970
Proceeds from disposal of property, plant and equipment		**765**	10,816
Dividend received from an associate		**150**	—
Acquisition of subsidiaries (net of cash and cash equivalents acquired)	36	**—**	(148,365)
Acquisition of an associate		**—**	(7,534)
Purchase of available-for-sale investments		**—**	(10,000)
Acquisition of additional interest in a subsidiary		**—**	(7,342)
Purchase of intangible assets		**—**	(438)
Proceeds from disposal of prepaid lease payment		**—**	7,552
Net cash used in investing activities		**(635,162)**	(366,558)
Financing activities			
New bank and other borrowings raised		**1,053,116**	619,244
Repayment of bank and other borrowings		**(771,714)**	(322,124)
Interest paid		**(51,750)**	(26,524)
Dividend paid		**(19,708)**	(12,960)
Proceeds from issue of shares		**—**	77,830
Capital contributed by a minority shareholder		**—**	12,600
Net cash from financing activities		**209,944**	348,066
Net increase in cash and cash equivalents		**86,815**	74,979
Effect of changes in exchange rates		**(1,262)**	(614)
Cash and cash equivalents at beginning of the year		**109,580**	35,215
Cash and cash equivalents at end of the year, represented by bank balances and cash		**195,133**	109,580

31 December 2008

1. GENERAL

The Company was established in the PRC with limited liability and its shares are listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The addresses of the registered office and principal place of business of the Company are disclosed in the introduction to the annual report.

The consolidated financial statements are presented in Renminbi ("RMB"), which is also the functional currency of the Company.

During the year, the Group was involved in the design, manufacture and sale of petroleum extraction machinery and related accessories, which included oil well pipes, oil well sucker rods, oil well pumps and oil well pumping machines. The principal activities of the Company's subsidiaries are set out in note 40.

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, the following new standards, amendments and interpretations ("new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are effective for the Group's financial year beginning on 1 January 2008.

HKAS 39 & HKFRS 7 (Amendments)	*Reclassification of financial assets*
HK(IFRIC) - INT 11	*HKFRS 2: Group and treasury share transactions*
HK(IFRIC) - INT 12	*Service concession arrangements*
HK(IFRIC) - INT 14	*HKAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction*

The adoption of the new HKFRSs had no material effect on how the results and financial position for the current or prior accounting periods have been prepared. Accordingly, no prior period adjustment has been required.

The Group has not early applied the following new or revised standards, amendments or interpretations that have been issued but are not yet effective.

HKFRSs (Amendments)	*Improvements to HKFRSs* [1]
HKAS 1 (Revised)	*Presentation of financial statements* [2]
HKAS 23 (Revised)	*Borrowing costs* [2]
HKAS 27 (Revised)	*Consolidated and separate financial statements* [3]
HKAS 32 & 1 (Amendments)	*Puttable financial instruments and obligations arising on liquidation* [2]
HKAS 39 (Amendment)	*Eligible hedged items* [3]
HKFRS 1 & HKAS 27 (Amendments)	*Cost of investment in a subsidiary, jointly controlled entity or associate* [2]
HKFRS 2 (Amendment)	*Vesting conditions and cancellations* [2]
HKFRS 3 (Revised)	*Business combinations* [3]
HKFRS 8	*Operating segments* [2]
HK(IFRIC) - INT 13	*Customer loyalty programmes* [4]
HK(IFRIC) - INT 15	*Agreements for the construction of real estate* [2]
HK(IFRIC) - INT 16	*Hedges of a net investment in a foreign operation* [5]
HK(IFRIC) - INT 17	*Distributions of non-cash assets to owners* [3]

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS *(continued)*

[1] Effective for annual periods beginning on or after 1 January 2009 except the amendments to HKFRS 5, effective for annual periods beginning on or after 1 July 2009.
[2] Effective for annual periods beginning on or after 1 January 2009.
[3] Effective for annual periods beginning on or after 1 July 2009.
[4] Effective for annual periods beginning on or after 1 July 2008.
[5] Effective for annual periods beginning on or after 1 October 2008.

The adoption of HKFRS 3 (Revised) may affect the accounting for business combination for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. HKAS 27 (Revised) will affect the accounting treatment for changes in a parent's ownership interest in a subsidiary.

The directors of the Company anticipate that the application of the other new or revised standards, amendments or interpretations will have no material impact on the results and the financial position of the Group.

3. RESTATEMENT OF CERTAIN 2007 FIGURES

In December 2007, the Group has acquired subsidiaries and the fair value of the assets and liabilities acquired has been determined provisionally as the acquisition is completed near the year end date. Therefore, adjustments on the provisional fair value was made in this year after the finalisation of the identification and valuation of the assets and liabilities acquired. Details are disclosed in note 36.

The consolidated balance sheet as at 31st December, 2007 has been restated to reflect the finalised fair value of acquiree's assets and liabilities.

3. RESTATEMENT OF CERTAIN 2007 FIGURES *(continued)*

In addition, reclassifications of some of the prior year's consolidated balance sheet figures are made to conform with current year's presentation.

	31 December 2007 RMB'000 (originally stated)	Adjustments RMB'000 (note 36)	Reclassifications RMB'000	31 December 2007 and 1 January 2008 RMB'000 (as restated)
Balance sheet items				
Property, plant and equipment	820,313	4,150	—	824,463
Deposit paid for acquisition of property, plant and equipment	—	—	6,738	6,738
Investment properties	3,574	(3,574)	—	—
Prepaid land lease payments	90,497	3,691	(732)	93,456
Goodwill	147,115	(4,142)	—	142,973
Investment in an associate	2,142	15	—	2,157
Deferred tax assets	15,705	(298)	—	15,407
Inventories	599,168	(4,635)	—	594,533
Trade and other receivables	291,662	(734)	(21,990)	268,938
Other payables and accruals	(259,117)	1,758	96,556	(160,803)
Amounts due to related parties	(18,132)	—	(80,572)	(98,704)
Tax payable	(47,256)	3,172	—	(44,084)
Deferred tax liabilities	(13,631)	347	—	(13,284)
Total effect on assets and liabilities	1,632,040	(250)	—	1,631,790

4. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis, except for certain financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statement have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances and income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combinations and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Acquisition of additional interest in subsidiaries

Acquisition of additional interest in subsidiaries is recorded at the book value of the net asset attributable to the interests. The excess of the cost of acquisition over net asset value of the subsidiary attributable to the additional interest acquired is recognised as goodwill.

Business combinations

The acquisition of businesses is accounted for using the purchase method. The cost of acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under HKFRS 3 Business Combinations are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identified assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest in minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Goodwill

Goodwill arising on an acquisition of a business for which the agreement date is on or after 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identified assets, liabilities and contingent liabilities of the relevant business at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on acquisition of a business is presented separately in the consolidated balance sheet.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of the relevant cash-generating unit, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

Interests in associates

An associate is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

The results and assets and liabilities of associates are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associates, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of the associate recognised at the date of acquisition is recognised as goodwill. The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment.

Any excess of the Group's share of the net fair value of the identified assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment is recognised immediately in profit or loss.

Where a group entity transacts with an associate of the Group, profits or losses are eliminated to the extent of the Group's interest in the relevant associate.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold in the normal course of business, net of discounts and sales related taxes.

Revenue from sale of goods is recognised when the goods are delivered and title has passed.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Property, plant and equipment

Property, plant and equipment including buildings held for use in the production or supply of goods and services, or for administrative purposes (other than construction in progress) are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment, other than construction in progress, over their estimated useful lives and after taking into account of their estimated residual value, using the straight line method.

Construction in progress represents property, plant and equipment in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated income statement in the year in which the item is derecognised.

Investment properties

Investment properties are properties held to earn rentals or for capital appreciation.

On initial recognition, investment properties are measured at cost, including any directly attributable expenditure. Subsequent to initial recognition, investment properties are stated at cost less subsequent accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the cost of investment properties over their estimated useful lives and after taking into account of their estimated residual value, using the straight line method.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Rental income from operating leases is recognised in the consolidated income statement on a straight line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight line basis over the lease term.

The Group as lessee

Rental payable under operating leases are charged to the consolidated income statement on a straight line basis over the term of the relevant lease. Benefits received and receivable as an incentive as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight line basis.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions.

At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are recognised in profit or loss in the period in which they arise.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group (i.e. RMB) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

31 December 2008

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs. Grants related to expense items are recognised in the same period as those expenses are charged in the consolidated income statement and are reported separately as "other income".

Retirement benefit costs

Payments to defined contribution retirement benefit schemes managed by the PRC government and the Mandatory Provident Fund Schemes ("MPF") are charged as expenses when employees have rendered service entitling them to the contributions.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amount of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Intangible assets

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity.

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible asset is reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

Financial instruments

Financial assets and financial liabilities are recognised on the consolidated balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in the consolidated income statement.

Financial assets

The Group's financial assets are classified into one of three categories, including financial assets at fair value through profit or loss ("FVTPL") loans and receivables and available-for-sale financial assets.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period.

Interest income is recognised on an effective interest basis for debt instruments.

31 December 2008

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Financial instruments *(continued)*

Financial assets (continued)

Financial assets at fair value through profit or loss

Financial assets at FVTPL represent financial assets held for trading.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

At each balance sheet date subsequent to initial recognition, financial assets at FVTPL are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and other receivables, bills receivables, amounts due from an associate, pledged bank deposits and bank balances and cash) are carried at amortised cost using the effective interest method, less any identified impairment losses (see accounting policy in respect of impairment loss on financial assets below).

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Financial instruments *(continued)*

Financial assets (continued)

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as financial assets at FVTPL, loans and receivables or held-for-maturity investments.

At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognised in equity is removed from equity and recognised in profit or loss (see accounting policy on impairment loss on financial assets below).

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, they are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition (see accounting policy on impairment loss on financial assets below).

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial assets have been affected.

For an available-for-sale equity investment, a significant or prolonged decline in the fair value of that investment below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Financial instruments *(continued)*

Financial assets (continued)

Impairment of financial assets *(continued)*

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period and observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, an impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial assets. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade and other receivables, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

For financial assets measured at amortised cost, if, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment losses was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

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4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Financial instruments *(continued)*

Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The Group's financial liabilities generally classified into financial liabilities at FVTPL and other financial liabilities.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Interest expense is recognised on an effective interest basis.

Financial liabilities at fair value through profit or loss

Financial liabilities at FVTPL represent financial liabilities held for trading.

A financial liability is classified as held for trading if:

- it has been incurred principally for the purpose of repurchasing in the near future; or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Financial instruments *(continued)*

Financial liabilities and equity (continued)

Financial liabilities at fair value through profit or loss *(continued)*

At each balance sheet date subsequent to initial recognition, financial liabilities at FVTPL are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

Other financial liabilities

Other financial liabilities including bank and other borrowings, trade and other payables and amounts due to related parties are subsequently measured at amortised cost, using the effective interest method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments and hedging

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

Impairment losses on tangible and intangible assets (other than goodwill)

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the tangible and intangible assets is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

5. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group's accounting policies, which are described in Note 4, management has made the following estimates that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Estimated impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise. As at 31 December 2008 and 2007, the carrying amount of goodwill is RMB142,973,000. Details of the recoverable amount calculation are disclosed in note 18.

Estimated allowance for doubtful debts of trade receivables

The Group makes allowance for doubtful debts based on an assessment of the recoverability of debtors. Allowances are made on trade debtors whenever there is any objective evidence that the balances may not be collectible. In determining whether an allowance for bad and doubtful debts is required, the Group takes into consideration the aging status and the likelihood of collection. Following the identification of doubtful debts, the responsible sale personnel discuss with the relevant customers and report on the recoverability. Specific allowance is only made for trade receivables that are unlikely to be collected. Where the expectation on the recoverability of the debts is different from the original estimate, such difference will impact the carrying amounts of debtors and doubtful debt expenses in the periods in which such estimate has been changed.

The carrying amount of trade debtors at 31 December 2008 is RMB443,387,000 (net of allowance for bad and doubtful debts of RMB28,534,000) (2007: RMB232,957,000 (net of allowance for bad and doubtful debts of RMB3,958,000).

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6. BUSINESS AND GEOGRAPHICAL SEGMENTS

Business segments

No business segment information is presented as over 90% of the Group's operations relate to the sale of petroleum machinery.

Geographical segments

The Group's operating business is with customers based in the PRC, the United States, Japan and other countries. Each of the Group's geographical segments represents customer destinations to which the Group sells products or provides services which are subject to risks and returns that are different from those of the other geographical segments. These geographical segments are the basis on which the Group report its primary segment.

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

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's geographical segments for the years ended 31 December 2008 and 2007:

	PRC		United States		Japan		Other countries		Consolidated	
	2008 RMB'000	2007 RMB'000	**2008 RMB'000**	2007 RMB'000	**2008 RMB'000**	2007 RMB'000	**2008 RMB'000**	2007 RMB'000	**2008 RMB'000**	2007 RMB'000 (restated)
Segment revenue	**1,442,096**	892,161	**608,191**	286,701	**238,089**	124,198	**470,302**	397,345	**2,758,678**	1,700,405
Result										
Segment result	**253,538**	162,232	**105,089**	46,597	**41,139**	20,186	**81,263**	64,579	**481,029**	293,594
Unallocated corporate income									**17,119**	33,639
Gain on fair value of foreign currency forward contracts									**5,270**	–
Share of results of associates									**332**	4,196
Unallocated corporate expenses									**(101,479)**	(66,666)
Finance costs									**(49,015)**	(26,524)
Profit before taxation									**353,256**	238,239
Income tax expense									**(33,857)**	(37,210)
Profit for the year									**319,399**	201,029

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6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(continued)*

Consolidated balance sheet

	PRC		United States		Japan		Other countries		Consolidated	
	2008	2007	**2008**	2007	**2008**	2007	**2008**	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000 (restated)
Assets										
Segment assets	**890,559**	575,151	**167,651**	131,039	**52,332**	16,688	**128,783**	104,612	**1,239,325**	827,490
Unallocated assets									**2,096,084**	1,441,322
Consolidated total assets									**3,335,409**	2,268,812
Liabilities										
Segment liabilities	**35,165**	7,077	**524**	333	**–**	115	**934**	46,695	**36,623**	54,220
Unallocated liabilities									**2,188,763**	1,374,814
Consolidated total liabilities									**2,225,386**	1,429,034

Analysis of other information including capital addition, depreciation and amortisation, allowance for trade receivables, reversal of allowance for inventories and other receivables has not been presented as all of them are attributable to the PRC.

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7. OTHER INCOME

	2008 RMB'000	2007 RMB'000 (restated)
Other income comprises:		
Bank interest income	8,363	6,970
Gain on disposal of prepaid lease payments	—	2,394
Gain on disposal of property, plant and equipment	—	5,997
Government subsidies	5,556	7,334
Penalty fee income	978	753
Profit from sale of scrap and raw materials	—	10,410
Reversal of allowance for inventories	4,138	4,584
Reversal of allowance for trade receivables	—	2,240
Reversal of allowance for other receivables	219	—
Others	1,798	402
VAT refund (note)	424	9,789
	21,476	50,873

Note: The VAT refund for the years ended 31 December 2008 and 2007 represented the VAT received by 濰坊墨龍鑽採設備有限公司 (Weifang Molong Drilling Equipment Company Limited) ("Molong Drilling Equipment"), a subsidiary of the Group, which was approved by 國家稅務總局 (State Administration of Taxation) as a welfare enterprise (民政福利企業). According to the tax document Cai Shui [2007] No.92, "Notice about the levy of turnover tax of welfare enterprises for the purpose of encouraging employment for the disabled issued by the State Tax Bureau" (「關於促進殘疾人就業稅收優惠政策的通知」), the output VAT paid by Molong Drilling Equipment was refundable.

8. FINANCE COSTS

	2008 RMB'000	2007 RMB'000 (restated)
Interest on bank and other borrowings wholly repayable within five years	51,750	26,524
Less: Amount capitalised in construction in progress	(2,735)	—
	49,015	26,524

Borrowing costs capitalised during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 6.3% (2007: nil) per annum to expenditure on qualifying assets.

9. INCOME TAX EXPENSE

	2008	2007
	RMB'000	RMB'000
The income tax expense comprises:		
Current taxation	**40,283**	32,004
Deferred taxation (note 32)	**(6,426)**	5,206
	33,857	37,210

On 15 January 2009, the Company was named as one of the 2008 Shandong Province New and High Technical Enterprise (山東省高新技術企業). According to the PRC Law on Enterprise Income Tax promulgated on 16 March 2007, the Company is entitled to a concessionary rate of income tax at 15% over 3 years, beginning on 1 January 2008. The Company was subject to 33% PRC corporate income tax in 2007.

For the subsidiaries located in Mainland China, they are subject to the PRC corporate income tax at a rate of 25% (2007: 33%) on its assessable profits. The subsidiary in Hong Kong is subject to Hong Kong Profits Tax rate of 16.5% (2007: 17.5%) on its assessable profits.

The income tax expense for the year can be reconciled to the profit before taxation per the consolidation income statement as follows:

Year ended 31 December 2008

	RMB'000
Profit before taxation	**353,256**
Tax at statutory tax rate of 15%	**52,988**
Additional tax benefit on qualified plant and machinery (note)	**(30,195)**
Tax exemption granted to a welfare enterprise for the year	**(106)**
Additional deductible research and development expenses	**(1,413)**
Tax effect of expenses not deductible for tax purpose	**956**
Tax effect of income not taxable for tax purpose	**(1,677)**
Effect of different tax rates of subsidiaries	**13,449**
Decrease in opening deferred tax assets resulting from decrease in applicable tax rate	**1,419**
Others	**(1,564)**
Income tax expense for the year	**33,857**

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9. INCOME TAX EXPENSE *(continued)*

Year ended 31 December 2007

	RMB'000
Profit before taxation	238,239
Tax at statutory tax rate of 33%	78,619
Additional tax benefit on qualified plant and machinery (note)	(29,819)
Tax exemption granted to a welfare enterprise for the year	(7,248)
Additional deductible research and development expenses	(3,264)
Tax effect of expenses not deductible for tax purpose	1,034
Tax effect of income not taxable for tax purpose	(4,172)
Decrease in opening deferred tax assets resulting from decrease in applicable tax rate	2,214
Others	(154)
Income tax expense for the year	37,210

Note: Pursuant to the relevant tax rules and regulations, the Company claimed PRC Enterprise Income Tax credits on 40% of the acquisition cost of certain qualified plant and machinery in PRC Enterprise Income Tax Expenses.

10. PROFIT FOR THE YEAR

	2008 RMB'000	2007 RMB'000 (restated)
Profit for the year has been arrived at after charging:		
Auditors' remuneration	**600**	900
Allowance for trade receivables	**24,576**	—
Amortisation of intangible asset	**941**	314
Depreciation of property, plant and equipment	**65,669**	39,917
Foreign exchange losses	**—**	1,453
Loss on disposal of property, plant and equipment (included in other expenses)	**600**	—
Release of prepaid lease payments	**2,050**	929
Research and development costs (included in administrative expenses)	**18,245**	19,778
Rental expense	**—**	323
Staff costs, including directors' emoluments (note 11)	**77,827**	49,987
and after crediting:		
Bank interest income	**8,363**	6,970
Foreign exchange gains	**44**	—
Gain on fair value change of foreign currency forward contracts	**5,270**	—
Gain on disposal of property, plant and equipment	**—**	5,997
Gain on disposal of prepaid lease payments	**—**	2,394
Reversal of allowance for inventories	**4,138**	4,584
Reversal of allowance for trade receivables	**—**	2,240
Reversal of allowance for other receivables	**219**	—
Rental income	**—**	743

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11. DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The emoluments paid or payable on each of the 12 (2007: 12) directors and supervisors were as follows:

	Directors						Independent non-executive directors			Supervisors			
	Zhang En Rong RMB'000	Zhang Yun San RMB'000	Lin Fu Long RMB'000	Xie Xin Cang RMB'000	Wang Ping RMB'000	Chen Jian Xiong RMB'000	Qin Xue Chang RMB'000	Yan Yi Zhuang RMB'000	Loke Yu, alias Loke Hoi Lam RMB'000	Li Bao Hui RMB'000	Liu Wan Fu RMB'000	Fan Ren Yi RMB'000	Total RMB'000
2008													
Fees	—	—	—	—	—	—	30	60	90	—	—	—	180
Basic salaries and allowances	550	415	245	295	—	—	—	—	—	60	20	10	1,595
Retirement scheme contribution	—	5	5	5	—	—	—	—	—	—	—	—	15
Total	550	420	250	300	—	—	30	60	90	60	20	10	1,790
2007													
Fees	—	—	—	—	—	—	30	60	90	—	—	—	180
Basic salaries and allowances	565	462	144	257	—	—	—	—	—	60	20	10	1,518
Retirement scheme contribution	—	3	3	3	—	—	—	—	—	—	—	—	9
Total	565	465	147	260	—	—	30	60	90	60	20	10	1,707

12. EMPLOYEES' EMOLUMENTS

Of the five individuals with the highest emoluments in the Group, three (2007: four) were directors of the Company whose emoluments are included in note 11 above. The emoluments of the remaining two (2007: one) were as follows:

	2008 RMB'000	2007 RMB'000
Salaries and other benefits	**585**	220
Retirement benefit scheme contributions	**10**	3
Total emoluments	**595**	223

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13. DIVIDEND

	2008 RMB'000	2007 RMB'000
Dividends recognised as distribution during the year:		
Final - 2007: RMB0.015 (2006: RMB 0.02) per ordinary share	**49,339**	12,960

The final dividend of RMB0.02 (2007: RMB0.015) per ordinary share has been proposed by the directors and is subject to approval by the shareholders in general meeting.

14. EARNINGS PER SHARE

The calculation of the basic earnings per share attributable to the ordinary equity holders of the Company is based on the following data:

	2008 RMB'000	2007 RMB'000
Earnings attributable to equity holders of the Company for the purpose of basic earnings per share	**305,811**	200,330

	Number of shares	
	2008 '000	2007 '000 (restated)
Weighted average number of ordinary shares for the purpose of basic earnings per share	**3,289,240**	3,252,303

	2008 RMB	2007 RMB
Weighted average earnings per share	**0.093**	0.062

For the year ended 31 December 2007, the weighted average number of ordinary shares for the purpose of basic earnings per share has been adjusted for the bonus issue on 4 September 2007.

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15. PROPERTY, PLANT AND EQUIPMENT

	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
COST						
At 1 January 2007	104,043	400,587	6,321	8,078	49,650	568,679
Additions	6,408	7,665	1,511	541	251,011	267,136
Acquired from acquisition of subsidiaries (restated)	27,746	60,486	418	213	381	89,244
Disposals	(9,081)	(528)	—	(348)	—	(9,957)
Transferred from investment properties	8,069	—	—	—	—	8,069
Reclassifications	13,592	51,910	131	3,180	(68,813)	—
At 31 December 2007 and 1 January 2008 (restated)	150,777	520,120	8,381	11,664	232,229	923,171
Additions	16,264	73,139	3,772	1,770	157,321	252,266
Disposals	—	(3,820)	(283)	(832)	—	(4,935)
Reclassifications	36,380	210,856	31,975	—	(279,211)	—
At 31 December 2008	203,421	800,295	43,845	12,602	110,339	1,170,502
DEPRECIATION AND IMPAIRMENT						
At 1 January 2007	11,065	45,711	2,707	4,041	—	63,524
Charge for the year	5,574	31,982	1,015	1,346	—	39,917
Disposals	(4,585)	(261)	—	(292)	—	(5,138)
Transferred from investment properties	405	—	—	—	—	405
At 31 December 2007 and 1 January 2008 (restated)	12,459	77,432	3,722	5,095	—	98,708
Charge for the year	8,151	51,064	4,534	1,920	—	65,669
Disposals	—	(2,704)	(210)	(656)	—	(3,570)
At 31 December 2008	20,610	125,792	8,046	6,359	—	160,807
CARRYING VALUES						
At 31 December 2008	182,811	674,503	35,799	6,243	110,339	1,009,695
At 31 December 2007 (restated)	138,318	442,688	4,659	6,569	232,229	824,463

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

The above items of property, plant and equipment other than construction in progress are depreciated on a straight line basis at the following rates per annum:

Buildings	Over the shorter of the term of lease, or 20 years
Plant and machinery	2 - 20 years
Electronic equipment	3 - 5 years
Motor vehicles	5 years

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

The Group is in the process of applying for the property ownership certificate for buildings with net carrying value of RMB11,573,000 (2007: RMB11,872,000).

16. PREPAID LEASE PAYMENTS

The Group's prepaid lease payments at the balance sheet dates comprise of leasehold land outside Hong Kong under medium-term lease.

	2008 **RMB'000**	2007 RMB'000 (restated)
Analysed for reporting purposes as:		
Current assets	**2,100**	1,940
Non-current assets	**91,083**	91,516
	93,183	93,456

The Group is in the process of applying for the land use right for prepaid lease payments with carrying value of RMB1,614,000 (2007: RMB1,648,000).

17. INVESTMENT PROPERTIES

	RMB'000 (restated)
COST	
At 1 January 2007	8,069
Transferred to leasehold properties	(8,069)
At 31 December 2007 (restated) and 2008	—
AMORTISATION	
At 1 January 2007	405
Transferred to leasehold properties	(405)
At 31 December 2007 (restated) and 2008	—
CARRYING VALUES	
At 31 December 2008	—
At 31 December 2007 (restated)	—

The investment properties comprised of buildings only.

18. GOODWILL

	RMB'000 (restated)
COST	
At 1 January 2007	—
Arising on acquisition of subsidiaries (note 36)	142,973
At 31 December 2007, 1 January 2008 and 31 December 2008	142,973

The carrying amount of goodwill of RMB142,973,000 as at 31 December 2008 is allocated to the cash generating unit ("CGU") of the Group's operations relate to the sale of petroleum machinery. The management of the Group determined that there is no impairment of its goodwill at 31 December 2008.

The basis of the recoverable amount of the CGU and its major underlying assumption are summarised below:

The recoverable amount of the CGU is determined based on a value-in-use calculation. That calculation uses cash flow projects based on budgets approved by management covering a 4-year period, and discount rate of 10% (2007:10%). No growth rate is presumed in estimating the cash flows beyond the 4-year period.

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19. INTANGIBLE ASSETS

	Development costs RMB'000	Software RMB'000	Total RMB'000
COST			
At 1 January 2007	—	584	584
Additions	—	438	438
At 31 December 2007 and 1 January 2008	—	1,022	1,022
Additions	11,993	—	11,993
At 31 December 2008	11,993	1,022	13,015
AMORTISATION			
At 1 January 2007	—	331	331
Provided for the year	—	314	314
At 31 December 2007 and 1 January 2008	—	645	645
Provided for the year	600	341	941
At 31 December 2008	600	986	1,586
CARRYING VALUES			
At 31 December 2008	11,393	36	11,429
At 31 December 2007	—	377	377

Development costs were internally generated and have definite useful lives. Such intangible assets are amortised on a straight line basis over five years.

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20. INVESTMENT IN AN ASSOCIATE

	2008 RMB'000	2007 RMB'000 (restated)
Share of net assets – unlisted	**2,339**	2,157

Details of the Group's principal associates as at 31 December 2008 and 2007 are as follows:

Name	Legal form of business	Place of incorporation or registration/ operation	Percentage of registered capital indirectly held by the Group	Registered capital	Principal activities
克拉瑪依亞龍石油泵有限公司 (Kelamayi Ya Long Oil Pump Company Limited) ("Yalong Oil Pump")	Limited enterprise	PRC	30%	RMB4,500,000	Manufacture and sale of oil well pumps

The summarised financial information of the Group's associates is set out below:

Financial position

	2008 RMB'000	2007 RMB'000 (restated)
Total assets	**8,992**	8,834
Total liabilities	**(1,409)**	(1,212)
Net assets	**7,583**	7,622
Group's share of net assets of associate	**2,339**	2,157

Results for the year

	2008 RMB'000	2007 RMB'000
Revenue	**17,470**	15,460
Profit for the year	**1,105**	737

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21. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets comprise:

	2008 **RMB'000**	2007 RMB'000
Unlisted equity investment, at cost:		
壽光彌河水務有限公司 (Shouguang Mihe Water Company Limited) ("Mihe Water")	**10,000**	10,000

The unlisted equity investment of the Group at 31 December 2008 and 2007 represented a 9.7% equity interest held in Mihe Water, which was incorporated in the PRC on 5 November 2007 with a registered capital of RMB102,800,000. It is measured at cost less impairment at the balance sheet date as the directors of the Company are of the opinion that its fair value cannot be measured reliably.

22. INVENTORIES

	2008 **RMB'000**	2007 RMB'000 (restated)
Raw materials	**255,092**	153,482
Work in progress	**281,316**	182,019
Finished goods	**259,530**	259,032
	795,938	594,533

23. TRADE AND OTHER RECEIVABLES AND BILLS RECEIVABLES

	2008 **RMB'000**	2007 RMB'000 (restated)
Trade and other receivables:		
Trade receivables	**443,387**	232,957
Deposits and other receivables	**6,125**	5,198
Prepayments	**94,252**	30,783
	543,764	268,938
Bills receivables	**32,115**	28,080
	575,879	297,018

23. TRADE AND OTHER RECEIVABLES AND BILLS RECEIVABLES *(continued)*

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of three months, extending up to six months for major customers. The aged analysis of trade receivables net of allowance for doubtful debts is stated as follows:

	2008	2007
	RMB'000	RMB'000
		(restated)
Within three months	**390,444**	204,996
Three to six months	**24,255**	21,833
Six months to one year	**19,060**	4,219
Over one year	**9,628**	1,909
	443,387	232,957

Bills receivables are all aged within six months.

Trade receivables at the balance sheet dates mainly comprise amounts receivable from sales of petroleum extraction machinery and related accessories. No interest is charged on the trade receivables.

Included in trade receivables are debtors with carrying amounts of approximately RMB28,688,000 (2007: RMB6,128,000) which are past due at the balance sheet dates for which the Group had not provided for impairment loss as there has not been a significant change in credit quality and the amounts are still considered recoverable. The Group does not hold any collateral over these balances.

Ageing of trade receivables which are past due but not impaired:

	2008	2007
	RMB'000	RMB'000
		(restated)
One to six months past due	**19,060**	4,219
Six months to over one year past due	**9,628**	1,909
	28,688	6,128

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23. TRADE AND OTHER RECEIVABLES AND BILLS RECEIVABLES *(continued)*

Movement in the allowance for doubtful debts

	2008	2007
	RMB'000	RMB'000
		(restated)
Balance at beginning of the year	**3,958**	6,434
Allowance made	**28,526**	—
Amounts written off as uncollectible	**—**	(236)
Allowance reversed	**(3,950)**	(2,240)
Balance at end of the year	**28,534**	3,958

At 31 December 2008, trade receivables amounting to approximately RMB50,644,000 (2007: Nil) were used to secure certain bank facilities granted to the Group.

The Group's trade receivables which are denominated in currencies other than the functional currencies of the relevant group entities are set out below:

	2008	2007
	RMB'000	RMB'000
United States Dollars	**165,295**	91,056
Euro	**7,783**	—

24. AMOUNT DUE FROM AN ASSOCIATE

The amount is of trade nature, unsecured, interest-free and repayable on demand. The amount is aged within three months.

25. DERIVATIVE FINANCIAL INSTRUMENT

	2008		2007	
	Assets	**Liabilities**	Assets	Liabilities
	RMB'000	**RMB'000**	RMB'000	RMB'000
Foreign currency forward contracts	**49,650**	**44,380**	—	—

At the balance sheet date, major terms of the outstanding foreign currency forward contracts are as follows:

At 31 December 2008

Notional amount	**Date of maturity**	**Forward contract rates**
1 contract to buy US$20,000,000	24 April 2009	US$1 to RMB6.360
1 contract to buy US$30,000,000	24 April 2009	US$1 to RMB6.360
1 contract to buy US$10,000,000	24 April 2009	US$1 to RMB6.359
2 contracts to buy US$20,000,000 each	24 April 2009	US$1 to RMB6.359
1 contract to sell US$100,000,000	24 April 2009	US$1 to RMB6.429

The above forward contracts are required to be settled net in cash on maturity date and were measured at fair value at each balance sheet dates. Their fair values were determined based on the valuation provided by counterparty financial institutions for equivalent instruments at the balance sheet date.

26. BANK BALANCES AND CASH/PLEDGED BANK DEPOSITS

Bank balances and cash comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less.

Bank balances are interest bearing at respective saving deposits rate in the PRC, and the effective interest rates of the Group's bank balances ranged from 0.36% to 0.72% (2007: 0.72% to 0.81%) per annum.

At 31 December 2008, bank balances amounting to approximately RMB413,967,000 (2007: RMB163,957,000) were pledged to banks for securing bank facilities granted to the Group. The pledged bank balances carry interest rates ranged from 0.36% to 0.72% (2007: 0.72% to 0.81%) per annum.

The Group's pledged bank deposits and bank balances and cash which are denominated in currencies other than the functional currencies of the relevant group entites are set out below:

	2008	2007
	RMB'000	RMB'000
Hong Kong Dollars	**20**	41
United States Dollars	**18,335**	1,451

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27. TRADE AND BILLS PAYABLES

The following is an aged analysis by invoice date of trade and bills payables at the balance sheet date:

	2008 RMB'000	2007 RMB'000 (restated)
Within three months	**529,074**	323,593
Three to six months	**568,194**	220,666
Six months to one year	**17,132**	11,274
Over one year	**40,978**	19,506
	1,155,378	575,039

The Group's bills payable of RMB770,211,000 (2007: RMB376,744,000) were secured by the pledge of certain of the time deposits amounting to RMB413,967,000 (2007: RMB163,957,000) (note 26). The average credit period on purchase is six months. The Group has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

28. OTHER PAYABLES AND ACCRUED CHARGES

	2008 RMB'000	2007 RMB'000 (restated)
Advance from customers	**36,623**	54,220
Payroll payable	**23,440**	23,191
Other payables	**48,839**	32,142
Balance of consideration paid for acquisition of subsidiaries (note 36)	**14,510**	50,169
Accruals	**31,842**	1,081
	155,254	160,803

Other payables are interest-free.

The Group's other payables which are denominated in currencies other than the functional currencies of the relevant group entities are set out below:

	2008 RMB'000	2007 RMB'000
Hong Kong Dollars	**1,646**	—

29. AMOUNTS DUE TO RELATED PARTIES

The amounts were of non-trade nature, unsecured, interest-free and fully repaid in 2008.

The related parties represented directors, supervisor, key management personnel of the Company and two sons of the chairman of the Company, while one of them was a director of the Company. They were the major vendors in acquiring the Maolong Machinery as mentioned in note 36. The amount represented part of the acquisition cost payable to them.

30. BANK BORROWINGS

	2008 **RMB'000**	2007 RMB'000 (restated)
The bank borrowings are repayable as follows:		
On demand or within one year	**253,522**	182,120
More than one year, but not exceeding two years	**550,000**	350,000
	803,522	532,120
Less: Amount due within one year shown under current liabilities	**253,522**	182,120
	550,000	350,000
Secured	**50,644**	—
Unsecured	**752,878**	532,120
	803,522	532,120

The range of effective interest rates (which are also equal to contracted interest rates) on the Group's bank borrowings are as follows:

	2008	2007
Effective interest rates:		
Fixed-rate borrowings	**6.12% to 7.49%**	6.12% to 6.57%
Variable-rate borrowings	**5.75% to 7.47%**	6.12% to 7.29%

The Group's bank borrowings of RMB50,644,000 (2007: Nil) were secured by certain of the trade receivables amounting to RMB50,644,000 (2007: Nil) (note 23).

30. BANK BORROWINGS *(continued)*

The Group's bank borrowings which are denominated in currencies other than the functional currencies of the relevant group entities are set out below:

	2008 **RMB'000**	2007 RMB'000
United States Dollars	**62,878**	24,120

31. OTHER BORROWING

The other borrowing is a short-term loan which is unsecured, bearing fixed interest rate at 7.2% (2007: 7.3%) per annum and repayable within one year.

32. DEFERRED TAXATION

The deferred tax (liabilities) assets recognised and movements thereon during the current and prior years are as follows:

	Fair value adjustment arising from acquisition of subsidiaries RMB'000 (restated)	Allowance on fixed assets RMB'000	Allowance on inventories RMB'000	Allowance on receivables RMB'000	Accrued expenses RMB'000	Deferred development costs RMB'000	Derivative financial instruments RMB'000	Unrealised profit RMB'000	Depreciation in excess of depreciation allowance RMB'000	Total RMB'000
At 1 January 2007	—	—	4,482	2,069	1,542	—	—	—	849	8,942
Effect of change in tax rate	—	—	(1,110)	(512)	(382)	—	—	—	(210)	(2,214)
Deferred tax charged to the consolidated income statement for the year	—	—	(909)	(807)	(936)	—	—	—	(340)	(2,992)
Acquisition of subsidiaries	(13,284)	10,318	673	680	—	—	—	—	—	(1,613)
At 31 December 2007 at 1 January 2008 (restated)	(13,284)	10,318	3,136	1,430	224	—	—	—	299	2,123
Effect of change in tax rate	—	—	(910)	(300)	(90)	—	—	—	(119)	(1,419)
Deferred tax credit (charge) to the consolidated income statement for the year	2,112	(488)	(806)	3,761	(134)	45	(1,535)	5,070	(180)	7,845
At 31 December 2008	**(11,172)**	**9,830**	**1,420**	**4,891**	**—**	**45**	**(1,535)**	**5,070**	**—**	**8,549**

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32. DEFERRED TAXATION *(continued)*

For the purposes of balance sheet presentation, certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances for financial reporting purposes:

	2008 **RMB'000**	2007 RMB'000 (restated)
Deferred tax liabilities	**(19,364)**	(13,284)
Deferred tax assets	**27,913**	15,407
	8,549	2,123

33. SHARE CAPITAL

	Number of ordinary shares	**RMB'000**
Ordinary shares of RMB0.1 each		
Authorised:		
– at 1 January 2007	647,998,000	64,800
– increase during the year	2,641,244,000	264,124
– at 31 December 2007 and 2008	3,289,242,000	328,924
Issued and fully paid:		
– at 1 January 2007	647,998,000	64,800
– bonus issue of shares	2,591,992,000	259,200
– placement of shares	49,252,000	4,924
– at 31 December 2007 and 2008	3,289,242,000	328,924

On 25 May 2007, 2,591,992,000 new bonus shares of RMB0.1 each of the Company were issued to the shareholders in the proportion of two bonus shares for every existing shares by way of capitalisation of the retained profit and capital reserve of the Company of RMB129,600,000 and RMB129,600,000 respectively.

In September 2007, the Company entered into a placing agreement with independent placing agents and issued in aggregate 49,252,000 new shares of RMB0.1 each of the Company at a price of HK$1.70 per Share. The Company planned to use the proceeds for working capital of the Group.

The shares issued rank pari passu in all respects with the then existing shares of the Company.

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34. CAPITAL RISK MANAGEMENT

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from prior years. The capital structure of the Group consists of cash and cash equivalents, bank and other borrowings, and equity attributable to equity holders of the Group, comprising issued share capital and retained profits.

The directors of the Company review the capital structure on a semi-annual basis. As part of this review, the directors consider the cost of capital and risks associates with each class of capital. Based on recommendations of the directors, the Group will balance its overall structure through the payment of dividends, new share issues and share repurchases as well as the issue of new debt or the redemption of existing debt.

35. FINANCIAL INSTRUMENTS

(a) Categories of financial instruments

	2008 **RMB'000**	2007 RMB'000 (restated)
Financial assets		
Fair value through profit or loss (FVTPL)	**49,650**	—
Loans and receivables (including cash and cash equivalents)		
Trade and other receivables	**447,411**	235,189
Bills receivables	**32,115**	28,080
Amounts due from an associate	**531**	1,449
Pledged bank deposits	**413,967**	163,957
Bank balances and cash	**195,133**	109,580
	1,089,157	538,255
Available-for-sale investments	**10,000**	10,000
Financial liabilities		
Fair value through profit or loss (FVTPL)	**44,380**	—
Other financial liabilities at amortised cost		
Trade and bills payables	**1,155,378**	575,039
Other payables	**108,634**	110,283
Amounts due to related parties	**—**	98,704
Bank borrowings	**803,522**	532,120
Other borrowings	**15,000**	5,000
	2,082,534	1,321,146

35. FINANCIAL INSTRUMENTS *(continued)*

(b) Financial risk management and policies

The Group's major financial instruments include trade and other receivables, amount due from an associate, pledged bank deposits, bank balances and cash, trade and bills payable, other payables, amounts due to related parties, bank and other borrowings and derivative financial instruments. Details of these financial instruments are disclosed in respective notes. The risk associated with these financial instruments include market risk (currency risk), credit risk and liquidity risk and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Market risk

Foreign currency risk

Several subsidiaries of the Group have foreign currency sales and purchases and certain trade receivables, bank deposits, other payables and bank borrowings are denominated in foreign currencies other than the respective functional currencies of the relevant group entities and thus expose the Group to foreign currency risk. The management continuously monitors the foreign exchange exposure and will consider hedging foreign currency risk should the need arise.

The carrying amounts of the Group's significant foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Assets		**Liabilities**	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Hong Kong Dollars	**20**	41	**1,646**	—
United States Dollars	**183,630**	92,507	**62,878**	24,120
Euro	**7,783**	—	**—**	—

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35. FINANCIAL INSTRUMENTS *(continued)*

(b) Financial risk management and policies *(continued)*

Market risk (continued)

Sensitivity analysis

The Group is mainly exposed to the effect of fluctuation in Hong Kong Dollars, United States Dollars and Euro. The following table details the Group's sensitivity to a 5% increase and decrease in the functional currency exchange rates of the relevant group entities against the relevant foreign currencies. 5% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes outstanding foreign currency denominated monetary items and adjusts their translation at the year end for a 5% change in foreign currency exchange rates. A negative number below indicates a decrease in post-tax profit for the year where the functional currencies of the relevant subsidiaries strengthen 5% against relevant foreign currency. For a 5% weakening of the functional currencies of the relevant group entities against the relevant foreign currency, there would be an equal and opposite impact on the profit, and the balances below would be positive.

	2008	2007
	RMB'000	RMB'000
Hong Kong dollars	**68**	(2)
United States Dollars	**(5,160)**	(2,110)
Euro	**(331)**	—

Interest rate risk

The Group's cash flow interest rate risk relates primarily to variable-rate bank loans (see note 30) and bank balances and deposits (see note 26). The management considers the Group's exposure of the variable-rate bank loans and bank balances and deposits to interest rate risk is not significant as they have a short maturity period.

The Group is also exposed to fair value interest rate risk in relation to fixed-rate bank borrowings (see note 30). The management monitors interest rate exposure and will consider repay the fixed-rate bank borrowings when significant interest rate exposure is anticipated.

The Group's exposure to interest rates on financial liabilities are detailed in the liquidity risk section of this note. The Group's cash flow interest rate risk is mainly concentrated on the fluctuation of lending rate announced by The People's Bank of China arising from the Group's RMB denominated borrowings.

Sensitivity analysis

The sensitivity analysis below have been determined based on the exposure to interest rates at the balance sheet date. The analysis is prepared assuming the amount of variable-rate bank loans and bank balances and deposits at the balance sheet date was the amount outstanding for the whole year.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Group's post-tax profit for the year ended 31 December 2008 would increase/decrease by RMB14,823,000 (decrease/increase by 2007: RMB473,000). This is mainly attributable to the Group's exposure to interest rates on its variable-rate bank balances and deposits and bank borrowings.

35. FINANCIAL INSTRUMENTS *(continued)*

(b) Financial risk management and policies *(continued)*

Credit risk management

As at 31 December 2008, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to perform an obligation by the counterparties, is the carrying amount of the respective recognised financial assets as stated in the consolidated balance sheet.

In order to minimise the credit risk in relation to trade receivables, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the majority of the counterparties are reputable banks or banks with high credit-ratings assigned by international credit-rating agencies.

Credit risk is concentrated as 15% (2007: 18%) and 45% (2007: 45%) of the total trade receivables are due from the Group's largest customer and the five largest customers within the manufacture and sales of petroleum machinery business segment. However, the management considers, based on the strong financial background and good creditability of those debtors, there are no significant credit risks.

Liquidity risk management

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and mitigate the effects of fluctuations in cash flows. The Group relies on borrowings as a significant source of liquidity.

The Group relies on bank borrowings as a significant source of liquidity. As at 31 December 2008, the Group has available unutilised bank borrowings facilities of approximately RMB412,985,000 (2007: RMB354,560,000).

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35. FINANCIAL INSTRUMENTS *(continued)*

(b) Financial risk management and policies *(continued)*

Liquidity risk management (continued)

Liquidity tables

The following tables detail the Group's remaining contractual maturity for its financial liabilities and derivative financial assets. For non-derivative financial liabilities, the tables reflect the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The tables include both interest and principal cash flows.

For derivative instruments settled on a net basis, undiscounted net cash outflows (inflows) are presented.

	Effective interest rate %	On demand or less than 3 months RMB'000	3 months to 1 year RMB'000	More than 1 year RMB'000	Total undiscounted cash flows RMB'000	Total carrying amount at 31.12.2008 RMB'000
2008						
Non-derivative financial liabilities						
Trade and bills payables	—	422,472	732,906	—	1,155,378	1,155,378
Other payables	—	108,634	—	—	108,634	108,634
Bank borrowings						
– Fixed rate	6.59	158,310	26,648	373,065	558,023	523,522
– Variable rate	6.39	50,937	34,153	212,552	297,642	280,000
Other borrowings	7.20	15,270	—	—	15,270	15,000
		755,623	793,707	585,617	2,134,947	2,082,534
Derivative - net settlement						
Foreign currency forward contracts						
– inflows	—	—	(49,650)	—	(49,650)	(49,650)
– outflows	—	—	44,380	—	44,380	44,380
		—	(5,270)	—	(5,270)	(5,270)

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35. FINANCIAL INSTRUMENTS *(continued)*

(b) Financial risk management and policies *(continued)*

Liquidity risk management (continued)

Liquidity tables (continued)

	Effective interest rate %	On demand or less than 3 months RMB'000	3 months to 1 year RMB'000	More than 1 year RMB'000	Total undiscounted cash flows RMB'000	Total carrying amount at 31.12.2007 RMB'000
2007						
Non-derivative financial liabilities						
Trade and bills payables	—	223,164	351,875	—	575,039	575,039
Other payables	—	110,283	—	—	110,283	110,283
Amount due to related parties	—	98,704	—	—	98,704	98,704
Bank borrowings						
– Fixed rate	6.57	—	74,599	191,826	266,425	250,000
– Variable rate	6.41	93,693	25,614	180,897	300,204	282,120
Other borrowings	7.29	5,091	—	—	5,091	5,000
		530,935	452,088	372,723	1,355,746	1,321,146

(c) Fair value

The fair value of financial assets and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.

The fair value of derivative financial instruments are determined based on the valuation provided by counterparty financial institutions for equivalent instruments.

The directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values.

36. BUSINESS COMBINATION

On 27 December 2007, the Group acquired 100% equity interest in Maolong Machinery, which was controlled by related parties of the Company (please refer to note 29 for details of related parties relationships). Maolong Machinery and its subsidiary were engaged in the manufacture and sale of special petroleum metal materials and oil extraction machinery accessories. The consideration for the acquisition was RMB306,744,000 in the form of cash.

The initial accounting for the above business combination had been determined provisionally by the end of the period in which the combination was effected because the completion of the acquisition was effected towards the year end date and the fair values being assigned to the acquiree's identifiable assets and liabilities could only be determined provisionally. Therefore, the differences between the final and initial carrying amount and the differences between the final and provisional fair value were adjusted after the finalisation of the identification and valuation of Maolong Machinery's assets and liabilities.

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

	Carrying amount RMB'000	Provisional fair value RMB'000	Finalised fair value RMB'000	Differences RMB'000
NET ASSETS ACQUIRED				
Property, plant and equipment	80,037	85,094	89,244	4,150
Investment properties	1,030	3,574	—	(3,574)
Prepaid land lease payments	7,247	42,064	45,755	3,691
Investment in an associate	2,142	2,142	2,157	15
Long term prepayment	6,704	6,704	6,704	—
Deferred tax assets	11,969	11,969	11,671	(298)
Inventories	145,765	157,135	152,500	(4,635)
Trade receivables	22,695	22,695	22,695	—
Bills receivable	2,400	2,400	2,400	—
Prepayments, deposits and other receivables	13,939	14,673	13,939	(734)
Due from an associate	677	677	677	—
Cash and bank balances	9,506	9,506	9,506	—
Trade and bills payables	(78,160)	(78,160)	(78,160)	—
Other payables and accruals	(30,478)	(30,478)	(28,720)	1,758
Other borrowings	(5,000)	(5,000)	(5,000)	—
Due to related parties	(14,524)	(14,524)	(14,524)	—
Tax payable	(14,524)	(14,524)	(11,352)	3,172
Deferred tax liabilities	—	(13,631)	(13,284)	347
Interest-bearing bank loans	(30,000)	(30,000)	(30,000)	—
	131,425	172,316	176,208	3,892
Interest in an associate (note a)		(12,062)	(12,062)	—
Minority interests		(625)	(375)	250
Goodwill on acquisition		147,115	142,973	(4,142)
Satisfied by cash (note b)		306,744	306,744	—

36. BUSINESS COMBINATION *(continued)*

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

	RMB'000
Cash consideration (note c)	157,871
Cash and bank balances acquired	(9,506)
Net outflow of cash and cash equivalents in respect of the acquisition of a subsidiary	148,365

Notes:

(a) The Group has 25% equity interest in a subsidiary of Maolong Machinery at the time of acquisition.

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

(c) Cash consideration of RMB157,871,000 was paid in 2007. The unpaid consideration of RMB148,873,000 at 31 December 2007 were included in other payable (RMB50,169,000) and amounts due to related parties (RMB98,704,000) of which RMB134,363,000 was subsequently paid in 2008, remaining balance of RMB14,510,000 was not yet settled as at 31 December 2008.

Maolong Machinery was a supplier of the Group before acquisition. Goodwill arose in the business combination for the expected synergies, stable supply and future market development. These benefits are not recognised separately from goodwill as the future economic benefits arising from them cannot be measured reliably.

The contribution to the profit of the Group by Maolong Machinery between the acquisition date and 31 December 2007 is minimal.

If the acquisition had been completed on 1 January 2007, total group revenue for the year would have been RMB1,751 million, and profit for the year would have been RMB226 million. The proforma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2007, nor it intended to be a projection of future results.

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37. RETIREMENT/PENSION SCHEME BENEFITS

	2008 RMB'000	2007 RMB'000
Salaries and other benefits	**72,206**	45,412
Retirement benefit scheme contributions	**5,621**	4,575
Total	**77,827**	49,987

As stipulated by the laws, orders and regulations of the PRC, the Group participated in various defined contribution retirement plans organised by municipal governments for its staff. Currently, the Group is required to make contributions to the retirement plans at a rate of 20% (2007: 18%) of the salaries, bonuses and certain allowances of its staff. A member of the plan is entitled to a pension, to be paid by the municipal governments, equal to a fixed proportion of the salary prevailing at his retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. When the staff leaves the positions, the Group is not entitled to recover the contributions paid in respect of their pension scheme benefits.

38. CAPITAL COMMITMENTS

	2008 RMB'000	2007 RMB'000 (restated)
Capital expenditure in respect of the acquisition of property, plant and equipment contracted for but not provided in the consolidated financial statements	**255,727**	107,435

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39. RELATED PARTY TRANSACTIONS

(a) In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year. In addition to transactions with associates, certain transactions were entered into between the Group and the following related parties for the period from 1 January 2007 to the date immediately before these related parties became the Group's subsidiaries:

	Notes	**2008 RMB'000**	2007 RMB'000 (restated)
Purchases of raw materials from:			
Weihai Baolong	(i)	—	354,629
壽光墨龍機電設備有限公司 ("Shouguang Molong Electro-mechanical Equipment Company Limited) ("Molong Equipment")	(i)	—	96,346
		—	450,975
Sales of scrap and raw materials to:			
Molong Equipment	(i)	—	26,461
Weihai Baolong	(i)	—	1,547
		—	28,008
Sales of goods:			
Yalong Oil Pump	(ii)	**6,856**	9,880
Subcontracting income from:			
Molong Equipment	(i)	—	176
Subcontracting fees to:			
Molong Equipment	(i)	—	194
Property, plant and equipment purchased from:			
Maolong Machinery	(i)	—	43
Molong Equipment	(i)	—	30
		—	73
Property, plant and equipment sold to:			
Molong Equipment	(i)	—	250
Weihai Baolong	(i)	—	14
	(i)	—	264
Rental income from:			
Molong Equipment	(i)	—	690
Rental expenses to:			
Maolong Machinery	(i)	—	253
Molong Equipment	(i)	—	70
		—	323

Notes:

(i) The Group had acquired all equity interests in Maolong Machinery, and its subsidiaries, on 27 December 2007.

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

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39. RELATED PARTY TRANSACTIONS *(continued)*

(b) Credit facilities of RMB 250 million granted from banks from 21 September 2007 to 21 September 2008 were secured by a personal guarantee given by Mr. Zhang En Rong, a director of the Company.

(c) Compensation of key management personnel:

The remuneration of directors and other members of key management during the year was as follows:

	2008 RMB'000	2007 RMB'000 (restated)
Short-term employee benefits	**2,690**	2,527

Further details of directors' remuneration are included in note 11 to the financial statements. The related party transactions in terms of compensation of key management personnel above also constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules.

40. PARTICULARS OF SUBSIDIARIES OF THE COMPANY

Details of the Company's subsidiaries at 31 December 2008 and 2007are as follows:

Name of subsidiary	Place of incorporation or registration/ operations	Issued and fully paid up share/registered capital	Percentage of registered capital held by the Company		Principal activities
			directly %	indirectly %	
Molong Drilling Equipment	PRC	RMB6,000,000	**100**	—	Manufacture and sales of petroleum extraction machinery
MPM International Limited ("MPM")	Hong Kong	HK$7,800,000	**90**	—	Trading
壽光寶隆石油器材有限公司 (Shouguang Baolong Petroleum Material Company Limited) ("Shouguang Baolong")	PRC	RMB150,000,000	**70**	—	Manufacture and sales of casting pipes
Maolong Machinery	PRC	RMB12,380,000	**100**	—	Manufacture and sales of oil extraction machinery accessories
Molong Equipment	PRC	US$1,000,000	**—**	97.5	Manufacture and sales of oil extraction machinery accessories
壽光懋隆廢舊金屬回收有限公司 (Shouguang Maolong Old Metals Recycle Company Limited) ("Maolong Recycle")	PRC	RMB500,000	**10**	90	Trading of scrap metals

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40. PARTICULARS OF SUBSIDIARIES OF THE COMPANY *(continued)*

Name of subsidiary	Place of incorporation or registration/ operations	Issued and fully paid up share/registered capital	Percentage of registered capital held by the Company		Principal activities
			directly %	indirectly %	
Weihai Baolong	PRC	RMB10,000,000	—	99.9	Manufacture and sales of special petroleum metal materials
文登市寶隆再生資源有限公司 (Wendeng Baolong Recyclable Resource Company Limited) ("Wendeng Recyclable")	PRC	RMB300,000	—	99.99	Trading of scrap metals

None of the subsidiaries had issued any debt securities at the end of the year.

41. OTHER EVENT

Pursuant to the extraordinary general meeting held on 8 January 2009, the Company will apply to the China Securities Regulatory Commission and such other PRC authorities for the issue of not more than 70 million A shares of RMB1 each to individuals, legal persons and institutions with A share accounts at the Shenzhen Stock Exchange (except those who are prohibited from subscribing for A shares pursuant to the relevant PRC laws and regulations and other applicable regulatory requirements).