

FOR THE YEAR ENDED 31ST DECEMBER, 2004

Xian Xigema Certified Public Accountants Firm Limited

Xi Hui Shen Zi Audit Report (2004) No.0482
Auditors' report

To the shareholders of Jiaoda Kunji High-Tech Company Limited

We have audited the Group's and the Company's balance sheet as of 31st December, 2004 and the Group's and the Company's profit and loss account and profits distribution and cash flow statement for the year then ended. These financial statements are the responsibility of the Company. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Independent Auditing Standards for Chinese Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting policies used and significant accounting estimates made by management, as well as evaluating the overall presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements are prepared in conformity with the "Accounting Standard for Business Enterprises", and the "Accounting Regulations for Business Enterprises" and, in all material respects, present fairly the financial positions of the Company as at 31st December, 2004 and the results of its operations and cash flow for the year then ended.

**Xian Xigema Certified Public
Accountants Firm Limited**
Xian, the PRC

Chinese Certified Public Accountants
Wang Xia
Chinese Certified Public Accountants
Fan Min Hua

27th April, 2005

AS AT 31ST DECEMBER, 2004

Unit: RMB

ASSETS	Note	31st December, 2004		31st December, 2003	
		The Group	The Company	The Group	The Company
CURRENT ASSETS:					
Bank balances and cash	5.1	196,667,287.24	121,861,338.59	194,990,479.05	139,866,908.23
Short-term investments	5.2	13,454,045.52	13,454,045.52	—	—
Bills receivable	5.3	17,947,434.06	14,092,474.06	46,962,787.36	16,342,787.36
Dividends receivable		—	4,163,885.27	—	—
Interest receivable		—	—	—	—
Accounts receivable	5.4	77,677,859.61	31,942,562.76	58,337,393.58	24,342,298.64
Other receivables	5.5	11,319,504.70	6,363,471.58	17,218,265.34	31,763,264.07
Prepayments	5.6	61,483,659.31	2,702,984.45	45,297,556.05	4,099,345.89
Subsidies receivable		—	—	—	—
Inventories	5.7	323,471,136.42	209,794,867.01	246,791,009.13	191,884,511.25
Prepaid expenses	5.8	124,123.42	—	88,073.00	—
Net loss on deferred current assets		—	—	—	—
Long-term debt investment due within one year		—	—	—	—
TOTAL CURRENT ASSETS		702,145,050.28	404,375,629.24	609,685,563.51	408,299,115.44
LONG-TERM INVESTMENTS:					
Long-term equity investments	5.9	9,788,087.27	96,412,837.03	11,186,269.67	94,186,997.87
Comprising: consolidated difference in value	5.9	9,788,087.27	9,788,087.27	11,186,269.67	11,186,269.67
Comprising: difference in equity investments	5.9	9,788,087.27	9,788,087.27	11,186,269.67	11,186,269.67
Long-term debt investment		—	—	—	—
Total long-term investments		9,788,087.27	96,412,837.03	11,186,269.67	94,186,997.87
FIXED ASSETS:					
Fixed assets at cost	5.10	456,791,998.78	374,778,182.93	387,865,544.74	348,986,147.46
Less: Accumulated depreciation	5.10	164,769,276.64	147,919,440.68	143,892,855.74	130,898,093.87
FIXED ASSETS, NET BOOK VALUE	5.10	292,022,722.14	226,858,742.25	243,972,689.00	218,088,053.59
Less: Provision for impairment loss	5.10	1,948,216.95	1,948,216.95	2,084,560.17	2,084,560.17
FIXED ASSETS, NET REALISABLE VALUE		290,074,505.19	224,910,525.30	241,888,128.83	216,003,493.42
Project materials		—	—	—	—
CONSTRUCTION IN PROGRESS, NET REALISABLE VALUE					
Disposal of fixed assets	5.11	58,376,694.19	34,931,971.28	46,311,094.07	27,159,121.47
Loss on deferred fixed assets, net		—	—	—	—
TOTAL FIXED ASSETS		348,451,199.38	259,842,496.58	288,199,222.90	243,162,614.89
INTANGIBLE AND OTHER ASSETS					
Intangible assets	5.12	65,344,602.05	25,193,228.41	56,048,518.11	26,220,722.91
Long-term deferred expenditures	5.13	111,441.20	—	683,804.11	345,629.91
Other long-term investments		—	—	—	—
TOTAL INTANGIBLE AND OTHER ASSETS		65,456,043.25	25,193,228.41	56,732,322.22	26,566,352.82
DEFERRED TAXATION:					
Deferred taxation		—	—	—	—
TOTAL ASSETS		1,125,840,380.18	785,824,191.26	965,803,378.30	772,215,081.02

Company's Legal Representative: Zhang Hanrong
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

AS AT 31ST DECEMBER, 2004

Unit: RMB

ASSETS	Note	31st December, 2004		31st December, 2003	
		The Group	The Company	The Group	The Company
CURRENT LIABILITIES:					
Short-term loans	5.14	137,091,000.00	98,000,000.00	119,000,000.00	119,000,000.00
Bills payable		—	—	—	—
Accounts payable	5.15	62,640,557.32	22,005,521.35	48,120,874.13	13,855,693.25
Advances from customers	5.16	294,381,649.15	111,151,535.58	193,023,605.38	77,275,176.41
Accrued salary	5.17	2,401,981.42	2,401,981.42	3,276,822.70	3,233,812.24
Accrued welfare		7,061,979.86	5,094,790.75	4,397,425.79	2,811,771.67
Dividends payable		2,101,732.59	—	1,060,761.27	—
Taxes payable	5.18	14,758,896.08	11,777,336.20	11,089,376.32	7,672,637.54
Other payable	5.19	465,951.33	449,815.00	364,056.53	204,249.00
Other accrual	5.20	25,250,268.44	12,406,383.93	11,347,413.27	5,165,462.42
Accrued expenses	5.21	2,072,716.96	1,779,501.06	2,790,505.57	2,255,318.89
Estimated liabilities		—	—	—	—
Long-term loans due within one year	5.22	342,168.90	342,168.90	342,168.90	342,168.90
Other current liabilities		—	—	10,800.00	10,800.00
TOTAL CURRENT LIABILITIES		548,568,902.05	265,409,034.19	394,823,809.86	231,827,090.32
LONG-TERM LIABILITIES:					
Long-term loans	5.23	—	—	1,500,000.00	1,500,000.00
Long-term payable	5.24	10,482,384.80	3,282,384.80	10,695,593.90	3,495,593.90
Specific project payable	5.25	2,647,563.01	2,647,563.01	2,971,423.01	2,971,423.01
Deferred gain	5.26	9,714,394.95	9,714,394.95	10,579,910.07	10,579,910.07
TOTAL LONG-TERM LIABILITIES		22,844,342.76	15,644,342.76	25,746,926.98	18,546,926.98
DEFERRED TAXATION:					
Deferred taxation		—	—	—	—
TOTAL LIABILITIES		571,413,244.81	281,053,376.95	420,570,736.84	250,374,017.30
MINORITY INTEREST		49,656,321.06	—	23,391,577.74	—
SHAREHOLDERS' EQUITY:					
Share capital	5.27	245,007,400.00	245,007,400.00	245,007,400.00	245,007,400.00
Less: Returned on investment		—	—	—	—
Share capital, net		245,007,400.00	245,007,400.00	245,007,400.00	245,007,400.00
Capital reserves	5.28	305,291,280.12	305,291,280.12	305,280,480.12	305,280,480.12
Surplus reserves	5.29	16,812,657.84	16,812,657.84	16,812,657.84	16,812,657.84
Including: Statutory public welfare fund	5.29	8,406,328.92	8,406,328.32	8,406,328.92	8,406,328.92
Unappropriated profits	5.30	(62,340,523.65)	(62,340,523.65)	(45,259,474.24)	(45,259,474.24)
TOTAL SHAREHOLDERS' EQUITY		504,770,814.31	504,770,814.31	521,841,063.72	521,841,063.72
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		1,125,840,380.18	785,824,191.26	965,803,378.30	772,215,081.02

Company's Legal Representative: Zhang Hanrong
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

FOR THE YEAR ENDED 31ST DECEMBER, 2004

1. STATEMENT OF INCOME

Unit: RMB

ITEMS	Note	2004		2003	
		The Group	The Company	The Group	The Company
1. Principal operating income	5.31	469,436,370.36	284,113,480.62	330,613,353.32	200,027,331.41
Less: Principal operating cost	5.31	339,097,776.38	205,494,287.06	228,563,883.95	138,533,234.26
Principal operation tax and addition	5.32	200,105.93	—	930,360.88	—
2. Principal operating profit		130,138,488.05	78,619,193.56	101,119,108.49	61,494,097.15
Add: Profit from other operations	5.33	1,245,304.71	1,123,734.41	1,742,711.07	1,693,535.65
Less: Selling expenses		31,360,043.52	16,586,900.17	22,448,647.65	14,293,934.74
Administrative expenses		66,762,377.18	39,670,699.98	56,831,336.54	37,204,939.18
Financial expenses	5.34	6,523,140.76	4,327,378.25	5,577,147.17	5,154,305.09
3. Operating profit		26,738,231.30	19,157,949.57	18,004,688.20	6,534,453.79
Add: Investment income	5.35	(38,136,044.49)	(35,306,940.51)	(1,425,758.37)	6,128,396.77
Subsidy income	5.36	2,654,766.16	2,000,000.00	1,642,310.61	1,000,000.00
Non-operating income	5.37	266,062.81	125,712.81	1,476,377.77	1,456,027.77
Less: Non-operating expenses	5.38	1,231,959.04	1,151,339.81	89,997.89	55,860.40
4. Profit before income tax		(9,708,943.26)	(15,174,617.94)	19,607,620.32	15,063,017.93
Less: Income tax	5.39	4,269,092.22	1,906,431.47	2,297,840.74	—
Minority interest		3,103,013.93	—	2,246,761.65	—
5. Net profit for the period		(17,081,049.41)	(17,081,049.41)	15,063,017.93	15,063,017.93

Unit: RMB

SUPPLEMENTARY INFORMATION	2004		2003	
	The Group	The Company	The Group	The Company
1. Profit from sale and disposal of investee companies	—	—	—	—
2. Loss arising from natural disasters	—	—	—	—
3. Increase (decrease) in profit due to change in accounting policies	—	—	—	—
4. Increase (decrease) in profit due to change in accounting estimate	—	—	—	—
5. Loss arising from debt restructuring	—	—	—	—
6. Others	—	—	—	—

Company's Legal Representative: Zhang Hanrong

Financial Controller: Yu Yan

Prepared by: Zhao Qiongfeng

FOR THE YEAR ENDED 31ST DECEMBER, 2004

2. STATEMENT OF APPROPRIATION*Unit: RMB*

ITEMS	Note	2004		2003	
		The Group	The Company	The Group	The Company
1. Net profit for the period	5.30	(17,081,049.41)	(17,081,049.41)	15,063,017.93	15,063,017.93
Add: Accumulated losses at beginning of the year	5.30	(45,259,474.24)	(45,259,474.24)	(60,322,492.17)	(60,322,492.17)
2. Profit for distribution	5.30	(62,340,523.65)	(62,340,523.65)	(45,259,474.24)	(45,259,474.24)
Less: Statutory surplus reserve		-	-	-	-
Statutory public welfare fund		-	-	-	-
Employee welfare and bonus		-	-	-	-
Reserve fund		-	-	-	-
Corporate development fund		-	-	-	-
Return on investment		-	-	-	-
3. Profit available for distribution to shareholders	5.30	(62,340,523.65)	(62,340,523.65)	(45,259,474.24)	(45,259,474.24)
Less: Preference shares dividend paid		-	-	-	-
Surplus reserve		-	-	-	-
Ordinary share dividend paid		-	-	-	-
Convertible share dividend		-	-	-	-
4. Unappropriate profit	5.30	(62,340,523.65)	(62,340,523.65)	(45,259,474.24)	(45,259,474.24)

Company's Legal Representative: Zhang Hanrong
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

FOR THE YEAR ENDED 31ST DECEMBER, 2004

ITEMS	Note	Unit: RMB	
		The Group	The Company
1. Cash flows from operating activities:			
Cash received from sales of goods or rendering of services		649,674,276.97	358,484,849.48
Refund of taxes and surcharges received		2,654,766.15	2,000,000.00
Other cash received relating to operating activities		—	23,430,498.07
Sub-total of cash inflows		652,329,043.13	383,915,347.55
Cash paid for goods and services		415,648,852.94	197,017,987.70
Cash paid to and on behalf of employees		57,012,343.58	45,513,254.72
Taxes and surcharges paid		32,365,158.79	22,674,652.11
Other cash paid relating to operating activities	5.41	40,106,241.49	26,165,050.98
Sub-total of cash outflows		545,132,596.80	291,370,945.51
Net cash flows from operating activities		107,196,446.32	92,544,402.04
2. Cash flow from investing activities:			
Receipt of investment proceed		26,642,500.00	26,642,500.00
Dividend income received		808,092.39	808,092.39
Net cash received from disposal of fixed assets, intangible assets and other long term assets		535,227.34	535,227.34
Other cash received relating to investing activities		4,250,000.00	4,250,000.00
Sub-total of cash inflows		32,235,819.73	32,235,819.73
Cash paid to acquire fixed assets, intangible assets and long term assets		98,584,777.81	36,210,770.31
Cash paid for investment		51,000,000.00	55,958,802.85
Other cash paid relating to investing activities		—	—
Sub-total of cash outflows		149,584,777.81	92,169,573.16
Net cash flows from investing activities		(117,348,958.08)	(59,933,753.43)
3. Cash flows from financing activities			
Cash from proceeds for use of investment		24,202,700.71	—
Including: Cash from proceeds arising from minority fund		24,202,700.71	—
Cash from borrowings		161,091,000.00	112,000,000.00
Other cash received relating to financing activities		—	—
Sub-total of cash inflows		185,293,700.71	112,000,000.00
Loan interest paid		144,500,000.00	134,500,000.00
Cash payments for distribution of dividends on, profits and payments of interest expenses		6,523,140.76	4,327,378.25
Including: dividend paid by subsidiaries to minority shareholders		—	—
Other cash paid relating to financing activities		3,000,000.00	—
Sub-total of cash outflows		154,023,140.76	138,827,378.25
Net cash flows from financing activities		31,270,559.95	(26,827,378.25)
4. Effect of foreign exchange rate changes on cash		—	—
5. Net increase in cash and cash equivalents		21,118,048.19	5,783,270.36

Company's Legal Representative: Zhang Hanrong
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfen

42 CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2004

SUPPLEMENTARY INFORMATION		Note	The Group	The Company
			Unit: RMB	
1.	Reconciliation of loss to cash flows from operating activities:			
	Net loss		(17,081,049.41)	(17,081,049.41)
	Add: Gain or loss of minority shareholders		3,103,013.93	—
	Provision for diminution in value of assets		46,795,484.57	38,044,664.28
	Amortization of deferred income		(865,515.12)	(865,515.12)
	Depreciation of fixed assets		22,165,655.03	18,250,820.00
	Amortization of intangible assets		5,521,011.06	1,691,709.50
	Amortization of long term deferred expenses		602,755.31	345,629.91
	Decrease in deferred expenses (less: increase)		(36,050.42)	—
	Increase in accrual expenses (less: decrease)		(717,788.61)	(475,817.83)
	Loss on disposal of fixed assets, intangible assets and other long term assets (less: income)		500,785.21	(203,020.07)
	Loss on deserted fixed assets		—	—
	Financial expenses		6,523,140.76	4,327,378.25
	Investment loss (less: income)		590,090.01	(2,239,013.97)
	Credit on deferred tax (less: borrowing)		—	—
	Decrease in inventory (less: increase)		(72,088,353.51)	(13,729,812.28)
	Decrease in operating receivables (less: increase)		(14,170,112.87)	17,050,596.18
	Increase in operating payables (less: decrease)		130,554,640.38	50,281,492.60
	Others		(4,201,260.00)	(2,853,660.00)
	Net cash flows from operating activities		107,196,446.32	92,544,402.04
2.	Financing and investing activities not involving in cash:			
	Debts capitalized		—	—
	Convertible bond due within one year		—	—
	Fixed assets under financial lease		—	—
3.	Net increase in cash and cash equivalents:			
	Cash and bank balances at the end of the period	5.40	186,103,027.24	119,007,678.59
	Less: Cash and bank balances at the beginning of the period	5.40	164,984,979.05	113,224,408.23
	Add: Cash equivalents at the end of the period		—	—
	Less: Cash equivalents at the beginning of the period		—	—
	Net increase in cash and cash equivalents	5.40	21,118,048.19	5,783,270.36

Company's Legal Representative: Zhang Hanrong
 Financial Controller: Yu Yan
 Prepared by: Zhao Qiongfeng

FOR THE YEAR ENDED 31ST DECEMBER, 2004

Unit: RMB

ITEMS	At 31st January, 2004	Addition this year	Decrease during the year			At 31st December, 2004
			Written back due to the increase of asset value	Reduction/ transfer out this year	Total	
1. Bad debt provision	27,544,902.39	12,857,657.52	—	—	—	40,402,559.91
Comprising: Accounts receivable	23,414,321.75	10,689,973.27	—	—	—	34,104,295.02
Other receivables	4,130,580.64	2,167,684.25	—	—	—	6,298,264.89
2. Provision for diminution in value of short-term investment	—	37,545,954.48	—	—	—	37,545,954.48
Comprising: Investment in shares	—	37,545,954.48	—	—	—	37,545,954.48
Investment in debts	—	—	—	—	—	—
3. Provision of diminution in inventory	38,807,945.26	4,500,353.99	9,092,127.77	—	9,092,127.77	34,216,171.48
Comprising: Finished goods	7,404,814.00	4,444,447.66	—	—	—	11,849,261.66
Raw materials	6,319,254.26	55,906.33	1,760,484.30	—	1,760,484.30	4,614,676.29
Work in progress	25,083,877.00	—	7,331,643.47	—	7,331,643.47	17,752,233.53
4. Provision for diminution in value of long-term investment	2,000,000.00	—	—	—	—	2,000,000.00
Comprising: Long-term equity investment	2,000,000.00	—	—	—	—	2,000,000.00
Long-term debt investment	—	—	—	—	—	—
5. Provision for diminution in value of fixed assets	2,084,560.17	—	—	136,343.22	136,343.22	1,948,216.95
Comprising: Buildings	—	—	—	—	—	—
Plant and machinery	1,660,803.07	—	—	112,911.95	112,911.95	1,547,891.12
Furniture, fixture and equipment	423,757.10	—	—	23,431.27	23,431.27	400,325.83
6. Provision for diminution in value of intangible assets	—	—	—	—	—	—
Comprising: Patents	—	—	—	—	—	—
Trademarks	—	—	—	—	—	—
7. Provision for diminution in value of construction in progress	651,597.07	983,646.35	—	—	—	1,635,243.42
8. Provision for diminution in value of designated loans	—	—	—	—	—	—
9. Total	71,089,004.89	55,887,612.34	9,092,127.77	136,343.22	9,228,470.99	117,748,146.24

Company's Legal Representative: Zhang Hanrong
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

FOR THE YEAR ENDED 31ST DECEMBER, 2004

Unit: RMB

ITEMS	The Group		The Company	
	As at 31st December, 2004	As at 31st December, 2003	As at 31st December, 2004	As at 31st December, 2003
1. Issued Share Capital				
At beginning of the year	245,007,400.00	245,007,400.00	245,007,400.00	245,007,400.00
Increase during the year	-	-	-	-
Comprising: Transfer from capital surplus	-	-	-	-
Transfer from statutory surplus reserve	-	-	-	-
Transfer from retained profits	-	-	-	-
Increase in issued share capital	-	-	-	-
Decrease for the year	-	-	-	-
At end of the year	<u>245,007,400.00</u>	<u>245,007,400.00</u>	<u>245,007,400.00</u>	<u>245,007,400.00</u>
2. Capital surplus:				
At beginning of the year	305,291,280.12	305,280,480.12	305,291,280.12	305,280,480.12
Increase during the year	-	-	-	-
Comprising: Share premium	-	-	-	-
Donation of non-cash items	-	-	-	-
Cash donation	-	-	-	-
Shares investment reserve	-	-	-	-
Transfer of general funds	-	-	-	-
Exchange reserve	-	-	-	-
Others capital revenue	-	-	-	-
Decrease for the year	-	-	-	-
Comprising: Transfer of capital	-	-	-	-
At end of the year	<u>305,291,280.12</u>	<u>305,280,480.12</u>	<u>305,291,280.12</u>	<u>305,280,480.12</u>
3. Statutory and discretionary surplus revenue:				
At beginning of the year	8,406,328.92	8,406,328.92	8,406,328.92	8,406,328.92
Increase for the year	-	-	-	-
Comprising: Transfer from retained earnings	-	-	-	-
Comprising: Statutory surplus reserve	-	-	-	-
Discretionary surplus reserve	-	-	-	-
General reserve fund	-	-	-	-
Enterprise development fund	-	-	-	-
Transfer from statutory public welfare fund	-	-	-	-
Decrease for the year	-	-	-	-
Comprising: Losses	-	-	-	-
Transfer of share capital	-	-	-	-
Distribution of dividend or profits	-	-	-	-
Distribution of stock dividend	-	-	-	-
At end of the year	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>
Comprising: Statutory surplus reserve	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>
General reserve fund	-	-	-	-
Enterprise development fund	-	-	-	-
4. Statutory public welfare fund				
At beginning of the year	8,406,328.92	8,406,328.92	8,406,328.92	8,406,328.92
Increase for the year	-	-	-	-
Comprising: Transfer from retained profits	-	-	-	-
Decrease for the year	-	-	-	-
At end of the year	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>
5. Retained profit (loss):				
At beginning of the year	(45,259,474.24)	(60,322,492.17)	(45,259,474.24)	(60,322,492.17)
Net profit (loss) for the year	(17,081,049.41)	15,063,017.93	(17,081,049.41)	15,063,017.93
Appropriation	-	-	-	-
Retained profit (accumulated loss) at end of the year	<u>(62,340,523.65)</u>	<u>(45,259,474.24)</u>	<u>(62,340,523.65)</u>	<u>(45,259,474.24)</u>

Company's Legal Representative: Zhang Hanrong

Financial Controller: Yu Yan

Prepared by: Zhao Qiongfen

1. GENERAL

Jiaoda Kunji High-Tech Company Limited (formerly known as Kunming Machine Tool Company Limited) ("the Company") was established in the People's Republic of China as a sino-foreign joint stock limited company as part of the reorganization of a state-owned enterprise known as Kunming Machine Tool Plant ("KMT Plant"). Pursuant to the reorganization, the operations, assets and liabilities of KMT Plant were divided between the Company and Kunming Kun Ji Group Company ("Kun Ji Group Company"). The Company was established on 19th October, 1993. The Company's A shares and H shares have been listed on the Shanghai Securities Exchange in Shanghai and the Stock Exchange of Hong Kong Limited in Hong Kong respectively. The Company is engaged principally in the design, development, production and sale of machine tool, precision measuring equipment and precision transducers.

On 25th December, 2000, Xian Jiaotong University Industrial (Group) Incorporation ("Jiaotong Group") entered into an agreement with Yunnan Provincial People's Government ("Yunnan Government"), the Company's former controlling shareholder whereby Yunnan Government would transfer a 29% interest of 71,052,146 state-owned shares in the Company to Jiaotong Group. The Ministry of Finance signed approval of State-owned shares transfer of Jiaoda Kunji High-tech Company Limited (Cao Qi [2001] No. 283), and approved the share transfer. Upon completion of share transfer procedure on 5th June, 2001, Jiaotong Group became substantial shareholder of the Company.

Pursuant to extraordinary general meeting of the Company held on 31st December, 2001. After the assets restructuring, the Company changed from a traditional machinery manufacturing company which focused on production of machine tools to a high-tech and diversified production company.

With effective from 29th March, 2002, the Company uses the name "Jiaoda Kunji High Tech Company Limited". The amount of registered capital RMB245,007,400. The place of registration is 23 Ciba Road, Kunming City, Yunnan Province. The business registration number is Qi Gu Dian Zong Zi No. 000682.

2. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS

1. Accounting Standards and Accounting System

The financial statements have been prepared in accordance with "Accounting Standards for Business Enterprises", "Accounting System for Business Enterprises" and the complementary regulation.

2. Accounting Fiscal Year

The accounting year of the Company commences on 1st January and ends on 31st December each year.

3. Reporting Currency

The reporting currency of the Company is Renminbi ("RMB")

4. Recording Principles and Accounting Basis

The Company adopts the accrual basis as the basis of accounting and the historical cost as the principle of valuation.

5. Foreign Currency Translation

Transactions in foreign currencies are translated at the market exchange rates (middle rate), ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated into RMB at the market exchange rates (middle rate), ruling on the balance sheet date. Profits and losses arising on exchange are included in financial expenses apart from those relating to the construction in progress..

FOR THE YEAR ENDED 31ST DECEMBER, 2004

6. Recognition Criteria for Cash equivalents

Cash equivalents included in the cash-flow statement are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are within three months of maturity and subject to limited risk on changes in value.

7. Accounting for Bad Debts**(1) Recognition criteria for bad debt**

1. The irrecoverable amount of a debtor who has gone bankrupt or has died and has insufficient asset or estate to repay;
2. The irrecoverable amount, demonstrated by sufficient evidence, of a debtor who does not comply with his/her repayment obligation after the debt fall due.

The irrecoverable amount stated above is cancelled as bad debt after hierarchical approval ratified by the Board of Directors.

(2) The cost of bad debts is calculated on the provision method. Provision for bad debts is made using the provision method based on aging analysis.

The provision percentage is reasonably estimated based on the past experiences of management of the Company, the financial position and cash flows condition of the relevant debtor, as well as other relevant information.

The estimated bad debt loss percentage excluding special provision is as follows: The estimated provision percentage is 5% when the accounts receivable age is within 1 year; The estimated provision percentage is 50% when the accounts receivable age is 1 to 2 years; the estimated provision percentage is 100% when the accounts receivable age is over 2 years.

8. Accounting for Inventories

- (1) Inventory category: Inventories include merchandise inventory, self-made semi-finished goods, raw materials, low value consumables and packaging materials.
- (2) Valuation method of inventories. Buying-in of raw materials, packaging materials and low value consumables are stated at cost incurred. Inventory issued and inventory shipped are recorded based on the weighted average cost method.
- (3) Amortization of low value consumables: Low value consumables are fully charged to cost when they are issued.
- (4) Inventories are recorded at the lower of cost and net realizable value and provision for loss on realization of inventories is recognized using the single-item comparison method.

Net realizable value represents the estimated selling price less the estimated cost of completion and the estimated costs to be incurred in marketing, selling and distribution in general operation.

9. Accounting for Short-term Investment

- (1) Short-term investment is stated at the historical cost. Gain on an investment is recognized when the investment is transferred or repaid on maturity.
- (2) Short-term investment is recorded at the lower of cost and market value at the end of each period. Provision for impairment on short-term investment should be recognized according to the investment collectively.

10. Accounting for long-term investment

- (1) Long-term bond investment

Long-term bond investment is recorded at its initial cost on acquisition. Premium and discount are amortized during the period when bonds are held using the straight-line method. Accrual interest is made at the period end.

- (2) Long-term equity investment

The cost method is adopted when the amount of the investment is below 20 percent of the amount of registered capital of the investee enterprise; the equity method is adopted when the amount of the investment is above 20 percent of the amount of registered capital of the investee enterprise; the equity method is adopted and the financial statements are consolidated when the amount of the investment is above 50 percent of the amount of registered capital of the investee enterprises or below 50% with control power.

- (3) Method of amortizing equity investment difference; the debit balance of the equity investment difference is amortized on a straight-line basis for the terms in investment as stated in the contract and charged to the profit and loss account. If there is no specific term stated in the contract, amortization is carried out over within 10 years; the credit balance of the equity investment difference is recorded in the account of capital reserve-provision for equity investment.
- (4) If the recoverable amount of any long-term equity investment is lower than the carrying amount of that investment as a result of a continuing decline in market value or changes in operating conditions of investee enterprises and the reduced value can not be recovered in the foreseeable future period, provision should be made for the difference between the recoverable amount and the carrying amount of the investment.

11. Accounting for and Depreciation of Fixed Assets

- (1) Fixed assets are stated at initial cost.
- (2) Recognition Criteria for Fixed Assets: Fixed assets include buildings, plant, machinery and equipment, transportation equipment and other equipment, tools having useful lives over one year and used in production and operation. Other major equipment which is not used in production or operation but with unit value over RMB2,000 and having useful lives over two years are recognized as fixed assets.
- (3) Depreciation of Fixed Assets: Depreciation is provided using the straight-line method at the following rates per annum:

Category of fixed assets	Estimated useful lives	Residual value rate (%)	Annual depreciation rate (%)
Buildings	40	4	2.40
Plant and machinery	12-50	4	1.92-8.00
Furniture, fixture and equipment	10-14	4	6.86-9.60
Motor vehicles	10-14	4	6.86-9.60

The depreciation policy for assets held under finance bases are consistent with that for owned assets. If there is reasonable certainty that the lease will obtain ownership at the end of lease, the asset should be appreciated over the shorter of the lease term and the life of the asset.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

11. Accounting for and Depreciation of Fixed Assets (Continued)**(4) Provision on impairment loss on fixed assets**

The Company recognizes an impairment loss on fixed assets when realizable value fall lower than book value as a result of a continuing decline in market value, lagging behind in technology, damage and long-term idling. Provision on impairment loss on fixed assets is provided according to total amount of fixed assets if there exists:

1. Fixed assets have been idled in the long-term and will not be reused in the foreseeable future. They have no transfer value as well;
2. Fixed assets cannot be utilized because of their obsolete technology;
3. Large quantity of unqualified products are produced when fixed assets are used;
4. Fixed assets have been damaged and have no usage value and transfer value;
5. Fixed assets in substance cannot produce economic benefits for the Company.

12. Accounting for Construction in progress

Construction in progress is stated at initial cost. Costs on completed construction works are transferred to other categories of fixed assets. Interest incurred before the construction works are ready for their intended use is capitalized as part of the engineered cost. Interest incurred after the construction works are ready for their intended use is provided in the income statement.

Provision on impairment loss on construction in progress

At the period end, based on the investigation on each construction in progress, if there exists

1. construction in progress has been ceased for construction for a long period of time and no re-commencement of work is expected in the future 3 years;
2. construction in progress was technically and physically obsolete and its economics benefits to the Company are uncertain;
3. other evidences can prove the existence of the circumstance of the decline in value on construction in progress, the difference of the recoverable amount and the carrying amount of construction in progress can be made as provision on impairment loss on construction in progress.

The Company recognizes an impairment loss when realizable value fall lower than book value. The impairment loss is calculated based on the difference between book value and net realizable value.

13. Intangible Assets

(1) Amortisation of Intangible Assets

1. If the contract stipulates the benefiting period and the law does not prescribe the effective period, intangible assets are amortized over the effective period.
2. If the contract does not stipulate the benefiting period and the law prescribes the effective period, intangible assets are amortized over the effective period.
3. If the contract stipulates the benefiting period and the law prescribes the effective period, intangible assets are amortized over the shorter of the benefiting period and the effective period.
4. If the contract does not stipulate the benefiting period and the law does not prescribe the effective period, intangible assets are amortized over 10 years.

(2) Provision on impairment loss on intangible assets

At the period end, based on investigation on the intangible assets and estimation of their ability of producing economic benefits, provision should be made for the difference between realizable value and book value, when

1. one term of intangible assets has been replaced by other new technology and its ability of producing economic benefits has been affected significantly;
2. the market value of one item of intangible assets drops sharply in the current period and estimatedly cannot be recovered in the rest of the year.
3. one item of intangible assets unprotected by the law still has usage value.
4. other evidence indicates the loss on value of intangible assets.

14. Amortization of Initial Expenses and Long-term deferred expenditures

1. Initial cost is fully charged to income in the current month when operations begin.
2. Long-term deferred expenditures are evenly amortized during the benefiting period.

15. Borrowing Costs

Interest except for those incurred in connection with specific borrowings for the purchase of fixed assets should be recognized as financial expenses and recorded in the income statement in the current period accordingly.

Interest incurred in connection with specific borrowings for the purchase of fixed assets is capitalized before the relevant fixed asset being acquired or constructed is ready for its intended use. If acquisition and construction of one item of fixed assets are abnormally discontinued for 3 months, interest is temporarily ceased to be capitalized and the interest incurred in this period is recognized as a financial expense. Interest incurred after the construction work is ready for its intended use is made as financial expenses.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

16. Accounting for Bonds Payables

Bonds payables are stated at initial cost. Premiums and discounts are amortized during the existent period of bonds using the straight-line method.

17. Recognition Criteria for Revenue

- (1) Sales of goods: Revenue from sales of goods is recognized when the Company has transferred to the buyers the risk and ownership of the goods and received the relevant revenue or obtained the evidence proving the sales proceeds and the cost relating to sale of goods can be measured reliably.
- (2) Provision of services: When the provision of services is started and completed within the same accounting year, revenue is recognized at the time of completion of the services. When the provision of services is started and completed in different accounting years and the outcome of a transaction involving the rendering of services can be estimated reliably, the Company recognizes the service revenue at the balance sheet date by the use of the percentage of completion method.
- (3) Revenue from assets used by other parties: Interest revenue is calculated based on the length of time for which other parties use cash of the Company and the applicable interest rate; Occupancy expense revenue is calculated by the length of time and the method as stipulated in the contract.

Fund occupancy expense is provided to write off the financial expenses in the current period when fund occupancy expenses which relevant parties pay to the Company can be recognized as revenue and the Company received them. If the amount of fund occupancy expenses received exceed the amount of interest calculated at the rate of one-year-deposit placed with banks, the amount equivalent to that of the latter writes off the amount of the financial expense in the current period and the difference between the former and the latter is provided in capital surplus.

(4) Revenue from Finance Leases and Operating Leases

1. Rents from operation leases are recognized as revenue in each period using the straight-line method;
2. Revenue from finance leases in the current period is recognized adopting the real interest rate method. Unrecognized revenue from finance leases is allocated to each period over the lease term in accordance with the straight-line method. Rents the Company has not received after one period of rent payment should not been recognized as revenue from finance leases. If recognized, recognized revenue should be offset. Revenue from finance leases included in rents is recognized as revenue in the current period when actual receipts incur.

For the two items of finance leases stated above, the initial cost which is incurred in the course of negotiation and contracting and can be attributed directly to items of leases should be recognized as current cost. Contingent rents incurred should be recognized as revenue in the current period.

3. Sale and Leaseback Transactions

For finance leases resulting from sale and leaseback transactions, any difference between the sales proceeds and the original carrying amount of the assets involved are deferred and amortized as an adjustment to depreciation according to the depreciation pattern of the leased asset. For operating leases resulting from sale and leaseback transactions, any difference between the sales proceeds and the original carrying amount of the assets involved are deferred and amortized according to the proportion of the lease payments during the lease term.

18. Accounting for Income Taxes

Income taxes are calculated using the taxes receivable method.

19. Tax Refund

Tax refund is recorded in current year's profit when actual receipts incur.

20. Basis of Consolidation

The consolidated financial statements incorporate the financial statements of the Company and investee enterprises in which the Company holds more than half of the equity or where the Company controls the operation of the investee enterprises.

If there exists some difference between the accounting policies used by subsidiaries included in the consolidation and that used by the Company, the financial statements of subsidiaries are adjusted in accordance to the accounting policies used by the Company.

Pursuant to Cai Kuai Zi (1995) No. 11 "Notice on issuing 'Provisional Regulation on Consolidation of Financial Statements'", the financial statements of the Company and subsidiaries included in the consolidation and relevant materials, the amount of each item in the financial statements is consolidated and the following items are eliminated on consolidation:

- (1) equity investment of the Company and relevant parts of ownership interests of subsidiaries in the scope of consolidation.
- (2) all significant intercompany transactions and balances between the Company and subsidiaries in the scope of consolidation.

3. TAXATION

1. Value Added Tax

The amount of taxes payable is recorded after deducting input value added tax in the current period from output value added tax in the current period. Output value added tax is calculated at 17% of the revenue.

Except for Shanxi Hengtong Intelligent Machine Company Limited, the other subsidiaries of the Company is regarded as the same value added tax payer as the Company and the applicable tax rate is 17%; Shanxi Hengtong Intelligent Machine Company Limited is a small scale value added tax payer, the applicable tax rate is 6%.

2. Income Tax

According to the notice of Cai Shui Zi (1994) No. 017 jointly issued by the Ministry of Finance and the State Administration of Taxation, the applicable income tax rate of the Company is 15%.

Shanxi Hengtong Intelligent Machine Company Limited, Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited and Winko Machines Company Limited, subsidiaries of the Company, are all high-tech companies. The applicable income tax rate for them is 15%. Xian Ser Turbo Machinery Company Limited is being classified as high-tech company which can be exempted from income tax charge.

3. Business Tax

Business tax is calculated and paid at 3%, 5% of operating income.

4. Other Taxes

Other tax is calculated and paid according to the Law of Taxation..

FOR THE YEAR ENDED 31ST DECEMBER, 2004

4. SUBSIDIARIES AND JOINT VENTURES

(1) General of the Company's Subsidiaries and Joint Ventures

Name of subsidiaries and joint ventures	Place of Registration	Scope of Business	Registered Capital (RMB'000)	Investment Proportion (%)	Economic Nature	Date of Investment	Relationship with the Company
Xian Ser Turbo Machinery Company Limited ("Xian Ser")	Xian City	Design, develop and sales of turbo-machinery	4,561	45.00%	Limited liability	December 2001	Subsidiary
Shanxi Hengtong Intelligent Company Limited (Shanxi Hengtong)	Xian City	Develop and sale of Machine manufacturing moulds, machinery, equipment, electronic products, software and hardware	27,960	65.34%	Limited liability	December 2001	Subsidiary
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	Xian City	Develop, manufacture and Sale of electronic products, electronic machine and products of electronic power; Provide technology services	35,000	78.03%	Limited liability	December 2001	Subsidiary
Winko Machines Company Limited	Kunming City	Develop, apply and integrate hardware and software; Retail, wholesale, purchase on behalf of others and consign electronic products, machinery and electronic machine.	20,230	90.91%	Limited liability	November 2002	Subsidiary
Changsha Ser Turbo Machinery Equipment Company Limited ("Changsha Ser")	Changsha City	Design, develop and sales of turbo machinery	10,000	95.00%	Limited liability	January 2004	Subsidiary of Xian Ser
Hangzhou Ser Gas Engineering Company Limited ("Hangzhou Ser")	Hangzhou City	Design, develop and sales of turbo machinery	1,200	51.00%	Limited liability	April 2004	Subsidiary of Xian Ser

(2) The subsidiaries stated above have been included in the consolidation.

The above companies include in consolidated financial statement.

During the year Xian Ser increased its share capital. The number of shares held by the company was diluted from 80% to 45%. Since the majority of the Board of Directors of Xian Ser are from the Company, therefore Xian Ser was included in the consolidated financial statements this year.

Since Changsha Ser and Hangzhou Ser are the subsidiaries of Xian Ser, they are included in the consolidated financial statement.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

5. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (REPORTING CURRENCY: RMB)

1. Bank Balances and Cash

Items	At 31st December, 2004		At 1st January, 2004	
	Foreign currency	RMB	Foreign currency	RMB
Cash on hand		972,922.67		662,254.53
RMB		706,897.76		405,064.37
HKD	29,935.00	31,841.90	29,934.64	31,901.35
USD	27,347.15	226,338.68	13,890.65	114,968.74
IDR	390,000.00	390.00		
EUR	661.86	7,454.33	9,729.86	110,320.07
Bank		188,130,104.57		184,328,224.52
RMB		155,631,380.36		149,929,968.15
Including: time deposit		18,000,000.00		3,363,000.00
HKD	28,972,455.61	30,818,001.03	32,277,616.00	34,398,256.37
Including time deposit	25,000,000.00	26,592,500.00	25,000,000.00	26,642,500.00
USD	203,071.73	1,680,723.18		
Other currency		7,564,260.00		10,000,000.00
Total		<u>196,667,287.24</u>		<u>194,990,479.05</u>

Note:

(1) As at 31st December 2004, the cash in other currency including the restricted bank deposit (premium of guarantee letter).

(2) Time deposit of RMB amounting to RMB3,000,000 has been pledged.

2. Short-term Investments

	At 31st December, 2004		At 1st January, 2004	
	Amount	Provision	Amount	Provision
Share investment	50,000,000.00	37,480,416.81	—	—
Unit fund	1,000,000.00	65,537.67	—	—
Total	<u>51,000,000.00</u>	<u>37,545,954.48</u>	<u>—</u>	<u>—</u>

Note:

In February 2004, the Company entered into an agreement with China Fortune Securities ("China Fortune") for the Trusteeship of the Management of Investment in State Bonds (the "Trusteeship Agreement") pursuant to which the Company entrusted China Fortune to conduct investment on State Bonds with RMB50,000,000 (the "Funds") but China Fortune diverted the Fund to invest in several stocks. China Fortune was under the control of 德隆系證券公司 and is now being took over in custody by China Huarong Asset Management Corporation ("China Huarong"). The Company is currently in negotiation with China Huarong for the repayment of the Funds.

Because of the uncertainty of the recoverability of the Funds, the Company decided to recognized impairment loss of RMB37,480,416.81 based on the market value of RMB4,250,000 of the Funds on 31st December, 2004.

The impairment loss of the Funds was based on the market value on 31st December, 2004.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. Bill Receivable

Items	At 31st December, 2004	At 1st January, 2004
Bank acceptance notes	17,947,434.06	46,762,787.36
Commercial acceptance notes	—	200,000.00
Total	<u>17,947,434.06</u>	<u>46,962,787.36</u>

4. Accounts Receivable

Age	At 31st December, 2004			At 1st January, 2004		
	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within 1 year	65,764,693.17	58.83	2,690,505.48	54,248,145.87	66.36	2,299,626.20
1-2 years	23,768,131.94	21.26	10,217,964.96	8,790,526.21	10.75	3,770,820.49
2-3 years	6,906,229.99	6.18	6,056,229.99	8,475,515.82	10.37	7,669,852.57
Over 3 years	15,343,099.53	13.73	15,139,594.59	10,237,527.43	12.52	9,674,022.49
Total	<u>111,782,154.63</u>	<u>100.00</u>	<u>34,104,295.02</u>	<u>81,751,715.33</u>	<u>100.00</u>	<u>23,414,321.75</u>

Note:

- (1) There is no balance due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company.
- (2) The total amount of the 5 largest debtors is RMB16,221,651.00, constituting 14.51% of the total amount of accounts receivable.

5. Other Receivables

Age	At 31st December, 2004			At 1st January, 2004		
	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within 1 year	11,382,463.48	64.61	1,821,679.61	17,041,881.74	79.83	852,094.09
1-2 years	4,034,428.84	22.90	2,721,038.01	2,056,955.39	9.63	1,028,477.70
2-3 years	158,957.80	0.90	158,957.80	1,025,154.39	4.80	1,025,154.39
Over 3 years	2,041,919.47	11.59	1,596,589.47	1,224,854.46	5.74	1,224,854.46
Total	<u>17,617,769.59</u>	<u>100.00</u>	<u>6,298,264.89</u>	<u>21,348,845.98</u>	<u>100.00</u>	<u>4,130,580.64</u>

Note:

- (1) The balance due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company.
- (2) The total amount of other receivables from the 5 largest debtors is RMB2,745,316.03, constituting 15.58% of the total amount of accounts receivable.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

6. Prepayments

Age	At 31st December, 2004		At 1st January, 2004	
	Amount	Proportion (%)	Amount	Proportion (%)
Within 1 year	57,495,083.37	93.52	43,533,988.07	96.11
1-2 years	3,881,963.98	6.31	1,137,599.95	2.51
2-3 years	106,611.96	0.17	625,968.03	1.38
Over 3 years	—	—	—	—
Total	<u>61,483,659.31</u>	<u>100.00</u>	<u>45,297,556.05</u>	<u>100.00</u>

Note:

- (1) There is no prepayments to shareholders whose shares exceed 5% (including 5%) of the total shares of the Company.
- (2) As at 31st December, 2004, the amount of prepayments increased by 35.73% over that at the end of last year, mainly because the increase of orders in Xian Ser, one of the subsidiaries of the Company has made the amount of prepayments for raw materials increase.

7. Inventories

Items	At 31st December, 2004		At 1st January, 2004	
	Amount	Provision for loss on realization	Amount	Provision for loss on realization
Finished goods	121,982,886.61	11,722,480.66	95,452,752.79	7,404,814.00
Raw materials	48,095,775.32	4,015,433.51	37,900,070.18	5,758,540.00
Low value consumables	3,021,539.79	106,141.00	3,589,088.53	82,781.00
Work in progress	183,021,979.37	17,752,233.53	148,138,408.80	25,083,877.00
Materials purchased	493,101.78	493,101.78	518,634.09	477,933.26
Inventory	255,535.05	—	—	—
Goods sold	816,489.98	126,781.00	—	—
Total	<u>357,687,307.90</u>	<u>34,216,171.48</u>	<u>285,598,954.39</u>	<u>38,807,945.26</u>

8. Prepaid Expenses

Items	At 1st January, 2004	Addition in the current period	Amortization in the current period	At 31st December, 2004
Rentals	43,092.00	635,124.00	595,230.00	82,986.00
Others	44,981.00	147,096.75	150,940.33	41,137.42
Total	<u>88,073.00</u>	<u>782,220.75</u>	<u>746,170.33</u>	<u>124,123.42</u>

FOR THE YEAR ENDED 31ST DECEMBER, 2004

9. Long-term Equity Investment

- (1) General of investee enterprises

Name of Investee	Initial investment cost	Investment proportion	Investment period	Accounting
Yunan Cheng Jiang Copper Products Plant	2,000,000	40.00%	—	Cost method

- (2) Changes in Long-term Equity Investment

Name of Investee	At 1st January, 2004	Changes in the current period		Changes in accumulated equity		At 31st December, 2004
		Investment cost	Equity adjustment	Investment Cost	Equity adjustment	
Yunan Cheng Jiang Copper Products Plant	2,000,000.00	—	—	—	—	2,000,000.00
Less: Provision for diminution in value of long-term equity investment	2,000,000.00	—	—	—	—	2,000,000.00
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

- (3) Difference in long-term equity investment

Name of Investor	Initial investment cost	At 1st January, 2004	Addition in the current period	Amortization in the current period	At 31st December, 2004	Amortization period
Xian Ser	7,296,277.00	5,837,021.56	—	729,627.72	5,107,393.84	10 years
Shanxi Hengtong	6,849,713.19	5,349,248.11	—	668,554.68	4,680,693.43	10 years
Total	<u>14,145,990.19</u>	<u>11,186,269.67</u>	<u>—</u>	<u>1,398,182.40</u>	<u>9,788,087.27</u>	

Note:

- (1) Provision for impairment on long-term investment is provided on the basis of the total amount of investment the Company has made to Yunnan Cheng Jiang Copper Products Plant because the plant has lost of the ability of sustainable operation.
- (2) There is no significant difference between the accounting policies used by the investee enterprises and that used by the Company. There is no significant restrictions to realization of investment and investment income outflow as foreign currency.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

10. Fixed Assets and Accumulated Depreciation

Category	at 1st January, 2004	Increase this year	Decrease this year	at 31st December, 2004
Buildings	134,491,205.03	27,159,009.77	1,831,210.12	159,819,004.68
Furniture, fixture and equipment	34,937,622.14	3,042,884.27	497,304.60	37,483,201.81
Plant and machinery	204,312,974.52	35,804,430.21	706,232.60	239,411,172.13
Motor vehicles	13,606,011.05	6,756,943.05	1,548,157.05	18,814,797.05
Leasehold improvement	517,732.00	746,091.11	—	1,263,823.11
Sub-total	387,865,544.74	73,509,358.41	4,582,904.37	456,791,998.78
ACCUMULATED DEPRECIATION:				
Buildings	23,290,461.32	5,435,348.87	314,308.93	28,411,501.26
Furniture, fixture and equipment	18,046,018.21	2,664,428.40	4,132.41	20,706,314.20
Plant and machinery	98,326,513.86	11,074,529.03	549,579.24	108,851,463.65
Motor vehicles	4,164,419.57	2,806,150.47	679,913.43	6,290,656.61
Leasehold improvement	65,442.78	443,898.14	—	509,340.92
Sub-total	143,892,855.74	22,424,354.91	1,547,934.01	164,769,276.64
Net book value	243,972,689.00	51,085,003.50	3,034,970.36	292,022,722.14
PROVISION FOR IMPAIRMENT:				
Buildings	—	—	—	—
Plant and machinery	1,660,803.07	—	136,343.22	1,524,459.85
Furniture, fixture and equipment	423,757.10	—	—	423,757.10
Sub-total	2,084,560.17	—	136,343.22	1,948,216.95
NET REALIZABLE VALUE	241,888,128.83	51,085,003.50	2,898,627.14	290,074,505.19

Note:

- (1) Provision on impairment is recognized because the book value is higher than the net realizable value.
- (2) Buildings amounting to RMB63,673,726 in original cost and RMB51,448,370 in net realizable value have been pledged to secure loans amounting to RMB44,000,000.
- (3) The original book value of fixed assets from finance leases is RMB4,264,181.00. The amount of accumulated depreciation is RMB1,968,525.72 and the net realizable value is RMB2,295,655.28 accordingly.

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11. Construction in progress

Construction name	At 1st January, 2004	Additions this year	Transfer to fixed assets	Other transfer out	At 31st December, 2004	Source of funds
95 Technical improvement projects	12,021,785.25	3,455,051.39	10,661,977.26	–	4,814,859.38	Loans
including: Capitalised interest	1,233,332.00	–	1,231,910.06	–	1,421.94	Loans
Resources Office Building	18,386,914.90	3,832,647.84	–	–	22,219,562.74	Funds owned
New Factory	–	25,602,226.30	–	–	25,602,226.30	Funds owned
Others	16,553,990.99	4,999,563.88	14,178,265.68	–	7,375,289.19	Funds owned
Total	46,962,691.14	37,889,489.41	24,840,242.94	–	60,011,937.61	
LESS: provision on impairment loss on construction in progress	651,597.07	983,646.35	–	–	1,635,243.42	
Net realizable value	46,311,094.07	36,905,843.06	24,840,242.94	–	58,376,694.19	

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12. Intangible Assets

Items	Acquired method	Original cost	At 1st January, 2004	Addition this year	Transfer out this year	Amortization this year	At 31st December, 2004	Amortization Period left (year)
Good-Will (Note 1)	Acquisition of business	5,638,632.00	4,510,905.68	–	–	563,863.00	3,947,042.68	7
Goodwill (Note 2)	Acquisition of business	3,720,569.00	2,976,455.25	–	–	372,056.90	2,604,398.35	7
The All Over Controlled Vortex Technology		11,630,000.00	9,303,999.92	–	–	1,163,000.04	8,140,999.88	7
Technical know-how of fast moulding		14,730,000.00	11,783,999.50	–	–	1,473,000.00	10,310,999.50	7
Intelligent know-how		9,044,400.00	7,325,964.02	–	–	994,884.00	6,331,080.02	7
Technical know-how of embroidery machine		4,039,667.00	3,230,470.75	–	–	425,497.66	2,804,973.09	7.75
Land use right	Contributed	15,988,980.00	12,733,717.14	14,152,880.00	–	320,345.04	26,566,252.10	38.75
Usage right to staff quarter	Acquisition of business	4,485,988.00	3,738,324.05	–	–	93,458.04	3,644,866.01	39
Financial software	Acquisition of business	129,200.00	110,896.61	664,215.00	–	57,903.38	717,208.23	7.58
Company website development expenses	Acquisition of business	38,000.00	29,133.38	–	–	7,599.96	21,533.42	2.83
95 Technical improvement ORACLE software		494,030.00	304,651.81	–	–	49,403.04	255,248.77	5.17
Total		69,939,466.00	56,048,518.11	14,817,095.00	–	5,521,011.06	65,344,602.05	

FOR THE YEAR ENDED 31ST DECEMBER, 2004

12. Intangible Assets (Continued)*Note:*

- (1) Goodwill is made for the difference between the transaction price and the book value when Xian Jiaotong University Industrial Group acquired two subsidiaries from Intelligent Electronic Machine and Automatic Machine, in December 2001 during the course of the assets restructuring. The company made the investment of the assets in the two subsidiaries and relevant goodwill stated above and established Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited and Winko Machines Company Limited in this year. These two items of goodwill are amortized over 10 years.
- (2) Technical know-how is that the Company acquired from Xian Jiaotong University Industrial Group in December 2001 during the course of the assets restructuring. The Company made the investment of "Intelligent Technical Know-how" and "Embroidery Machine Technical Know-how" and established Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited and Winko Machines Company Limited. In 2003, the capital injection of the Company in Shanxi Hengtong was based on the carrying value of "Fast Moulding Technical Know-how".
- (3) Land use right was contributed by Yunnan Government as capital. The addition for current period was due to the purchase of land for Changsha Ser.

13. Long-term Deferred Expenditures

Items	Original costs	At 1st January, 2004	Addition this year	Amortization this year	Accumulated amortization	At 31st December, 2004	Remaining amortization period left
Office buildings reconstruction	298,876	177,299.20	30,392.40	96,250.40	187,434.80	111,441.20	2
Old united workshop	691,259	345,629.91	—	345,629.91	691,259.00	—	0
Repairs expenses							
Plant fitment	594,875	160,875.00	—	160,875.00	594,875.00	—	0
Total	1,585,010	683,804.11	30,392.40	602,755.31	1,473,568.80	111,441.20	

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14. Short-term Loans

Category	At 31st December, 2004		At 1st January, 2004	
	Amount	currency	Amount	currency
Guaranteed loans	39,091,000.00	RMB	—	RMB
Secured loans	44,000,000.00	RMB	44,000,000.00	RMB
Pledge loans	—	RMB	25,000,000.00	RMB
Credit Loans	54,000,000.00	RMB	50,000,000.00	RMB
Total	137,091,000.00		119,000,000.00	

Note:

All the secured loans are secured by buildings in possession of the Company, details refer to note 5.10.

15. Accounts payables

As at 31st December, 2004 and at 31st December, 2003, the balance of accounts payables amounts to RMB62,640,557.32, RMB48,120,874.13 respectively. The balance of accounts payables contain the amounts due to shareholders whose shares exceed 5% (including 5%) of total shares of the Company are disclosed in Note 7 "Related Party Relationship and Transactions".

16. Advances from customers

- (1) As at 31st December, 2004 and 31st December, 2003, the balance of advances from customers amounts to RMB294,381,649.15, RMB193,023,605.38 respectively, representing an increase of 52.51%. The main reason for the increase was the increase of sale orders of Xian Ser, one of subsidiaries of the Company.
- (2) No advances from shareholders whose shares exceed 5% (including 5%) of total shares of the Company.

17. Accrued salary

Accrued salary is made for the salary due to the employees of the Company. As at 31st December, 2004 and at 31st December, 2003, the balance of accrued salary totals up to RMB2,401,981.42 and RMB3,276,822.70 respectively.

18. Taxes payables

Items	At 31st December, 2004	At 1st January, 2004
Value added tax	9,585,420.91	7,796,169.02
Business tax	304,763.85	297,953.47
City construction tax	40,917.73	291,175.42
Income tax	4,584,707.72	2,651,427.23
Personal income tax	241,639.14	24,100.34
Others	1,446.73	28,550.84
Total	14,758,896.08	11,089,376.32

FOR THE YEAR ENDED 31ST DECEMBER, 2004

19. Other payables

Items	At 31st December, 2004	At 1st January, 2004
Additional educational fee	15,712.47	126,889.33
Flood-controlling funds	423.86	31,808.46
Housing funds	449,815.00	205,358.74
Total	<u>465,951.33</u>	<u>364,056.53</u>

20. Other accrual

As at 31st December, 2004 and at 31st December, 2003, the balance contains RMB25,250,268.44 and RMB11,347,413.27 respectively. The details of the balance due to shareholders whose shares exceed 5% (including 5%) of total shares of the Company are disclosed in Note 5 "Connected Party Relationship and Transaction".

21. Accrued Expenses

Items	At 31st December, 2004	At 1st January, 2004
Accrued rental	61,888.00	366,600.00
Accrued audit fee	1,727,814.33	1,810,332.00
Accrued water and electricity fee	231,327.90	168,586.68
Accrued consulting fee, lawyer fee etc.	51,686.73	444,986.89
Others	—	—
Total	<u>2,072,716.96</u>	<u>2,790,505.57</u>

22. Long-term Loans Due Within One Year

Items	At 31st December, 2004	At 1st January, 2004
Obligation under finance leases due within on 1 year	<u>342,168.90</u>	<u>342,168.90</u>

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23. Long-term loans

Category	At 31st December, 2004		At 1st January, 2004	
	Amount	Currency	Amount	Currency
Credit loans	—	RMB	1,500,000.00	RMB
Total	—		1,500,000.00	

24. Long-term payable

Category	Period	Original amount	Amount at 1st January, 2004	Increase this year	Decrease this year	Amount at 31st December, 2004
Obligation under Finance lease	20 years	6,843,378.00	6,159,040.20	—	342,168.90	5,816,871.30
Less: future finance charge		2,579,197.00	2,321,277.40	—	128,959.80	2,192,317.60
Less: amount due for settlement within one year		—	342,168.90	342,168.90	342,168.90	342,168.90
Sub-total		4,264,181.00	3,495,593.90	(342,168.90)	(128,959.80)	3,282,384.80
Add: infrastructure construction appropriation from the Office of Finance of Shanxi Province		—	200,000.00	—	—	200,000.00
Appropriation for intelligent electronic machine industrialization exemplary projects technology and equipment technology		—	7,000,000.00	—	—	7,000,000.00
Total		4,264,181.00	10,695,593.90	(342,168.90)	(128,959.80)	10,482,384.80

Note:

- (1) The difference between the present value of minimum lease payment amounting to RMB6,843,378 and the net book value of assets held under finance leases amounting to RMB4,264,181 is made as future finance charge and is amortized over 20 years using the straight-line method.
- (2) Appropriation for intelligent electronic machine technology and equipment technology industrialization exemplary projects represents appropriation for the projects based on Approval of Feasibility of Intelligent Electronic Machine Technology and Equipment Technology Industrialization Exemplary Projects signed by the State Development Plan Committee (Kuai Qi Gao Ji (2000) No. 1883).

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25. Specific Project Payable

Items	At 31st December, 2004	At 1st January, 2004
Specific project appropriation from the Science and Technology Committee of Yunnan province	2,647,563.01	2,971,423.01

26. Deferred Gain

Items	Original amount	Amount at 1st January, 2004	Addition this year	Provided for the year	Accumulated amortization	Amount at 31st December, 2004	Amortization period left
Buildings	4,023,642.00	3,121,342.41	–	451,150.20	1,353,449.79	2,670,192.21	17
Including:							
Operating lease	1,758,331.00	1,582,498.74	–	87,916.60	263,748.86	1,494,582.14	17
Finance lease	2,265,311.00	1,538,843.67	–	363,233.60	1,089,700.97	1,175,610.07	3-17
Land use right	8,287,344.00	7,458,567.66	–	414,364.92	1,243,141.26	7,044,202.74	17
Including:							
Operating lease	8,287,344.00	7,458,567.66	–	414,364.92	1,243,141.26	7,044,202.74	17
Finance lease	–	–	–	–	–	–	–
Total	12,310,986.00	10,579,910.07	–	865,515.12	2,596,591.05	9,714,394.95	

Note:

The Company leased back a portion of land use right and premise use right which had been disposed to Yunnan Government in December 2001 when the Company implemented the assets restructuring. The lease term is 20 years. The selling price of these assets is RMB28,438,361 and the book value of these assets is RMB16,127,375. The gain due from the transaction is to be deferred. For operating lease, deferred gain is to be allocated through the lease period according to rental expense; For finance lease, deferred gain is to be allocated to adjust depreciation expense according to depreciation rate.

27. Share Capital

Items	Amount at 1st January, 2004	Increase this year	Decrease this year	Amount at 31st December, 2004
1. Non-trading shares	120,007,400.00	–	–	120,007,400.00
Promoters shares	31,345,554.00			31,345,554.00
Including:				
State – Owned shares	31,345,554.00	–	–	31,345,554.00
Legal person shares	88,661,846.00	–	–	88,661,846.00
2. Trading shares	125,000,000.00	–	–	125,000,000.00
Including:				
A shares	60,000,000.00	–	–	60,000,000.00
H shares	65,000,000.00	–	–	65,000,000.00
Total shares	245,007,400.00	–	–	245,007,400.00

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28. Capital Reserves

Items	Amount at 31st December, 2004	Amount at 1st January, 2004
Share premium	293,744,338.00	293,744,338.00
Revaluation surplus	11,536,142.12	11,536,142.12
Donation	10,800.00	—
Total reserves	<u>305,291,280.12</u>	<u>305,280,480.12</u>

29. Surplus Reserves

Items	Amount at 1st January, 2004	Increase this year	Decrease this year	Amount at 31st December, 2004
Statutory surplus reserve	8,406,328.92	—	—	8,406,328.92
Statutory public reserve	8,406,328.92	—	—	8,406,328.92
Total	<u>16,812,657.84</u>	<u>—</u>	<u>—</u>	<u>16,812,657.84</u>

30. Unappropriated Profit

Items	2004
Retained profit at the beginning of the period	(45,259,474.24)
Add: net profit this year	(17,081,049.41)
Less: statutory surplus reserve	—
Statutory public reserve	—
Retained profit at the period end	<u>(63,340,523.65)</u>

31. Principal Operation Income and Cost

	2004		2003	
	Accumulated amount Revenue	Accumulated amount Cost	Accumulated amount Revenue	Accumulated amount Cost
Machine tool	262,246,383.68	191,337,032.68	183,276,013.60	128,419,795.34
Hige-effective Energy-saving Compressors	137,452,140.23	103,510,753.43	85,627,155.51	63,926,812.16
Embroidery Machine	15,223,136.07	10,215,171.15	13,799,621.50	10,229,433.02
Intelligent Electric Appliance	10,328,182.13	5,241,034.71	11,226,040.97	5,873,098.54
Machine Processing Service	14,708,642.40	11,012,318.54	13,925,761.86	9,050,992.19
Laser Prototyping System	13,404,104.84	8,097,121.00	9,850,378.27	5,021,424.35
Precision Measuring Equipment	5,366,865.09	2,863,439.08	7,473,193.66	3,411,355.77
Others	10,706,915.92	6,820,905.79	5,435,187.95	2,630,972.58
Total	<u>469,436,370.36</u>	<u>339,097,776.38</u>	<u>330,613,353.32</u>	<u>228,563,883.95</u>

Note: Total sales of the 5 largest customers total up to RMB96,480,260 which constitutes 20.55% of total sales of the Company.

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32. Principal Operation Tax and Addition

Items	Accumulated amount this year	Accumulated amount last year
Business tax	47,050.44	282,080.66
City construction tax	106,308.81	451,811.25
Education fee addition	46,746.68	196,468.97
Total	200,105.93	930,360.88

Note: City construction tax and education fee addition are calculated and paid at 7% of value added tax and 3% of business tax.

33. Profit from Other Operations

Items	Income	Cost	Profit
Materials sold	1,044,540.33	770,387.24	274,153.09
Rental income	220,428.32	228,014.08	(7,585.76)
Base materials	886,594.13	—	886,594.13
Technical services	367,850.00	275,706.75	92,143.25
Total	2,519,412.78	1,274,108.07	1,245,304.71

34. Financial Expenses

Items	Accumulated amount this year	Accumulated amount last year
Interest expenses	7,486,446.86	7,849,134.45
Less: interest income	1,270,224.67	2,337,929.72
Exchange (loss) gain	73,410.42	(164,852.40)
Bank's processing fee	104,548.35	101,835.04
Others	128,959.80	128,959.80
Total	6,523,140.76	5,577,147.17

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35. Investment Income

Items	Accumulated amount this year	Accumulated amount last year
Amortization of equity investment difference	(1,398,182.40)	(1,452,634.34)
Provision for diminution in value of short-term investment	(37,545,954.48)	—
Income from short-term investment	808,092.39	26,875.97
Total	<u>(38,136,044.49)</u>	<u>(1,425,758.37)</u>

36. Subsidies

Items	Accumulated amount this year	Accumulated amount last year
Income tax refunded	2,654,766.16	1,642,310.61
Total	<u>2,654,766.16</u>	<u>1,642,310.61</u>

37. Non-operating Income

Items	Accumulated amount this year	Accumulated amount last year
Gain on disposal of fixed assets	106,162.81	1,411,407.77
Income from provision of training	19,550.00	—
Others	140,350.00	64,970.00
Total	<u>266,062.81</u>	<u>1,476,377.77</u>

38. Non-operating Expenses

Items	Accumulated amount this year	Accumulated amount last year
Loss on disposal of fixed assets	113,577.85	31,320.99
Contribution expenses	71,500.00	—
Provision on impairment loss on fixed assets	—	—
Provision on impairment loss on construction in progress	983,646.35	—
Others	63,234.84	58,676.90
Total	<u>1,231,959.04</u>	<u>89,997.89</u>

39. Income Taxes

Income taxes of RMB4,269,092.22 represent income taxes paid by the Company and Xian Ser.

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40. Cash and cash equivalent

Items	At 31st December, 2004		At 1st January, 2004	
	Consolidated amount	Amount for the Company	Consolidated amount	Amount for the Company
Cash	196,667,287.24	121,861,338.59	194,990,479.05	139,866,908.23
Less: time deposit	7,564,260.00	2,853,660.00	30,005,500.00	26,642,500.00
Less: other currency investments	3,000,000.00	—	—	—
Cash and cash equivalents	<u>186,103,027.24</u>	<u>119,007,678.59</u>	<u>164,984,979.05</u>	<u>113,224,408.23</u>

41. Other cash paid relating to Operating Activities

Payment of other cash paid relating to operating activities amounting to RMB40,106,241.49 is as follows.

Items	Amount
Traveling expense	8,691,922.00
Office expense	4,921,799.57
Business entertainment expense	4,048,097.57
Administrative expense for stock exchange	2,018,668.30
Warrant expense	4,035,218.18
Property management fee	1,944,969.45
Audit fee, Consulting fee	3,341,601.24
Promotion & advertising fee	2,122,063.44
Research & development expense	962,958.48
Repair and Maintenance	4,048,097.57
Transportation fee	2,061,967.80
Total	<u>38,197,363.60</u>

42. Non-recurring items

Items	Amount
Gain on disposal of fixed assets	(7,415.04)
Written back on various provision for diminution in previous years	9,092,127.77
Government grants	4,004,766.16
Impairment loss on deposits placed with securities company	(37,480,416.81)
Non operating loss	25,165.16
Negative impact from profits tax	(288,685.75)
Total	<u>(24,654,458.51)</u>

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6. NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (UNIT: RMB)

1. Accounts Receivable

Age	At 31st December, 2004			At 1st January, 2004		
	Amount	Proportion (%)	Provision on bad debt	Amount	Proportion (%)	Provision on bad debt
Within 1 Year	25,964,326.09	49.35	928,848.01	21,385,372.62	64.09	923,666.14
1-2 years	11,515,109.46	21.88	4,861,529.72	5,385,289.21	13.16	2,068,201.99
2-3 years	2,344,893.36	4.46	2,294,893.36	4,463,315.44	10.91	4,463,315.44
Over 3 years	12,792,600.98	24.31	12,589,096.04	9,682,028.43	11.84	9,118,523.49
Total	<u>52,616,929.89</u>	<u>100.00</u>	<u>20,674,367.13</u>	<u>40,916,005.70</u>	<u>100.00</u>	<u>16,573,707.06</u>

Notes:

(1) No balance due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company.

(2) Total amount of the 5 largest debtors is RMB12,533,429.96, constituting 23.82% of total amount of accounts receivable.

2. Other Receivables

Age	At 31st December, 2004			At 1st January, 2004		
	Amount	Proportion (%)	Provision on bad debt	Amount	Proportion (%)	Provision on bad debt
Within 1 Year	6,168,777.61	88.54	233,141.38	17,828,501.09	53.35	349,594.72
1-2 years	675,670.70	9.70	247,835.35	14,288,873.95	43.60	4,516.25
2-3 years	27,032.50	0.39	27,032.50	7,000.00	0.02	7,000.00
Over 3 years	95,782.30	1.37	95,782.30	647,733.70	3.03	647,733.70
Total	<u>6,967,263.11</u>	<u>100.00</u>	<u>603,791.53</u>	<u>32,772,108.74</u>	<u>100.00</u>	<u>1,008,844.67</u>

Note:

(1) The balances due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company are disclosed in Note 7 "Relevant Party Relationship and Transaction".

(2) Total amount of the 5 largest debtors is RMB2,021,315.59, which constitutes 29.01% of the total amount of other receivables..

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3. Long-term Equity Investment**(1) General of Investee enterprises**

Name of investee	Original cost	Investment proportion	Investment period	Accounting
Xian Ser Turbo Machinery Company Limited	16,734,463	45.00%	N/A	Equity method
Shanxi Hengtong Intelligent Machine Company Limited	23,838,606	90.00%	N/A	Equity method
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	27,310,000	78.03%	N/A	Equity method
Winko Machines Company Limited	18,390,000	90.91%	N/A	Equity method
Yunnan Cheng Jiang Copper Products Plant	2,000,000	40.00%		Cost method

(2) Changes in Long-term Equity Investment

Name of investee	Amount at 1st January, 2004	Increase (decrease) in equity this year				Amount at 31st December, 2004
		Investment cost	Adjusted equity	Dividend paid	Disposal	
Xian Ser Turbo Machinery Company Limited	17,541,197.67	4,958,802.85	6,336,434.56	4,163,885.27	-	24,672,549.81
Shanxi Hengtong Intelligent Machine Company Limited	16,870,349.11	-	289,503.53	-	-	17,159,852.64
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	28,622,839.38	-	(1,243,359.07)	-	-	27,379,480.31
Winko Machines Company Limited	19,966,342.04	-	(2,553,475.04)	-	-	17,412,867.00
Yunnan Cheng Jiang Copper Products	2,000,000.00	-	-	-	-	2,000,000.00
Less: Provision on impairment loss on long-term investment	2,000,000.00	-	-	-	-	2,000,000.00
Total	83,000,728.20	4,958,802.85	2,829,103.98	4,163,885.27	-	86,624,749.76

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. Long-term Equity Investment (Continued)

(3) Equity Investment Difference

Items	Original cost	Amount at 1st January, 2004	Addition this year	Amortization this year	Amount at 31st December, 2004	Amortization period
Xian Ser Turbo Machinery Company Limited	7,296,277.00	5,837,021.56	–	729,627.72	5,107,393.84	10 years
Shanxi Hengtong Intelligent Machine Company Limited	6,849,713.19	5,349,248.11	–	668,554.68	4,680,693.43	10 years
Total	14,145,990.19	11,186,269.67	–	1,398,182.40	9,788,087.27	

Notes:

- (1) Provision for impairment on long-term investment is provided on the basis of the total amount of investment the Company has made to Yuanan Cheng Jiang Copper Products Plant because of its loss of sustainable operations ability.
- (2) There is no significant difference between the accounting policies used by the investee enterprises and that used by the Company. There is no significant restrictions to investment realization and investment gain outflow in foreign currency.

4. Principal Operation Revenue and Cost

Items	Accumulated amount this year		Accumulated amount Last year	
	Revenue	Cost	Revenue	Cost
Machine tool	262,930,144.36	193,064,905.56	183,396,407.17	128,963,795.34
Machine Processing Service	15,662,431.27	11,660,894.97	15,041,792.48	9,050,992.19
Others	5,520,904.99	768,486.53	1,589,131.76	518,446.73
Total	284,113,480.62	205,494,287.06	200,027,331.41	138,533,234.26

The total amount of sales from the top five customers in the year is RMB46,161,690.00, represents 16.25% of the total revenue.

5. Investment Income

Items	Accumulated amount this year	Accumulated amount last year
Income from investment in equity	2,829,103.98	7,554,155.14
Amortization of equity investment difference	(1,398,182.40)	(1,452,634.34)
Provision for diminution in value of short-term investment	(37,545,954.48)	–
Income from short-term investment	808,092.39	26,875.97
Total	(35,306,940.51)	6,128,396.77

FOR THE YEAR ENDED 31ST DECEMBER, 2004

7. RELATED PARTY RELATIONSHIP AND TRANSACTIONS

1. Details of Related Parties with Control Relationship

(1) Related Parties with Control Relationship

Name	Relationship with the company	Economic Nature	Place of registration	Scope of Business	Legal Representative
Jiaotong Group	substantial shareholders	state-owned	Xian city	Legally prohibited, not allowed to operate, should be approved, not allowed to operate before approval, not required to be legally approved, business which company is free to select, start the business activities.	Xi You Min
Xian Ser Turbo Machinery Company Limited (Xian Ser)	subsidiary	Limited liability	Xian city	Design, develop and sales of turbo-machinery	Wang Shangjin
Shanxi Hengtong Intelligent Machine Company Limited (Shanxi Hengtong)	subsidiary	Limited liability	Xian city	Develop and sale of manufacturing moulds, machinery, equipment, electronic products, software and hardware	Lu Bingheng
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	subsidiary	Limited liability	Xian city	Develop, manufacture and Sales of electronic products, electronic machinery and products of electronic power; Provide technology services	Zhang Hanrong
Winko Machines Company Limited	subsidiary	Limited liability	Kunming city	Develop, apply and integrate hardware and software; Retail, wholesale, purchase on behalf of others and consign electronic products, machinery and electronic machinery.	Zhang Hanrong

FOR THE YEAR ENDED 31ST DECEMBER, 2004

1. Details of Related Parties with Control Relationship (Continued)

(2) Registered Capital of Related Parties with Controlling Relationship

Name	Amount at 1st January, 2004	Increase this year	Decrease this year	Amount at 31st December, 2004
Jiaotong Group	30,000,000.00	–	–	30,000,000.00
Xian Ser Turbo Machinery Company Limited (Xian Ser)	2,000,000.00	2,560,692.00	–	4,560,692.00
Shanxi Hengtong Intelligent Machine Company Limited (Shanxi Hengtong)	27,960,000.00	–	–	27,960,000.00
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	35,000,000.00	–	–	35,000,000.00
Winko Machines Company Limited	20,230,000.00	–	–	20,230,000.00

(3) Shares and equity held by related parties with controlling relationship

Name	Amount	Proportion (%)	Amount at 1st January, 2004	Increase this year	Decrease this year	Amount at 31st December, 2004	Proportion (%)
Jiaotong Group	71,052,146.00	29	–	–	–	71,052,146.00	29.00
Xian Ser Turbo Machinery Company Limited	1,600,000.00	80	452,312.00	–	–	2,052,312.00	45.00
Shanxi Hengtong Intelligent Machine Company Limited	18,270,000.00	65.34	–	–	–	18,270,000.00	65.34
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	27,310,000.00	78.03	–	–	–	27,310,000.00	78.03
Winko Machines Company Limited	18,390,000.00	90.91	–	–	–	18,390,000.00	90.91

FOR THE YEAR ENDED 31ST DECEMBER, 2004

2. Related Parties with non-controlling Relationship

Name	Relationship with the Company
Kunji Group Company	Second-largest shareholders designated to manage equity
Yunnan Government	Promoter's shareholders
Jiaoda HongFan High-Tech Company Limited	Subsidiary of substantial shareholder of the Company
Xian Jiaoda Pharmaceutical (Group) Company Limited	Subsidiary of substantial shareholder of the Company

3. Related Party Transactions**(1) Sales of goods**

The Company sold goods amounting to RMB699,145.30 to related parties in 2004. The Company sold goods amounting to RMB890,182.00 to related parties in 2003.

(2) Provision and Receipts of Service

On 15th November, 1993, the Company entered into an agreement with Kunji Group Company relating to the provision of certain services to each other after the reorganization. Pursuant to this agreement, the Company agreed to provide certain public utility services available to the Company such as water and electricity to Kunji Group Company, while Kunji Group Company agreed to provide certain services to the Company including property management, employees' medical services, education and administrative fee for retired staffs. Service fee is reviewed by both parties on an annual basis and is determined by reference first to the standards set by the relevant government department for that particular service. If there are no applicable State standards, the Company and Kunji Group Company will determine the service fees based on market prices or transacted price at arm's length negotiations.

The connected transactions between the Company and the Kunji Group Company are as follows:

Items	Accumulated amount this year	Accumulated amount last year
Property management fees paid to Kun Ji Group Company	956,461.15	1,912,922.00
The provision of medical service from Kun Ji Group Company to the Company 's employees	75,000.00	150,000.00
The provision of social and education services from Kun Ji Group Company to the Company 's employees	325,000.00	1,200,000.00
Gardening expense paid to Kun Ji Group Company	—	—
Administrative fee for retired staffs	75,384.00	88,232.00
Total	<u>1,431,845.15</u>	<u>3,351,154.00</u>

(3) Purchase of goods

Shanxi Hengtong, the subsidiary of the Company, purchased goods amounting to RMB1,064,835.66 and RMB2,168,361.69 from the related parties Jiaoda HongFan High-Tech Company Limited in the year 2003 and 2004 respectively.

3. Related Party Transactions (Continued)

(4) Leases

The sixteen meeting of the Board of Director approved that starting from 1st January, 2004 the Company stopped to implement the supplementary premise rental agreement and supplementary land use rental agreement signed on 10th February, 2002 between the Company and Kunji Group Company and continues to use those agreements signed in 2001.

The above agreement involved the leased back asset from the Yunnan government.

In 2003, the Company leased back portion of premise and land use right at annual rent of RMB607,760 and RMB407,620. The lease term is 20 years.

In 2004, the Company leased back portion of premise and land use right at annual rent of RMB800,000 and RMB1,200,000. The lease term remains unchanged.

(5) Guarantee

The short term borrowing of RMB 20,000,000 by Xian Ser was guaranteed by Jiaotong Group.

(6) Other Transactions

The Company and its subsidiaries had the following transactions with Jiaoda Industrial Group Company or companies under its control:

Transaction events	Amount incurred this year	Amount incurred last year
Water and electricity service		
Fees paid to Jiaoda Industrial Group	847,383.33	—
Rental expense paid to Jiaoda Industrial Group	525,076.00	350,394.00
Total	1,372,459.33	350,394.00

Transactions between the Company and Xian Jiaotong University, investor of Jiaoda Industrial Group are as follows:

Transaction events	Amount incurred this year	Amount incurred last year
Research expense paid to Xian Jiaotong University	1,508,000.00	1,060,000.00
Total	1,508,000.00	1,060,000.00

FOR THE YEAR ENDED 31ST DECEMBER, 2004

4. Balances of Connected Transactions

Related Parties name	Item	Amount at the year end	Amount at the beginning	Nature
Jiaotong Group	Other receivables	–	1,517,987.02	Current account
	Accounts payable	–	125,500.00	Purchase of goods
	Other payables	1,440,000.00	1,440,000.00	Current account
	Accrued expenses	130,648.00	366,000.00	Accrued charge of electricity
Kunji Group Company	Other payables	1,787,515.38	1,551,210.00	Accrued management fee
Kunming Kunji Group Sales Company Limited	Advances from customers	285,000.00	80,000.00	Sale of goods
Yunan Government	Long-term payables due within one year	342,168.90	342,168.90	Payable rent of fixed assets
	Long-term payables	5,816,871.30	6,159,040.20	Payable rent of fixed assets
Jiaoda HongFan High-Tech Company Limited	Prepayments	248,735.53	417,144.21	

8. CONTINGENT EVENTS

The Company guarantees to pay for Winko Machines Company Limited of the subsidiary as follows:

Bank	Amount	Guarantee period	Remarks
華夏銀行城北支行	5,000,000.00	May 2004 to May 2005	Short-term borrowing
華夏銀行城北支行	4,091,000.00	June 2004 to June 2005	Short-term borrowing
Total	<u>9,091,000.00</u>		

9. COMMITMENTS

Lease commitments

The Company was obliged to pay the minimum rental payables as follows:

Accounting fiscal year	Amount
2005	342,168.90
2006	342,168.90
2007	342,168.90
After 3 years	<u>4,790,364.60</u>
Total	<u><u>5,816,871.30</u></u>

10. POST BALANCE SHEET EVENT

On 7th April, the Company and Tos Varnsdorf, A.S. entered into the Joint Venture Agreement ("JV Agreement") to establish a Joint Venture Company ("JV Company") for the purpose of research and development, production, assembly, sales and servicing of certain models of horizontal boring and milling machines identified under the JV Agreement. The JV Company's registered capital shall be Euro5,000,000 (approximately RMB54,000,000) and the Company owned 50% shares of the JV Company.

Pursuant to the JV Agreement, the Company shall contribute its share of the registered capital in the form of construction, specialized equipment, fixtures and tools, measuring equipment and office facilities amounting to an aggregate of Euro1,675,940 (approximately RMB18,100,000) and Euro824,060 (approximately RMB8,900,000) in cash.

11. DEBT RESTRUCTURING EVENTS

The Company has no debt restructuring events.

12. OTHER SIGNIFICANT EVENTS

1. Difference between PRC GAAP and Hong Kong GAAP:

These financial statements are prepared according to PRC GAAP, which are different from those prepared according to HK GAAP.

At balance sheet day, The amount of net profit and net assets are RMB(17,081,049.41) and RMB504,770,814.31 respectively according to PRC GAAP. These figures can be reconciled to that under HK GAAP as follows:

Items	Net profit	Net assets
In accordance to the PRC GAAP	(17,081,049.41)	504,770,814.31
Less: Amortisation on deferred gain on sale and lease back transaction	(664,333.00)	(664,333.00)
Add: Gain on sale and lease back transaction deferred and amortised	—	6,958,587.00
Add: Gain on injection of capital in subsidiaries	—	924,871.45
Add: Donations	10,800.00	—
Add: Tax recoverable	150,827.27	—
In accordance to the HK GAAP	<u>(17,583,755.14)</u>	<u>511,989,939.76</u>

The figures in accordance to the HK GAAP were audited by Deloitte Touche Tohmatsu.

2. The net asset profit ratio and earning per share for 2003 and 2004 are as followings:

Items	For the year ended 31st December, 2004				For the year ended 31st December, 2003			
	Net asset profit ratio (%)		Earning per share		Net asset profit ratio (%)		Earning per share	
	Dilutive	Weighted average	Dilutive	Weighted average	Dilutive	Weighted average	Dilutive	Weighted average
Principal operating income	25.78	25.35	0.5312	0.5312	19.38	19.66	0.4127	0.4127
Operating profit	5.30	5.21	0.1091	0.1091	3.45	3.50	0.0735	0.0735
Net profit	(3.38)	(3.33)	(0.0697)	(0.0697)	2.89	2.93	0.0615	0.0615
Net profit after deducting non-recurring items	1.50	1.48	0.0309	0.0309	1.46	1.48	0.0311	0.0311

FOR THE YEAR ENDED 31ST DECEMBER, 2004



TO THE SHAREHOLDERS OF JIAODA KUNJI HIGH-TECH COMPANY LIMITED

交大昆機科技股份有限公司

(a sino-foreign joint stock limited company established in the People's Republic of China with limited liability)

We have audited the financial statements on pages 79 to 113 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's Directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements 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.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. However, the evidence available to us was limited. As at 31st December, 2004, the Company had other investments amounting to RMB8,270,000 being held in its investment account with China Fortune Securities and which were held in custody by China Huarong Asset Management Corporation. We were unable to obtain sufficient documentary evidence to satisfy ourselves as to the Company's ownership in respect of these investments which have been included in the balance sheet as at 31st December, 2004.

There were no other audit procedures that we could adopt to satisfy ourselves in respect of the above matters. Any adjustments found to be necessary would decrease the net assets of the Company and the Group as at 31st December, 2004 and increase the loss of the Group for the year then ended.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

QUALIFIED OPINION ARISING FROM LIMITATION OF AUDIT SCOPE

Except for any adjustments that might have been found to be necessary had we been able to obtain sufficient evidence concerning the other investments, in our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31st December, 2004 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

In respect alone of the limitation on our work relating to the other investments, we have not obtained all the information and explanations we considered necessary for the purposes of our audit.

DELOITTE TOUCHE TOHMATSU

Certified Public Accountants

Hong Kong

27th April, 2005.

CONSOLIDATED INCOME STATEMENT 79

FOR THE YEAR ENDED 31ST DECEMBER, 2004

	NOTES	2004 RMB'000	2003 RMB'000
Turnover	5	469,436	330,613
Cost of sales		(339,298)	(229,494)
Gross profit		130,138	101,119
Other operating income	6	11,329	7,369
Administrative expenses		(70,066)	(59,339)
Distribution costs		(31,004)	(22,228)
Profit from operations	7	40,397	26,921
Finance costs	8	(8,966)	(7,979)
Unrealised holding loss on other investments	21	(41,796)	—
Gain on deemed partial disposal of a subsidiary	9	—	925
(Loss) profit before taxation		(10,365)	19,867
Income tax expense	10	(4,076)	(2,297)
(Loss) profit after taxation		(14,441)	17,570
Minority interests		(3,145)	(2,246)
Net (loss) profit for the year	11	(17,586)	15,324
(Loss) earnings per share	13	RMB(7.2 cents)	RMB6.3 cents

80 CONSOLIDATED BALANCE SHEET

AT 31ST DECEMBER, 2004

	NOTES	2004 RMB'000	2003 RMB'000
Non-current assets			
Property, plant and equipment	14	375,342	301,812
Goodwill	16	17,284	19,544
Intangible assets	17	27,424	31,554
Deferred costs	18	3,645	3,738
		<u>423,695</u>	<u>356,648</u>
Current assets			
Inventories	19	323,471	246,791
Trade receivables	20	96,275	105,301
Other receivables, deposits and prepayments		73,799	62,299
Amount due from a related company	35	–	3
Other investments	21	9,204	10,000
Taxation recoverable		193	16
Pledged time deposits	31	7,711	26,642
Bank balances and cash		188,957	158,348
		<u>699,610</u>	<u>609,400</u>
Current liabilities			
Trade payables	22	63,507	48,121
Advances from customers		300,934	193,024
Other payables		37,629	32,329
Amounts due to related companies	35	3,397	1,631
Taxation payable		4,601	2,667
Obligations under finance leases – due within one year	23	235	213
Bank borrowings	24	137,091	119,000
		<u>547,394</u>	<u>396,985</u>
Net current assets		<u>152,216</u>	<u>212,415</u>
		<u>575,911</u>	<u>569,063</u>

CONSOLIDATED BALANCE SHEET 81

AT 31ST DECEMBER, 2004

	NOTES	2004 RMB'000	2003 RMB'000
Capital and reserves			
Share capital	25	245,007	245,007
Reserves		267,133	284,719
		<u>512,140</u>	<u>529,726</u>
Minority interests		<u>49,698</u>	<u>23,391</u>
Non-current liabilities			
Obligations under finance leases – due after one year	23	3,453	3,625
Deferred gain	27	3,420	3,621
Other long-term loans	28	7,200	8,700
		<u>14,073</u>	<u>15,946</u>
		<u>575,911</u>	<u>569,063</u>

The financial statements on pages 79 to 113 were approved and authorised for issue by the Board of Directors on 27th April, 2005 and are signed on its behalf by:

Mr. Zhang Hanrong
DIRECTOR

Mr. Cheng Yunchuan
DIRECTOR

AT 31ST DECEMBER, 2004

	NOTES	2004 RMB'000	2003 RMB'000
Non-current assets			
Property, plant and equipment	14	273,250	256,687
Investments in subsidiaries	15	91,232	86,273
Advances to subsidiaries	15	756	23,655
Intangible assets	17	8,141	9,304
Deferred costs	18	3,645	3,738
		<u>377,024</u>	<u>379,657</u>
Current assets			
Inventories	19	209,795	191,885
Trade receivables		46,035	40,685
Other receivables, deposits and prepayments		12,474	12,014
Other investments	21	9,204	10,000
Taxation recoverable		–	16
Pledged time deposits	31	–	26,642
Bank balances and cash		121,861	103,225
		<u>399,369</u>	<u>384,467</u>
Current liabilities			
Trade payables		21,588	13,856
Advances from customers		107,213	77,275
Other payables		29,159	22,517
Amounts due to subsidiaries	15	3,526	–
Amounts due to related companies	35	2,073	1,631
Taxation payable		1,906	–
Obligations under finance leases – due within one year	23	213	213
Bank borrowings	24	98,000	119,000
		<u>263,678</u>	<u>234,492</u>
Net current assets		<u>135,691</u>	<u>149,975</u>
		<u>512,715</u>	<u>529,632</u>

AT 31ST DECEMBER, 2004

	NOTES	2004 RMB'000	2003 RMB'000
Capital and reserves			
Share capital	25	245,007	245,007
Reserves	26	260,877	275,879
		<u>505,884</u>	<u>520,886</u>
Non-current liabilities			
Obligations under finance leases – due after one year	23	3,411	3,625
Deferred gain	27	3,420	3,621
Other long-term loans	28	–	1,500
		<u>6,831</u>	<u>8,746</u>
		<u>512,715</u>	<u>529,632</u>

Mr. Zhang Hanrong
DIRECTOR

Mr. Cheng Yunchuan
DIRECTOR

FOR THE YEAR ENDED 31ST DECEMBER, 2004

	Share capital RMB'000	Share premium RMB'000	Capital reserve RMB'000 (Note 26)	Statutory surplus reserve RMB'000 (Note 26)	Statutory public welfare fund RMB'000 (Note 26)	Accumulated losses RMB'000	Total RMB'000
THE GROUP							
At 1st January, 2003	245,007	293,745	10,225	8,406	8,406	(51,387)	514,402
Net profit for the year	—	—	—	—	—	15,324	15,324
Transfer	—	—	—	311	155	(466)	—
At 31st December, 2003	245,007	293,745	10,225	8,717	8,561	(36,529)	529,726
Net loss for the year	—	—	—	—	—	(17,586)	(17,586)
Transfer	—	—	—	575	—	(575)	—
At 31st December, 2004	<u>245,007</u>	<u>293,745</u>	<u>10,225</u>	<u>9,292</u>	<u>8,561</u>	<u>(54,690)</u>	<u>512,140</u>

CONSOLIDATED CASH FLOW STATEMENT 85

FOR THE YEAR ENDED 31ST DECEMBER, 2004

	2004 RMB'000	2003 RMB'000
OPERATING ACTIVITIES		
Profit from operations	40,397	26,921
Adjustments for:		
Interest income	(1,269)	(751)
Investment income on other investments	(4,890)	(1,600)
Amortisation of deferred income	(201)	(201)
Depreciation and amortisation of property, plant and equipment	25,974	20,645
Amortisation of intangible assets	4,130	3,945
Amortisation of goodwill	2,260	2,443
Amortisation of prepaid rental	93	94
Net loss (gain) on disposal of property, plant and equipment	251	(1,379)
Gain on disposal of other investments	(168)	(14)
Allowance for bad and doubtful debts	13,982	10,701
Allowance for inventories written back	(4,031)	(5,280)
Operating cash flows before movements in working capital	76,528	55,524
Increase in inventories	(72,434)	(46,032)
Increase in trade receivables	(2,832)	(59,880)
Increase in other receivables, deposits and prepayments	(13,899)	(37,946)
Decrease in amount due from a related company	3	25
Increase in trade payables	15,386	29,095
Increase in advances from customers	107,910	137,954
Increase in other payables	4,259	9,875
Increase in amounts due to related companies	1,766	—
Cash generated from operations	116,687	88,615
Income taxes paid	(2,319)	(1,009)
NET CASH FROM OPERATING ACTIVITIES	114,368	87,606

FOR THE YEAR ENDED 31ST DECEMBER, 2004

	2004 RMB'000	2003 RMB'000
INVESTING ACTIVITIES		
Purchase of other investments	(136,000)	(30,998)
Purchase of property, plant and equipment	(99,420)	(34,571)
Proceeds from disposal of other investments	95,168	103,681
Decrease in pledged time deposits	18,931	13,863
Investment income on other investments	4,250	1,600
Interest received	1,269	751
Proceeds from disposal of property, plant and equipment	430	8,060
Repayment from an associate	—	400
Proceeds from disposal of interest in an associate	—	250
NET CASH (USED IN) FROM INVESTING ACTIVITIES	(115,372)	63,036
FINANCING ACTIVITIES		
Repayment of bank loans	(143,909)	(221,800)
Interest paid	(8,966)	(8,093)
Repayment of other long-term loans	(1,500)	(1,500)
Repayments of obligations under finance leases	(215)	(213)
New bank loans raised	162,000	149,000
Capital contributions by minority shareholders	24,203	9,630
Advances to related companies	—	1,434
Dividend paid to minority shareholders	—	(198)
NET CASH FROM (USED IN) FINANCING ACTIVITIES	31,613	(71,740)
NET INCREASE IN CASH AND CASH EQUIVALENTS	30,609	78,902
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	158,348	79,446
CASH AND CASH EQUIVALENTS AT END OF THE YEAR REPRESENTING		
Bank balances and cash	188,957	158,348

1. GENERAL

The Company is a sino-foreign joint stock limited company established in the People's Republic of China (the "PRC"). The Company acts as an investment holding company and it is also engaged in the design, development, manufacture and sale of machine tools, precision measuring equipment and precision transducers. The principal activities of its subsidiaries are set out in note 15.

2. POTENTIAL IMPACT ARISING FROM THE RECENTLY ISSUED ACCOUNTING STANDARDS

In 2004, the Hong Kong Institute of Certified Public Accountants (the "HKICPA") issued a number of new or revised Hong Kong Accounting Standards and Hong Kong Financial Reporting Standards ("HKFRSs") (herein collectively referred to as "new HKFRSs") which are effective for accounting periods beginning on or after 1st January, 2005.

The Group has commenced considering the potential impact of these new HKFRSs but is not yet in a position to determine whether these HKFRSs would have a significant impact on how its results of operations and financial position are prepared and presented. These HKFRSs may result in changes in the future as to how the results and financial position are prepared and presented.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention, as modified for the revaluation of investments in securities, in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31st December each year.

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.

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Service income is recognised when services are provided.

Interest income is accrued on a time basis by reference to the principal outstanding and at the interest rate applicable.

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

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation, amortisation and accumulated impairment losses.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

The cost of land use rights is amortised over the terms of the contract after obtaining the certificate of land occupancy rights.

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3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**Property, plant and equipment (Continued)**

Depreciation and amortisation are provided to write off the cost of property, plant and equipment, other than construction-in-progress, over their estimated useful lives, after taking into account their estimated residual value, using the straight-line method at the following rates per annum:

Buildings	2.5%
Plant and machinery	2% – 8%
Furniture, fixtures and equipment	6% – 10%
Motor vehicles	6% – 10%

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

Construction-in-progress

Construction-in-progress is stated at cost which includes all development expenditure and other direct costs, including borrowing costs, attributable to such projects. The cost of completed construction work is transferred to the appropriate asset category.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition.

Goodwill is capitalised as a separate asset and amortised on a straight-line basis over its useful economic life.

Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses.

The cost of technical knowhow is amortised on a straight-line basis over its expected useful life of ten years.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its 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. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such 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.

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss.

Inventories

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in securities

Investments in securities are recognised on a trade-date basis and are initially measured at cost.

Investments other than held-to-maturity debt securities are classified as investment securities and other investments.

Investment securities, which are securities held for an identified long-term strategic purpose, are measured at subsequent reporting dates at cost, as reduced by any impairment loss that is other than temporary.

Other investments are measured at fair value, with unrealised gains and losses included in net profit or loss for the year.

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.

All other borrowing costs are recognised as an expense 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 depreciable assets are presented as deferred income and are released to income over the useful lives of the assets. Grants related to expense items are recognised in the same period as those expenses are charged in the income statement and are reported separately as other income.

Leased assets

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the Group. Assets held under finance leases are capitalised at their fair values at the date of acquisition. The corresponding liability to the lessor, net of interest charges, is included in the balance sheet as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the outstanding principal amount at the inception of the finance lease, are charged to the income statement over the period of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

All other leases are classified as operating leases and the annual rentals are charged to the income statement on a straight-line basis over the relevant lease term.

Where assets are sold to a lessor and leased back by the Group, and the transaction results in a finance lease, any excess of sales proceeds over the carrying amount of the assets is deferred and amortised over the appropriate lease term.

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 net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes income statement items that are never taxable or deductible.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Taxation (Continued)

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the 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, 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 profits 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 income statement, except when it relates to items is charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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 resultant asset is amortised on a straight-line basis over its estimated useful life.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Retirement scheme cost

The Group participates in state-managed retirement plans pursuant to which the Group pays a fixed percentage of its qualifying staff's wages as contribution to the plan. The contribution payable to the retirement plan in respect of the year is charged to the income statement.

Foreign currencies

The Group maintains its books and records in Renminbi.

Transactions in foreign currencies are translated at the rates ruling on the dates of the transactions quoted by the People's Bank of China. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates ruling on the balance sheet date quoted by the People's Bank of China. Profits and losses arising on exchange are dealt with in the income statement.

4. SEGMENT INFORMATION

In accordance with the Group's internal financial reporting, the Group has determined that business segment by products is its primary reporting segment.

Business segments

The Group reports its primary segment information by products, which are boring machines, computerised embroidery machines, intelligence electrical appliances, turbo machines and laser phototyping machines. Segment information about these products is presented below:

2004

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligence electrical appliances RMB'000	Turbo machines RMB'000	Laser phototyping machines RMB'000	Consolidated RMB'000
TURNOVER	284,314	23,298	10,985	137,514	13,325	469,436
SEGMENT RESULT	23,908	(2,498)	(1,589)	15,152	534	35,507
Investment income on other investments						4,890
Profit from operations						40,397
Finance costs						(8,966)
Unrealised holding loss on other investments						(41,796)
Loss before taxation						(10,365)
Income tax expense						(4,076)
Loss after taxation						(14,441)
Minority interests						(3,145)
Net loss for the year						(17,586)

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4. SEGMENT INFORMATION (CONTINUED)**Business segments (Continued)**

The following is an analysis of the carrying amount of segment assets and segment liabilities, analysed by products:

2004

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligence electrical appliances RMB'000	Turbo machines RMB'000	Laser phototyping machines RMB'000	Eliminations RMB'000	Consolidated RMB'000
ASSETS							
Segment assets	550,533	40,055	48,182	293,828	29,665	(45,023)	917,240
Unallocated corporate assets							206,065
Consolidated total assets							<u>1,123,305</u>
LIABILITIES							
Segment liabilities	(166,980)	(9,081)	(6,923)	(263,318)	(7,608)	45,023	(408,887)
Taxation payable							(4,601)
Borrowings							(147,979)
Consolidated total liabilities							<u>(561,467)</u>
OTHER INFORMATION							
Capital additions	39,166	1,846	4,066	54,449	658	–	100,185
Depreciation and amortisation of property, plant and equipment	21,999	1,002	304	2,226	443	–	25,974
Amortisation of goodwill	1,398	298	564	–	–	–	2,260
Amortisation of intangible assets	1,163	500	995	–	1,472	–	4,130
Amortisation of prepaid rental	93	–	–	–	–	–	93
Allowance for bad and doubtful debts	4,206	2,793	3,975	2,871	137	–	13,982

4. SEGMENT INFORMATION (CONTINUED)

Business segments (Continued)

2003

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligence electrical appliances RMB'000	Turbo machines RMB'000	Laser phototyping machines RMB'000	Consolidated RMB'000
TURNOVER	198,791	21,273	15,072	85,627	9,850	330,613
SEGMENT RESULT	12,344	1,893	1,895	8,753	436	25,321
Investment income on other investments						1,600
Profit from operations						26,921
Finance costs						(7,979)
Gain on deemed partial disposal of a subsidiary						925
Profit before taxation						19,867
Income tax expense						(2,297)
Profit after taxation						17,570
Minority interests						(2,246)
Net profit for the year						15,324

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4. SEGMENT INFORMATION (CONTINUED)**Business segments (Continued)**

The following is an analysis of the carrying amount of segment assets and segment liabilities, analysed by products:

2003

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligence electrical appliances RMB'000	Turbo machines RMB'000	Laser phototyping machines RMB'000	Eliminations RMB'000	Consolidated RMB'000
ASSETS							
Segment assets	550,079	34,204	47,695	136,902	25,817	(23,655)	771,042
Unallocated corporate assets							195,006
Consolidated total assets							<u>966,048</u>
LIABILITIES							
Segment liabilities	(118,900)	(16,810)	(5,655)	(155,553)	(5,463)	23,655	(278,726)
Taxation payable							(2,667)
Borrowings							(131,538)
Consolidated total liabilities							<u>412,931</u>
OTHER INFORMATION							
Capital additions	16,141	1,239	14,860	995	1,450	—	34,685
Depreciation and amortisation of property, plant and equipment	17,623	571	250	1,748	453	—	20,645
Amortisation of goodwill	1,507	372	564	—	—	—	2,443
Amortisation of intangible assets	1,991	405	813	—	736	—	3,945
Amortisation of prepaid rental	94	—	—	—	—	—	94
Allowance for bad and doubtful debts	5,887	691	688	2,884	551	—	10,701

More than 90% of the Group's turnover and operating results are derived from the PRC market. All assets and liabilities of the Group are located in the PRC as all operations are carried in the PRC and therefore no geographical analysis has been presented.

5. TURNOVER

Turnover represents the amounts received and receivable, which is net of value-added tax ("VAT") and returns, for goods sold and services rendered by the Group to outside customers during the year.

An analysis of the Group's turnover is as follows:

	2004 RMB'000	2003 RMB'000
Sales of goods	447,428	307,656
Services rendered	22,008	22,957
	<u>469,436</u>	<u>330,613</u>

6. OTHER OPERATING INCOME

	2004 RMB'000	2003 RMB'000
Other operating income comprises:		
Interest income on deposits with banks	1,269	751
Investment income on other investments	4,890	1,600
Gain on disposal of other investments	168	14
Net gain on disposal of property, plant and equipment	—	1,379
VAT refund for new products	2,655	1,642
Government grant (note 34)	1,350	—
Others	997	1,983
	<u>11,329</u>	<u>7,369</u>

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7. PROFIT FROM OPERATIONS

	2004 RMB'000	2003 RMB'000
Profit from operations has been arrived at after charging:		
Staff costs including:		
Directors' and Supervisors' remuneration		
– Fees		
Executive Directors and Supervisors	204	210
Non-Executive Directors	96	96
Independent Non-Executive Directors	108	108
– Other emoluments		
Executive Directors and Supervisors	1,196	397
Non-Executive Directors	5	83
– Retirement schemes contributions	46	41
	<u>1,655</u>	<u>935</u>
Other retirement schemes contributions	5,209	4,252
Other staff costs	57,666	53,083
	<u>64,530</u>	<u>58,270</u>
Auditors' remuneration	1,804	1,500
Depreciation and amortisation		
– Amortisation of prepaid rental	93	94
– Amortisation of goodwill included in administrative expenses	2,260	2,443
– Amortisation of intangible assets included in administrative expenses	4,130	3,945
– Depreciation and amortisation of property, plant and equipment		
– owned by the Group	25,325	19,333
– held under finance lease	649	1,312
	<u>32,457</u>	<u>27,127</u>
Net loss on disposal of property, plant and equipment	251	–
Research and development costs	2,205	1,825
Allowance for bad and doubtful debts	13,982	10,701
and after crediting:		
Amortisation of deferred income included in administrative expenses	201	201
Allowance for inventories written back	<u>4,031</u>	<u>5,280</u>

7. PROFIT FROM OPERATIONS (CONTINUED)

Emoluments of Directors are within the following bands:

	No. of Directors 2004 & 2003
Nil to RMB1,000,000	11

The emoluments of the five highest paid employees are analysed as follows:

The five highest paid employees of the Group in the year included five (2003: five) Executive Directors of the Company, details of whose emoluments are set out above.

During the year, no emoluments were paid by the Group to the respective five highest paid individuals, including Directors, as an inducement to join or upon joining the Group or as compensation for loss of office. In addition, during the year, no Director waived any emoluments.

8. FINANCE COSTS

	2004 RMB'000	2003 RMB'000
Interest on:		
– bank borrowings wholly repayable within five years	8,837	7,964
– obligations under finance leases	129	129
Total borrowing costs	8,966	8,093
Less: amount capitalised in construction-in-progress	–	(114)
	8,966	7,979

Borrowing costs capitalised during the year ended 31st December, 2003 are calculated by applying a capitalisation rate of 5.94% to expenditure on qualifying assets.

FOR THE YEAR ENDED 31ST DECEMBER, 2004

9. GAIN ON DEEMED PARTIAL DISPOSAL OF A SUBSIDIARY

	2004 RMB'000	2003 RMB'000
Gain on deemed partial disposal of Shanxi Hengtong Intelligence Machine Company Limited ("Hengtong")	—	925

During the year ended 31st December, 2003, a non-wholly owned subsidiary, Hengtong, increased its registered capital to RMB27,360,000 which caused the Group's interest in Hengtong to dilute from 90% to 65.34% and resulted in a gain on deemed partial disposal of the subsidiary amounted to RMB925,000.

10. INCOME TAX EXPENSE

	2004 HK\$	2003 HK\$
The charge comprises:		
PRC income tax	4,076	2,297

- (a) Pursuant to a document issued by the PRC State Tax Bureau on 21st October, 1993 and confirmed by a notice issued by the Ministry of Finance and the State Tax Bureau on 18th April, 1994, the Company's profit is subject to income tax at a rate of 15% as from 1st January, 1993.

No provision for PRC income tax of the Company has been made in the financial statements as the Company's assessable profit for the year was wholly absorbed by tax losses brought forward.

Pursuant to the relevant laws and regulations in the PRC, certain of the Group's PRC subsidiaries are entitled to an exemption from PRC income tax for the two years starting from the first production year. The taxation charge for the year represents provision for PRC income tax for certain subsidiaries taking into account of these tax incentives.

10. INCOME TAX EXPENSE (CONTINUED)

- (b) The tax charge for the year can be reconciled to the (loss) profit before taxation per the consolidated income statement as follows:

	2004 RMB'000	2003 RMB'000
(Loss) profit before taxation	<u>(10,365)</u>	<u>19,867</u>
Tax at the standard income tax rate of 15% (2003: 15%)	(1,554)	2,980
Tax effect of different tax rates in other jurisdictions	59	294
Tax effect of income not taxable for tax purpose	(1,207)	(1,083)
Tax effect of expenses not deductible for tax purpose	8,114	1,401
Tax effect of utilisation of previously unrecognised tax losses	<u>(1,336)</u>	<u>(1,295)</u>
Tax expense for the year	<u>4,076</u>	<u>2,297</u>

At 31st December, 2004, the Group had no unutilised tax losses carried forward (2003: utilised tax losses of RMB8,904,000 available to set off against future profits).

There was no other significant unprovided deferred taxation during the year or at the balance sheet date.

11. NET (LOSS) PROFIT FOR THE YEAR

The Group incurred a net loss of RMB17,586,000 (2003: a net profit of RMB 15,324,000) for the year.

In accordance with Article 177 of the PRC Company Law, net profit for the year is applied as follows:

- (1) making up prior year losses;
- (2) allocation to statutory surplus reserve;
- (3) allocation to statutory public welfare fund;
- (4) allocation to discretionary surplus reserve; and
- (5) payment of dividends in respect of ordinary shares.

The Board of Directors proposed that no appropriation be made for the year ended 31st December, 2003.

12. TRANSFER TO STATUTORY SURPLUS RESERVE AND STATUTORY PUBLIC WELFARE FUND

No transfer is proposed to be made to the statutory surplus reserve or the statutory public welfare fund as the Company has accumulated losses.

13. (LOSS) EARNINGS PER SHARE

The calculation of (loss) earnings per share is based on the net loss for the year of RMB17,586,000 (2003: net profit of RMB15,324,000) and the 245,007,400 (2003: 245,007,400) shares in issue throughout the year.

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14. PROPERTY, PLANT AND EQUIPMENT

	Land use rights in the PRC RMB'000	Buildings under medium term lease in the PRC RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Construction- in-progress RMB'000	Total RMB'000
THE GROUP							
COST							
At 1st January, 2004	17,568	134,730	204,570	37,793	13,599	45,695	453,955
Additions	14,153	39,050	1,602	4,904	4,636	35,840	100,185
Transfers	–	11,204	9,869	1,675	–	(22,748)	–
Disposals	–	(605)	(846)	(10)	(661)	–	(2,122)
At 31st December, 2004	31,721	184,379	215,195	44,362	17,574	58,787	552,018
DEPRECIATION AND AMORTISATION							
At 1st January, 2004	4,834	23,652	100,389	18,745	3,871	652	152,143
Provided for the year	321	3,930	15,054	4,184	1,502	983	25,974
Eliminated on disposals	–	(314)	(872)	(6)	(249)	–	(1,441)
At 31st December, 2004	5,155	27,268	114,571	22,923	5,124	1,635	176,676
NET BOOK VALUES							
At 31st December, 2004	26,566	157,111	100,624	21,439	12,450	57,152	375,342
At 31st December, 2003	12,734	111,078	104,181	19,048	9,728	45,043	301,812
THE COMPANY							
COST							
At 1st January, 2004	17,568	133,485	176,385	32,195	8,770	27,308	395,711
Additions	–	332	1,020	2,998	2,808	32,008	39,166
Transfers	–	11,204	9,869	1,675	–	(22,748)	–
Disposals	–	(605)	(693)	(7)	(661)	–	(1,966)
At 31st December, 2004	17,568	144,416	186,581	36,861	10,917	36,568	432,911
DEPRECIATION AND AMORTISATION							
At 1st January, 2004	4,834	23,462	90,170	17,154	2,752	652	139,024
Provided for the year	320	3,657	13,173	3,044	822	983	21,999
Eliminated on disposals	–	(314)	(795)	(4)	(249)	–	(1,362)
At 31st December, 2004	5,154	26,805	102,548	20,194	3,325	1,635	159,661
NET BOOK VALUES							
At 31st December, 2004	12,414	117,611	84,033	16,667	7,592	34,933	273,250
At 31st December, 2003	12,734	110,023	86,215	15,041	6,018	26,656	256,687

FOR THE YEAR ENDED 31ST DECEMBER, 2004

14. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

The Group has been granted the rights to use the land, on which its buildings are situated, by the relevant PRC authorities for a period of 50 years from October 1993 onwards.

At 31st December, 2004, the cumulative amount of interest capitalised in construction-in-progress amounted to approximately RMB261,000 (2003: RMB1,233,000).

The net book value of the property, plant and equipment of the Group at 31st December, 2004 includes an amount of approximately RMB2,248,000 (2003: RMB2,951,000) in respect of motor vehicles held under finance leases.

The net book value of property, plant and equipment of the Company at 31st December, 2004 includes an amount of approximately RMB2,184,000 (2003: RMB2,951,000) in respect of motor vehicles held under finance lease.

15. INVESTMENTS IN SUBSIDIARIES/ADVANCE TO A SUBSIDIARY/AMOUNTS DUE TO SUBSIDIARIES

	2004 RMB'000	2003 RMB'000
Unlisted shares, at cost	<u>91,232</u>	<u>86,273</u>
Advance to a non-wholly owned subsidiary	<u>756</u>	<u>23,655</u>
Amounts due to subsidiaries	<u>3,526</u>	<u>—</u>

The amount advanced to a non-wholly owned subsidiary of approximately RMB756,000 (2003: advances of RMB23,655,000 to non-wholly owned subsidiaries) is for the purpose of financing the operations of the non-wholly owned subsidiary. This advance is unsecured, interest-free and has no fixed repayment terms. In the opinion of the Directors, repayment of the advance will not be demanded in the coming financial year, and therefore, the advance is classified as non-current.

The amounts due to subsidiaries of approximately RMB3,526,000 (2003: Nil) represent trade payables to the non-wholly owned subsidiaries. The advances are unsecured, interest-free and repayable on demand.

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15. INVESTMENTS IN SUBSIDIARIES/ADVANCE TO A SUBSIDIARY/AMOUNTS DUE TO SUBSIDIARIES (CONTINUED)

Details of the Company's subsidiaries at 31st December, 2004 are as follows:

Name of subsidiary	Form of business structure	Place of incorporation and operations	Registered capital	Proportion of registered capital held by the Company		Principal activities
				Directly	Indirectly	
Xian Ser Turbo Machinery Equipment Company Limited ("Xian Ser") 西安賽爾機泵成套設備有限公司 (「西安賽爾」)	Limited liability	PRC	RMB2,000,000	45% (Note)	–	Design, develop and sales of turbo-machinery
Changsha Ser Turbo Machinery Equipment Company Limited 長沙賽爾機泵成套設備有限責任公司	Limited liability	PRC	RMB10,000,000	–	95%	Design, develop and sales of turbo-machinery
Hangzhou Ser Gas Engineering Company Limited 杭州賽爾氣體設備工程有限公司	Limited liability	PRC	RMB1,200,000	–	51%	Design, develop and sales of turbo-machinery
Hengtong 陝西恆通智能機器有限公司	Limited liability	PRC	RMB27,960,000	65.34%	–	Develop and sale of manufacturing moulds, machinery, equipment, electronic products, software and hardware
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited 西安交大思源智能電器有限公司	Limited liability	PRC	RMB35,000,000	78.03%	–	Research, develop manufacturing and sale of automatic machines for industries such as water utilities, civil engineering and construction
Winko Machines Company Limited 昆明交大昆機自動機器有限公司	Limited liability	PRC	RMB20,230,000	90.91%	–	Research, develop, manufacturing and sale of intelligent computerised coloured embroidery machines

None of the subsidiaries had any debt securities outstanding at the end of the year or at any time during the year.

Note: The Company has the power to appoint 4 out of 7 directors of Xian Ser and has retained its controlling power over Xian Ser. Accordingly, the Company is accounted for as a subsidiary.

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16. GOODWILL

	THE GROUP RMB'000
GROSS AMOUNT	
At 1st January, 2004 and at 31st December, 2004	24,430
AMORTISATION	
At 1st January, 2004	4,886
Provided for the year	2,260
At 31st December, 2004	7,146
CARRYING AMOUNT	
At 31st December, 2004	17,284
At 31st December, 2003	19,544

The amortisation period adopted for goodwill is 10 years.

17. INTANGIBLE ASSETS

	THE GROUP RMB'000 (Note)	THE COMPANY RMB'000 (Note)
COST		
At 1st January, 2004 and at 31st December, 2004	39,444	11,630
AMORTISATION		
At 1st January, 2004	7,890	2,326
Provided for the year	4,130	1,163
At 31st December, 2004	12,020	3,489
NET BOOK VALUES		
At 31st December, 2004	27,424	8,141
At 31st December, 2003	31,554	9,304

Note:

The intangible assets of the Group and the Company are technical knowhow.

The cost of technical knowhow of RMB26,360,000 and RMB11,630,000 of the Group and the Company respectively represents the laser prototyping and manufacturing technology and the controllable centrifugal energy conservation compressor technology.

The remaining balance of RMB13,084,000 of the Group represents the technical knowhow of developing intelligent computerised coloured embroidery machines and intelligent electrical appliances.

The technical knowhow is amortised over a period of 10 years..

FOR THE YEAR ENDED 31ST DECEMBER, 2004

18. DEFERRED COSTS

THE GROUP AND THE COMPANY

	Prepaid rental RMB'000
COST	
At 1st January, 2004 and 31st December, 2004	4,486
AMORTISATION	
At 1st January, 2004	748
Provided for the year	93
At 31st December, 2004	841
NET BOOK VALUES	
At 31st December, 2004	3,645
At 31st December, 2003	3,738

Pursuant to an agreement entered into between the Company and Kun Ji Group Company ("Kun Ji") on 10th December, 1993, the Company and Kun Ji paid RMB2,000,000 and RMB3,000,000 respectively for the purpose of joint construction of staff quarters. In 1995, a further sum of RMB297,000 was paid by the Company. The staff quarters were completed in October 1995. Subsequently, Kun Ji is entitled to the ownership of the staff quarters and the Company is entitled to lease five floors as staff quarters for 48 years commencing January 1996. The lease rental is calculated with reference to the floor area occupied and the actual construction cost of the building. On this basis a further sum of RMB2,189,000 was paid by the Company in 1996, bringing the aggregate sum paid for the lease to RMB4,486,000 which is accounted for as prepaid rental and is amortised over the lease period of 48 years.

19. INVENTORIES

	THE GROUP		THE COMPANY	
	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Raw materials	46,996	40,236	26,915	23,580
Work-in-progress	165,269	123,913	84,747	87,941
Finished goods	111,206	82,642	98,133	80,364
	323,471	246,791	209,795	191,885

Included above are inventories carried at net realisable value set out as below:

	THE GROUP		THE COMPANY	
	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Raw materials	19,059	14,999	241	2,531
Work-in-progress	33,384	82,976	28,489	47,863
Finished goods	12,063	14,052	5,548	7,691
	64,506	112,027	34,278	58,085

20. TRADE RECEIVABLES

The Group agrees credit terms with its trade customers on an individual basis. An aged analysis of the Group's trade receivables is as follows:

	THE GROUP	
	2004 RMB'000	2003 RMB'000
Within one year	82,035	98,912
Between one to two years	12,857	5,020
Between two to three years	806	806
Over three years	577	563
	<u>96,275</u>	<u>105,301</u>

21. OTHER INVESTMENTS

	THE GROUP AND THE COMPANY	
	2004 RMB'000	2003 RMB'000
Unlisted unit fund in the PRC, at market value	934	10,000
Listed shares in the PRC, at market value (note)	8,270	—
	<u>9,204</u>	<u>10,000</u>

Note:

During the year, the Company entered into an agreement with China Fortune Securities ("China Fortune") for the Trusteeship of the Management of Investment in State Bonds (the "Trusteeship Agreement"), pursuant to which the Company entrusted China Fortune to conduct investment on State Bonds with RMB50,000,000 (the "Funds") with a term of the entrustment of one year from 23rd February, 2004 to 23rd February, 2005.

On 7th June, 2004, the Company discovered that, China Fortune failed to comply with the Trusteeship Agreement concerning investment in State Bonds, and diverted the Funds to invest in several A-share stocks.

Subsequent to 7th June, 2004, the Company found that China Fortune incurred operating failure and was took over in custody by China Huarong Asset Management Corporation ("China Huarong") as appointed by the China Regulatory Commission. Through discussion with the officials of China Huarong, the Company noted that China Huarong is currently in negotiation with the major shareholders of China Fortune for a restructuring plan to recover the Funds.

In the opinion of the directors, after consultation with its legal advisors, the Company has good claims on the underlying assets held in the investment account with China Fortune despite that China Fortune has breached its contract and such investments which were held in custody by China Huarong had been accounted for as other investments at market value of RMB8,270,000 in the balance sheet as at 31st December, 2004.

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22. TRADE PAYABLES

Details of the aged analysis of trade payables are as follows:

	THE GROUP	
	2004 RMB'000	2003 RMB'000
Within one year	60,022	46,042
Between one to two years	1,872	353
Between two to three years	261	287
Over three years	1,352	1,439
	<u>63,507</u>	<u>48,121</u>

23. OBLIGATIONS UNDER FINANCE LEASES

	THE GROUP			
	Minimum lease payments		Present value of minimum lease payments	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
The maturity of obligations under finance leases is as follows:				
Within one year	366	342	235	213
In the second to fifth year inclusive	<u>5,520</u>	<u>5,817</u>	<u>3,453</u>	<u>3,625</u>
	5,886	6,159	3,688	3,838
Less: Future finance charge	<u>(2,198)</u>	<u>(2,321)</u>	<u>-</u>	<u>-</u>
Present value of obligations under finance leases	<u>3,688</u>	<u>3,838</u>	3,688	3,838
Less: Amount due for settlement within one year (shown under current liabilities)			<u>(235)</u>	<u>(213)</u>
Amount due after one year			<u>3,453</u>	<u>3,625</u>

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23. OBLIGATIONS UNDER FINANCE LEASES (CONTINUED)

	THE COMPANY			
	Minimum lease payments		Present value of minimum lease payments	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
The maturity of obligations under finance leases is as follows:				
Within one year	342	342	213	213
In the second to fifth year inclusive	5,474	5,817	3,411	3,625
	5,816	6,159	3,624	3,838
Less: Future finance charge	(2,192)	(2,321)	–	–
Present value of obligations under finance leases	3,624	3,838	3,624	3,838
Less: Amount due for settlement within one year (shown under current liabilities)			(213)	(213)
Amount due after one year			3,411	3,625

All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. The average term of the finance leases entered into is 20 years (2003: 20 years).

24. BANK BORROWINGS

	THE GROUP		THE COMPANY	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
The maturity of the bank borrowings is as follows:				
Within one year	137,091	119,000	98,000	119,000
Analysed as:				
– secured	54,000	69,000	44,000	69,000
– unsecured	83,091	50,000	54,000	50,000
	137,091	119,000	98,000	119,000

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25. SHARE CAPITAL

	Registered, issued and fully paid 2004 & 2003 RMB'000
Ordinary shares of RMB1 each	
– A shares	180,007
– H shares	65,000
	<u>245,007</u>

Except for the currency in which dividends are paid and the restrictions as to whether the shareholders can be PRC investors or foreign investors, A shares and H shares rank pari passu in all material respects with each other.

26. RESERVES

	Share premium RMB'000	Capital reserve RMB'000	Statutory surplus reserve RMB'000	Statutory public welfare fund RMB'000	Accumulated losses RMB'000	Total RMB'000
THE COMPANY						
At 1st January, 2003	293,745	10,225	8,406	8,406	(53,994)	266,788
Net profit for the year	–	–	–	–	9,091	9,091
At 31st December, 2003	293,745	10,225	8,406	8,406	(44,903)	275,879
Net loss for the year	–	–	–	–	(15,002)	(15,002)
At 31st December, 2004	<u>293,745</u>	<u>10,225</u>	<u>8,406</u>	<u>8,406</u>	<u>(59,905)</u>	<u>260,877</u>

The balance of capital reserve represents the profit of Kunming Machine Tool Plant (a state-owned enterprise before the reorganisation in 1993) for the period from 1st July, 1993 to 18th October, 1993 less an amount of RMB7,000,000 which the Company paid in cash to Yunnan Provincial People's Government ("Yunnan Government") pursuant to a demerger agreement dated 20th November, 1993 between Kun Ji and the Company.

The balance of statutory surplus reserve represents appropriations from profit after taxation in accordance with the PRC Company Law. Statutory surplus reserve is part of the shareholders' equity and when its balance reaches an amount equal to 50% of the Company's registered capital, further appropriation need not be made. According to PRC Company Law, the statutory surplus reserve may be used to make up past losses, to increase production and business operations or to increase capital by means of conversion. However, when funds from the statutory surplus reserve are converted to capital, the funds remaining in such reserve shall amount to not less than 25% of the registered capital.

According to Article 66 of Accounting Standards for Industrial Enterprises issued by the Finance Department of the PRC, the statutory public welfare fund is principally used for expenditure on staff welfare facilities. The statutory public welfare fund cannot be used for the payment of staff welfare expenses.

No profit is available for distribution as the Company had accumulated losses of RMB62,341,000 in accordance with the PRC accounting standards as at 31st December, 2004 (2003: RMB45,259,000).

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27. DEFERRED GAIN

	THE GROUP AND THE COMPANY RMB'000
GROSS AMOUNT	
At 1st January, 2004 and 31st December, 2004	4,023
AMORTISED TO INCOME	
At 1st January, 2004	402
Amortised during the year	201
At 31st December, 2004	603
CARRYING AMOUNT	
At 31st December, 2004	3,420
At 31st December, 2003	3,621

The gain on disposal of certain buildings is deferred as the buildings are subsequently leased back by the Group. Such leases qualify as finance leases and the gain is deferred and amortised to income over the lease term of 20 years.

28. OTHER LONG-TERM LOANS

The amounts are unsecured and non-interest bearing. These amounts will not be demanded within the next twelve months from the balance sheet date and the amounts are therefore shown in the balance sheet as non-current.

29. OPERATING LEASE COMMITMENTS

THE GROUP AS LESSEE

Minimum lease payments of the Group paid under operating lease during the year:

	2004 RMB'000	2003 RMB'000
Land and buildings	2,987	1,641

At the balance sheet date, the Group and the Company had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	THE GROUP		THE COMPANY	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within one year	2,217	1,198	1,658	673
In second to fifth year inclusive	8,027	4,632	6,631	2,692
Over five years	19,883	8,957	19,756	8,751
	30,127	14,787	28,045	12,116

Operating lease payment represents rental payable by the Group for certain of its office properties, factories and staff quarters. Significant leases are negotiated for an average term of 20 years.

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30. CAPITAL COMMITMENTS

At the balance sheet date, the Group and the Company had the following capital commitments:

	THE GROUP		THE COMPANY	
	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Capital expenditure contracted for but not provided in the financial statements				
– Acquisition of property, plant and equipment	4,195	2,342	4,195	2,342
– Construction in progress	20,613	18,623	–	–
	24,808	20,965	4,195	2,342

31. PLEDGE OF ASSETS

At the balance sheet date, the Group had pledged land and buildings having a net book value of approximately RMB51,448,000 (2003: RMB52,977,000) and pledged time deposits of RMB7,711,000 (2003: RMB26,642,000) to secure bank loans granted to the Group.

At the balance sheet date, the Company had pledged land and buildings having a net book value of approximately RMB51,448,000 (2003: RMB52,977,000). At 31st December, 2003, the Company had also pledged time deposits of RMB26,642,000 to secure bank loans granted to the Company.

32. RETIREMENT BENEFIT SCHEME

The Group is a participant in a state-managed retirement benefits plan pursuant to which the Company pays a fixed percentage of its qualifying staff's wages as contribution to the plan. The Company's financial obligation under this plan is limited to the payment of the employer's contribution.

During the year, the contributions made by the Group relating to the arrangement were approximately RMB5,255,000 (2003: RMB4,293,000). There was no forfeited contribution for reduction in the Company's future contribution during the year.

33. NON-CASH TRANSACTIONS

- (a) During the year, the Group entered into a finance lease arrangement in respect of motor vehicle with a total capital value at the inception of the lease of RMB65,000.
- (b) Repayment of the trade receivable of RMB915,000 was satisfied by the transfer of plant and machinery and inventories at a carrying amount of RMB700,000 and RMB215,000 from the trade debtor to the Company, respectively.

34. GOVERNMENT GRANT

During the year, the Group received a government subsidy of approximately RMB2,700,000 (2003: Nil) towards the cost for the upgrades of its manufacturing plant. The amount has been treated as deferred income and is transferred to income over the useful lives of the relevant assets.

35. CONNECTED PARTIES AND RELATED PARTY TRANSACTIONS AND BALANCES

During the year, the Group had significant transactions with connected parties as defined in the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules"). The transactions with these connected parties during the year and balances with them at the balance sheet date are as follows:

CONNECTED PARTIES

(A) TRANSACTIONS

Name of company	Nature of transactions	THE GROUP	
		2004	2003
		RMB'000	RMB'000
<i>Substantial shareholders of the Company</i>			
Jiaotong Group (including its associates as defined by the Listing Rules, other than members of the Group)	Purchases of materials from Jiaotong Group (note a)	2,168	1,065
	Research and development expenditure paid to Jiaotong Group (note b)	1,508	1,060
	Utility service fee paid to Jiaotong Group (note c)	847	—
	Rental expenses (note c)	565	350
	Guarantees given by Jiaotong Group (note f)	20,000	—
Yunnan Government	Rental for buildings to Yunnan Government (note d)	458	608
	Rental for land to Yunnan Government (note d)	1,200	408
	Interest expenses on obligations under finance lease paid to Yunnan Government (note e)	129	129
<i>Company controlled by the substantial shareholders</i>			
Kun Ji (including its associates as defined by the Listing Rules, other than members of the Group)	Payment to Kun Ji for building management fees, and provision of social, education and medical services to the Company's employees (note g)	1,600	3,351
	Sales of finished goods to Kun Ji (note a)	699	890

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35. CONNECTED PARTIES AND RELATED PARTY TRANSACTIONS AND BALANCES (CONTINUED)**CONNECTED PARTIES (Continued)****(B) BALANCES**

Name of company	Nature of balances	THE GROUP		THE COMPANY	
		2004	2003	2004	2003
		RMB'000	RMB'000	RMB'000	RMB'000
<i>Substantial shareholder of the Company</i>					
Jiaotong Group	Balance due from (to)				
	Jiaotong Group				
	– prepayments (note h)	249	417	–	–
	– non-trade payable (note h)	(1,440)	(414)	–	–
		<u>(1,191)</u>	<u>3</u>	<u>–</u>	<u>–</u>
Yunnan Government	Balance of obligations under				
	finance leases due to Yunnan				
	Government (note h)	<u>(3,624)</u>	<u>(3,838)</u>	<u>(3,624)</u>	<u>(3,838)</u>
<i>Company controlled by the substantial shareholders</i>					
Kun Ji	Balance due to Kun Ji				
	– trade payable (note h)	(285)	(80)	(285)	(80)
	– non-trade payable (note h)	(1,921)	(1,551)	(1,788)	(1,551)
		<u>(2,206)</u>	<u>(1,631)</u>	<u>(2,073)</u>	<u>(1,631)</u>

Notes:

- (a) In the opinion of the Directors, these transactions were carried out at market price or, where no market price was available, at cost plus a percentage profit mark up, or determined and agreed by both parties.
- (b) Research and development expenditure was determined by terms agreed by both parties.
- (c) The Company entered into an agreement with Jiaotong Group whereby Jiaotong Group provides certain housing facilities and utilities services to the subsidiaries at prices to be determined by reference to the State stipulated price for utility services. The agreement has a term of three years commencing 31st December, 2001.
- (d) Upon disposal of its land and buildings to Yunnan Government during the year ended 31st December, 2002, the Group entered into separate agreements to lease back certain land and buildings for its use for a term of 20 years. The annual rental is approximately RMB1,200,000 per annum for the lease back of land and approximately RMB458,000 per annum for the lease back of buildings which were determined by reference to the prevailing market rates as certified by a professional valuer. The rental will be revised every three years based on market rates as certified by professional valuers. Details of these lease arrangement are set out in a circular to shareholders dated 5th December, 2002.
- (e) Upon disposal of its land and buildings to Yunnan Government during the year ended 31st December, 2001, the Group entered into separate agreements with Yunnan Government to lease back certain land and buildings for a term of 20 years. The balance with Yunnan Government as the lessor of these arrangement are set out in note 23, obligations under finance leases. The relevant interest expenses on obligations under finance leases were determined with reference to the prevailing market rates.
- (f) At 31st December, 2004, Jiaotong Group had given corporate guarantee of RMB20,000,000 to a bank to secure bank loan granted to a subsidiary.
- (g) The receipt and payment of these service income and expenses were priced with reference to a composite services agreement entered into between Kun Ji and the Company in 1993 and renewed in 2004.
- (h) The balances are unsecured, interest-free and repayable on demand.

36. POST BALANCE SHEET EVENT

On 27th January, 2005, the Company and Tos Varnsdorf, A.S. entered into the Joint Venture Agreement ("JV Agreement") to establish a Joint Venture Company ("JV Company") for the purpose of research and development, production, assembly, sales and servicing of certain models of horizontal boring and milling machines identified under the JV Agreement.

Pursuant to the JV Agreement, the JV Company's registered capital shall be Euro5,000,000 (approximately RMB54,000,000). The JV Company shall be owned as to 50% by the Company and as to 50% by Tos Varnsdorf, A.S. Each of the investment parties shall contribute Euro2,500,000 (approximately RMB27,000,000) respectively. The Company shall contribute its share of the registered capital in the form of construction, specialised equipment, fixtures and tools, measuring equipment and office facilities amounting to an aggregate of Euro1,640,000 (approximately RMB17,712,000) and Euro860,000 (approximately RMB9,288,000) in cash.

37. DIFFERENCES BETWEEN PRC ACCOUNTING STANDARDS ("PRC GAAP") AND HONG KONG ACCOUNTING STANDARDS ("HK GAAP") AS APPLICABLE TO THE GROUP

The major differences between the financial statements prepared under the PRC GAAP and HK GAAP are as follows:

Impact on the consolidated results

	2004 RMB'000	2003 RMB'000
(Loss) profit for the year as per financial statements prepared under the PRC GAAP	(17,081)	15,063
Gift received recognised as an income under HK GAAP	11	—
Amortisation on deferred gain on sale and lease back transaction	(666)	(664)
Taxation recoverable recognised on accrual basis, net of minority interest effect of RMB42,000, under HK GAAP	150	—
Gain on deemed partial disposal of a subsidiary recognised as an income under HK GAAP	—	925
(Loss) profit for the year as per financial statements prepared under the HK GAAP	<u>(17,586)</u>	<u>15,324</u>

Impact on the consolidated net assets as at 31st December

	2004 RMB'000	2003 RMB'000
Net assets as per financial statements prepared under the PRC GAAP	504,771	521,841
Gain on sale and lease back transaction deferred and amortised	6,294	6,960
Gain on deemed partial disposal of a subsidiary credited directly against investments under PRC GAAP but recognised as an income under HK GAAP	925	925
Taxation recoverable recognised on accrual basis, net of minority interest effect of RMB42,000, under HK GAAP	150	—
Net assets as per financial statements prepared under the HK GAAP	<u>512,140</u>	<u>529,726</u>

Note: There are also other differences in balance sheet items due to differences in classification between the PRC GAAP and the HK GAAP.